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Report 369

Australian Government Procurement

Joint Committee of Public Accounts and Audit

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Chairman's Foreword

Government procurement can have a significant impact on the domestic economy of a country through industry development and promoting international competitiveness of that country's industry. It is essential that the purchasing power of the Australian Government is harnessed so as to maximise the opportunities for Australian industry.

In 1997–98 the value of purchasing by Commonwealth Budget funded agencies was \$8.8 billion, excluding purchases made by government business enterprises. Telstra, for example, spent \$8.5 billion on goods and services in 1997–98. It is estimated that the three tiers of government, local, state and Commonwealth, between them spend around \$45 billion a year on goods and services.

Decisions to purchase from Australian suppliers can impact on the Australian economy by influencing employment, taxation revenue, technological development, and ultimately Australia's balance of trade.

Government procurement has been the subject of a number of Parliamentary inquiries. The last major inquiry in 1994 found that the opportunities which Commonwealth procurement should provide for Australian industry development are not being fully grasped. The major objective of the Joint Committee of Public Accounts and Audit (JCPAA) was to assess the performance of government agencies in managing their procurement function, and, in particular, their effectiveness in maximising opportunities for Australian industry.

It is our overall assessment that Commonwealth Government procurement has improved since 1994. Anecdotal evidence suggests that the culture and attitude of purchasing officers has improved, but there are still areas of government procurement that need further improvement.

The speed and rate of devolution in recent years has resulted in inconsistent service delivery, and a loss of oversight and coordination at the whole of government level. To address this situation, the JCPAA has recommended that the Department of Finance and Administration (DoFA) administer an accreditation

system to assess the performance of individual agencies. The Office of Small Business should, with DoFA, develop future versions of the Commonwealth Procurement Guidelines and expand its oversight role in relation to the needs of small business.

In raising the prominence of purchasing, we have called for Chief Executive Officers (CEOs) of departments and agencies to take a greater role in managing their purchasing responsibilities. In addition, the JCPAA will seek a higher level of accountability from CEOs.

Government agencies in managing their industry development objectives should seek to balance the often competing principles of value for money, open and effective competition, and Australian industry development. The JCPAA does not support preferential treatment but advises agencies that where Australian-New Zealand products are equal to overseas items in terms of value for money and other principles in the Commonwealth Procurement Guidelines, then the ANZ products should be purchased.

We consider that the recommendations and findings made in this report will help to improve the quality and accountability of government procurement. At the same time, the JCPAA emphasises that there is merit in Parliamentary Committees conducting follow-up inquiries to check on the implementation of findings and recommendations made in previous inquiries. The JCPAA will continue to use this process as an additional tool to scrutinise executive government.

It should be noted that House of Representatives Committees can conduct follow-up inquiries through their independent power to review the annual reports of agencies. This power provides these committees with opportunities to scrutinise the purchasing performance of agencies, and other aspects of public administration, on an ad hoc basis. This opportunity should not be wasted.

In conclusion, and on behalf of the JCPAA, I would like to thank all those who have contributed to this inquiry.

Bob Charles MP
Chairman

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Membership of the Committee

Chairman Bob Charles MP

Deputy Chairman David Cox MP

Members

Senator Helen Coonan	Mr Kevin Andrews MP
Senator the Hon John Faulkner	Mr Malcolm Brough MP
Senator the Hon Brian Gibson	Mr Petro Georgiou MP
Senator John Hogg	Mr Alan Griffin MP
Senator Andrew Murray	Ms Julia Gillard MP
Senator John Watson	Hon Alex Somlyay MP
	Mr Stuart St Clair MP
	Ms Tanya Plibersek MP



Membership of the Sectional Committee

Chairman Bob Charles MP

Members Senator John Hogg

Mr Mal Brough MP

Mr Petro Georgiou MP

Mr Alan Griffin MP

Ms Tanya Plibersek MP

Mr Stuart St Clair MP

Committee Secretariat

Secretary Dr Margot Kerley

**Inquiry
Secretary** Mr Stephen Boyd

Inquiry staff Ms Georgina Binks
 Ms Tiana Gray



Duties of The Committee

The Joint Committee of Public Accounts and Audit is a statutory committee of the Australian Parliament, established by the *Public Accounts and Audit Committee Act 1951*.

Section 8(1) of the Act describes the Committee's duties as being to:

- (a) examine the accounts of the receipts and expenditure of the Commonwealth, including the financial statements given to the Auditor-General under subsections 49(1) and 55(2) of the *Financial Management and Accountability Act 1997*;
- (b) examine the financial affairs of authorities of the Commonwealth to which this Act applies and of intergovernmental bodies to which this Act applies;
- (c) examine all reports of the Auditor-General (including reports of the results of performance audits) that are tabled in each House of the Parliament;
- (d) report to both Houses of the Parliament, with any comment it thinks fit, on any items or matters in those accounts, statements and reports, or any circumstances connected with them, that the Committee thinks should be drawn to the attention of the Parliament;
- (e) report to both Houses of the Parliament any alteration that the Committee thinks desirable in:
 - (i) the form of the public accounts or in the method of keeping them; or
 - (ii) the mode of receipt, control, issue or payment of public moneys;

- (f) inquire into any question connected with the public accounts which is referred to the Committee by either House of the Parliament, and to report to that House on that question;
- (g) consider:
 - (i) the operations of the Audit Office;
 - (ii) the resources of the Audit Office, including funding, staff and information technology;
 - (iii) reports of the Independent Auditor on operations of the Audit Office;
- (h) report to both Houses of the Parliament on any matter arising out of the Committee's consideration of the matters listed in paragraph (g), or on any other matter relating to the Auditor-General's functions and powers, that the Committee considers should be drawn to the attention of the Parliament;
- (i) report to both Houses of the Parliament on the performance of the Audit Office at any time;
- (j) consider draft estimates for the Audit Office submitted under section 53 of the *Auditor-General Act 1997*;
- (k) consider the level of fees determined by the Auditor-General under subsection 14(1) of the *Auditor-General Act 1997*;
- (l) make recommendations to both Houses of Parliament, and to the Minister who administers the *Auditor-General Act 1997*, on draft estimates referred to in paragraph (j);
- (m) determine the audit priorities of the Parliament and to advise the Auditor-General of those priorities;
- (n) determine the audit priorities of the Parliament for audits of the Audit Office and to advise the Independent Auditor of those priorities; and
- (o) undertake any other duties given to the Committee by this Act, by any other law or by Joint Standing Orders approved by both Houses of the Parliament.



Terms of reference

The JCPAA will examine whether Commonwealth entities, during the last four years, have achieved effective outcomes in the way purchasing policies are implemented, and whether Australian business has achieved more equitable outcomes arising from these policies. The inquiry will have particular reference to:

1. the performance of Commonwealth entities in managing and implementing purchasing policies during the last four years;
2. statistical information identifying trends in purchasing outcomes during the last four years;
3. an assessment of whether Commonwealth purchasing policies have maximised commercial opportunities for Australian suppliers; and
4. possible initiatives that could further enhance Commonwealth purchasing policies.



List of abbreviations

ACCI	Australian Chamber of Commerce and Industry
ACS	Australian Customs Service
AGPS	Australian Government Publishing Service
AGS	Australian Government Solicitor
AIIA	Australian Information Industry Association
AIPMM	Australian Institute of Purchasing and Materials Management Limited
ANAO	Australian National Audit Office
ANZ	Australian-New Zealand
APS	Australian Public Service
APUs	Accredited Purchasing Units
ATO	Australian Taxation Office
BEP	Business Entry Point
CEOs	Chief Executive Officers
CIT	Canberra Institute of Technology
CPC	Commonwealth Procurement Circular
CPGs	Commonwealth Procurement Guidelines
CUA	Common Use Arrangements
DAFFA	Department of Agriculture, Fisheries and Forestry – Australia
Defence	Department of Defence

DFAT	Department of Foreign Affairs and Trade
DISR	Department of Industry, Science and Resources
DoFA	Department of Finance and Administration
ESA	Endorsed Supplier Arrangements
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMAR	<i>Financial Management and Accountability Regulations 1997</i>
GBEs	Government Business Enterprises
HORIST	House of Representatives Standing Committee on Industry, Science and Technology
ISONET	Industrial Supplies Office Network
JCPA	Joint Committee of Public Accounts
JCPAA	Joint Committee of Public Accounts and Audit
MAB/MIAC	Management Advisory Board/Management Improvement Advisory Board
MOU	Memorandum of Understanding
OGO	Office for Government Online
OSB	Office of Small Business
PACCER	Procurement and Contracting Centre for Education and Research
PSMPC	Public Service Merit Protection Commission
QCCI	Queensland Chamber of Commerce and Industry
SMEs	Small and Medium Enterprises
VGPB	Victorian Government Purchasing Board



Conclusions and recommendations

1 INTRODUCTION

On 1 July 1998 the Joint Committee of Public Accounts and Audit (the Committee) resolved that it would conduct an inquiry into Australian Government purchasing policy and practice. The inquiry lapsed with the dissolution of the House of Representatives and the prorogation of the Parliament on 31 August 1998. On 10 December 1998 the Committee of the 39th Parliament resolved to re-open the inquiry.

There are several reasons why the Committee chose to review the purchasing activities of Commonwealth entities. First, is the large expenditure of public monies associated with purchasing. In 1997–98, the total value of purchases by Commonwealth budget funded agencies was about \$8.8 billion. This excludes purchases made by government business enterprises. Telstra, for example, spent \$8.5 billion on goods and services in 1997–98. The Committee, therefore, has a clear responsibility, on behalf of the Parliament, to scrutinise the receipts and expenditure of the Commonwealth and help to ensure the best outcomes for the Australian public.

Second is the need to examine the efficiency and effectiveness by which Commonwealth entities manage their purchasing function. Purchasing is a complex task and involves consideration of a number of competing objectives.

Third, the Committee sought to determine whether Commonwealth entities had learnt from the recommendations made in the Bevis Report and improved their performance during the last five years.

2 DEVOLUTION AND DECENTRALISATION

The Committee, in examining the issue of devolution and decentralisation, is struck by the cyclical nature of this debate. It seems that, depending on the prevailing management theory, organisations will choose a management style that is in vogue at the time. In 1994, the Bevis Report, for example, criticised the degree of devolution and called for purchasing over a certain value to be managed by accredited purchasing units.

In 1997, an internal review of Commonwealth purchasing rejected the existing purchasing arrangements and recommended that a devolved system be introduced where individual departments and agencies assume greater control and responsibility for purchasing decisions. Before discussing the merits or otherwise of these arrangements it is necessary to be clear on the difference between devolution and decentralisation as the meanings of these concepts are often confused.

Devolution is the transfer of decision-making capacity from higher levels in an organisation to lower levels, that is it is about who is best placed in an organisation to make decisions. Decentralisation is the redistribution of functions or tasks from central units in organisations to more widely dispersed units, that is it is about where in an organisation particular functions are best carried out.

At the whole of government level, the purchasing arrangements have been devolved to individual agencies. Some of the criticisms that were raised with this approach focused on the need for more consistency, oversight and coordination, and monitoring of the impact on purchasing officers. From the point of consistency, the Committee noted that agencies had different interpretations of Financial Management and Accountability Regulation 8, and different definitions of 'Australian made' and 'small and medium enterprise'. On these and other significant matters there must be consistency. To achieve consistency, there must be an effective level of oversight and coordination. However, this does not necessarily mean more resources will need to be allocated to the Department of Finance and Administration to manage a more intensive oversight role.

The Victorian Government Purchasing Board is responsible for coordinating the Victorian Government's devolved purchasing arrangements. Consistency and quality of service delivered by the individual agencies is governed by a rigorous accreditation system. Individual agencies must prove that they have the capacity to provide purchasing services at certain standards. Only once this capacity has been proven will an agency receive purchasing responsibility. So therefore, the devolution is managed within a tight framework of controls based on evidentiary proof of competency.

The Committee supports the devolution of purchasing authority and responsibility to individual agencies. At a whole of government level, devolution of responsibilities and greater accountability are consistent with the objectives of the *Financial Management and Accountability Act 1997*. There are merits in allowing agencies to tailor their services and to provide a flexible response free of central bureaucracy. However, it is clear that the scale and speed of devolution in the Commonwealth context has resulted in some inefficiencies, and a lack of opportunities for some SMEs. There was never a management framework or system of accreditation to ensure that agencies were in a position to take up the purchasing responsibilities.

The Committee, therefore, recommends that the Department of Finance and Administration (DoFA) develop and administer an accreditation system for assessing the purchasing performance of individual agencies. Agencies should be encouraged to attain standards of accreditation that best meet their needs. Agencies that do not meet suitable standards will need to develop a strategy to improve performance.

Some groups suggested that there is the need for an independent organisation to monitor purchasing policy and administration. The Australian Purchasing and Supply Consultants proposed that the National Procurement Board (NPB) should be reconvened. ISONET also suggested that there could be merit in the reintroduction of an independent monitoring body to oversee implementation of Commonwealth purchasing policy. Australian Business, however, commented that there was a vacuum since the demise of the NPB but there was not the need for a structure quite the same size.

The Committee suggests that it is too early to recommend the creation of an independent monitoring body to oversight purchasing. The current purchasing framework is in need of refinement and the recommendations in this report seek to make it more effective. However, the purchasing framework is not at crisis point and wholesale changes are not required at this early point. The Committee believes, however, that there is a potential role for the Office of Small Business in monitoring how effectively agencies are maximising opportunities for SMEs. More about this will be discussed in Chapter four.

In relation to DoFA's Purchasing Complaints and Advisory Service (PCAS), there is a need for this to be more heavily promoted. The next version of the CPGs should include information about PCAS in a prominent part at the front of the CPGs. Its current position in the CPGs is restricting awareness of this service.

At the agency level, the Committee received evidence relating to the merits or otherwise of decentralisation. It became clear that there was greater efficiency and effectiveness created from having certain purchasing functions centralised within agencies. The evidence from three agencies is notable in this discussion. First, the

Department of Foreign Affairs and Trade (DFAT) in 1991 decentralised the processing of accounts to divisions. An internal review soon discovered that the error rate for processing of accounts was unacceptably high and, therefore, DFAT recentralised the processing of accounts. It should be noted that the responsibility for initiating a purchase remained devolved to the divisions.

Second, the Department of Agriculture, Fisheries and Forestry – Australia (DAFFA) reported a similar situation to DFAT. DAFFA revealed, through an internal audit, that some requirements were not being consistently applied in some program areas.

The third example focuses on the financial administrative arrangements within Telstra. Telstra has moved to a centralised purchasing model which Telstra claims has resulted in greater control and information at the management level, and with reduced complexity for suppliers. It needs to be noted that, in 1997–98, Telstra spent \$8.5 billion on goods and services compared to \$8.8 billion for all Budget funded agencies. Telstra reported that in the previous decentralised model there were various levels of sourcing competence, duplication of effort between business units, loss of bulk purchase buying power and more complexity for suppliers. Therefore, Telstra centralised its arrangements and created a centre of expertise in strategic sourcing. The power to initiate a purchase still remains devolved to the various business units. These business units have the power to spend up to \$250 000 where those goods and services are not currently under contract to Telstra. An electronic interface informs the business units of what is already on contract to Telstra and if it is not on contract the business units can buy direct and then register that contract as the company contract.

These examples are supported by general observations made by the Australian National Audit Office (ANAO). The ANAO commented that there was merit in having, within agencies, a centralised cell on purchasing but, ‘in this era of devolution, it is also important to allow program managers to make decisions which affect the achievement of their program objectives’.

Evidence from DFAT, Telstra and the ANAO confirmed that there was a move towards centralised processing arrangements in the private sector. The ANAO, through its examination of centralised processing of payments, reported that significant economies of scale had been achieved by US firms in conjunction with other better practices.

The Committee, therefore, concludes that all agencies should review their purchasing arrangements with a focus on evaluating the efficiency and effectiveness of the distribution of functions or tasks within the agency. The Committee is not in a position to make a generic recommendation that all agencies should centralise certain purchasing functions. We do not have that level of information for each agency. The Committee, however, reminds agencies that

there are some persuasive case studies and general findings by the ANAO that a certain level of centralisation can create improvements in efficiency and effectiveness.

The Committee will monitor agencies' administrative arrangements relating to purchasing through two approaches. First, will be through examining Auditor-General performance audits relating to the efficiency and effectiveness of agency purchasing arrangements.

Second, the Committee notes that Chief Executive Officers (CEOs) have distinct responsibilities in relation to procurement. More about these responsibilities will be discussed in the next chapter. The Committee asserts that CEOs should be asking questions relating to the most efficient and effective way that they should distribute functions or tasks within their agencies. In 12 months time, the Committee will request agency CEOs to outline their purchasing arrangements and provide evidence of the efficiency gains and effectiveness accruing from those arrangements. Depending on the evidence provided, the Committee may summon CEOs to give an account of their agencies' arrangements.

Recommendation 1

That the Department of Finance and Administration develop and administer an accreditation system for assessing the purchasing performance of individual agencies.

3 THE COMMONWEALTH PURCHASING FRAMEWORK

Financial Management and Accountability Regulation 8

Financial Management and Accountability Regulation 8 is one of the overarching regulations which all agencies under the Financial Management and Accountability Act must follow. It is apparent that there is confusion amongst agencies in how FMAR 8 should be interpreted. This is a case in point that, in the current devolved environment, the regulations and guidelines must be clearly enunciated and consistently interpreted and applied.

FMAR 8 requires purchasing officers to have regard to the *Commonwealth Purchasing Guidelines* but, after having done so, they are under no legal requirement to follow them. FMAR 8(2) requires purchasing officers to record reasons why they have deviated from the CPGs.

FMAR 8 is part of the current purchasing strategy which hands back to agencies almost sole responsibility for purchasing. The objective is to streamline purchasing, make it more flexible, cut red tape and facilitate working with industry. FMAR 8 seeks to give individual agencies flexibility by allowing agencies to reject the CPGs if, in specific purchasing situations, they are not relevant.

The Committee acknowledges and supports the need for flexibility and the need for improved service delivery. However, FMAR 8 has created confusion amongst agencies in how it should be interpreted. No agencies have indicated that the flexibility offered by FMAR 8 has helped to improve their purchasing functions. The Committee asserts that if the discretion in FMAR8 is removed, then agencies will have more incentive to acknowledge and adhere to the CPGs. This will help to create a cultural shift that embraces greater recognition of the importance of government purchasing. Therefore, the Committee recommends that FMAR 8 be amended to read that purchasing officers *must act in accordance* with the *Commonwealth Purchasing Guidelines*.

Recommendation 2

That Financial Management and Accountability Regulation 8 be amended to read that ‘An Official performing duties in relation to the procurement of property or services must act in accordance with the Commonwealth Procurement Guidelines’.

CEOs – accountability and performance

The responsibility and accountability of Chief Executive Officers (CEOs) for purchasing activities is a key element of achieving an effective purchasing framework. The Financial Management and Accountability Act and accompanying regulations allocate responsibility for purchasing to CEOs. The Committee suspects that some CEOs are not involved and do not place a lot of importance on their role in managing their agencies’ purchasing. This is because CEOs obviously will focus on their core objectives that may relate, for example, to service delivery or policy development. It is unlikely, therefore, that the

performance of CEOs will be measured on their management of procurement. This is in contrast with the model used in the Victorian Government where CEOs are held to account for, and part of their performance is assessed on, how effectively they administer the purchasing function.

The US *Government Performance and Results Act 1993* provides for agency heads to report performance against objectives to the President and the Congress for each financial year. The Committee has cited this example for the purpose of showing the need to assign accountability and measure the performance of agency heads and their departments in delivering agreed performance objectives. In the case of the US Government, they have legislated these requirements.

The Committee asserts that the purchasing framework can be improved if CEOs are held to greater account for their administration of this activity. The Committee considers government purchasing and its associated multiplier effects to be a significant factor in our economy. Under the current purchasing framework, CEOs are given responsibility for purchasing but there does not appear to be appropriate measures of accountability and performance assessment consistent with this responsibility. Therefore, the Committee believes there is merit in the creation of formal performance measures regarding purchasing administration. These should include indicators for how effectively CEOs have performed against the key objectives in the Commonwealth Procurement Guidelines and Chief Executive Instructions of agencies.

The Committee would like the purchasing function to evolve to the point where CEOs ask, for example, how effectively their agency is applying the value for money principle, and whether more can be done to maximise the opportunities for ANZ industry.

Recommendation 3

Measurement of the performance of the senior management, including Chief Executive Officers, of Commonwealth agencies should include reference to how efficiently and effectively the purchasing function is administered, and whether agreed objectives are being met, such as ANZ content and the commitment to maximise opportunities for SMEs.

Value for money

The Commonwealth Procurement Guidelines state that ‘best value for money means the best available outcomes when all relevant costs and benefits over the procurement cycle are considered’. Price alone is not often a reliable indicator of value for money.

There is general support from industry for the definition of value for money used by Commonwealth agencies. Most Commonwealth agencies provided an effective definition of value for money in their submissions or when asked about this issue at public hearings. However, most industry groups argued that value for money was simply being interpreted as the lowest purchase price. In response to this accusation, most agencies could not provide evidence of their efficiency and effectiveness in determining value for money.

The Committee supports the current definition of value for money but there is no evidence to show that this principle is being applied correctly or consistently. The Committee acknowledges that the tender process is complex and that there are numerous issues that are considered in making value for money determinations. But the complexity of the issue is no excuse for making quick decisions that essentially focus on price. After all, value for money is the essential test against which agencies must justify any procurement outcome.

Agency CEOs and heads of procurement have a responsibility to ensure that the value for money principle is being applied correctly and evidence should be collected to demonstrate this. CEOs should request that their agencies’ evaluation plan include an assessment of value for money. In addition, internal audit should be used more to randomly select tenders and assess value for money determinations.

At the whole of government level, the Australian National Audit Office (ANAO) should increase the number of performance audits on the purchasing function of agencies and give special attention to the implementation of purchasing principles such as value for money.

The Committee will request CEOs, from June 2000, to furnish the JCPAA with results from its internal audits that relate to purchasing activities. In cases where internal audits have not been conducted, the Committee will request CEOs to show cause why they should not be summoned to appear before the Committee to review their purchasing activities.

In addition, the Committee will, during the next two years, pay special regard to ANAO performance audits that focus on government purchasing.

Culture, training and education

In 1994, it was reported that among government purchasers there was an attitudinal bias which resulted in a reluctance to purchase from Australian suppliers. Since the Bevis Report of 1994, anecdotal evidence suggests that the purchasing culture has improved, although it is not possible to be definitive about this and there is certainly no room for complacency on this matter. Purchasing culture can be influenced by a range of factors including the role and influence of CEOs, the purchasing systems that are in place, the level of accountability and, most importantly, the prevailing attitudes, values and approaches of purchasing officers. Training and education can help to influence the attitudes and approaches of purchasing officers as well as give them a skill base to efficiently and effectively conduct their purchasing responsibilities.

In respect to training and education of purchasing officers, the Commonwealth does not have a systematic approach. Some agencies reported that they have accredited purchasing units and offer training opportunities. However, this is contrasted with the claim by ISONET that the majority of purchasing officers are not accredited and do not receive ongoing formal training. In addition, the requirement in the *Commonwealth Procurement Guidelines* that 'all persons undertaking procurement functions, including those officers overseeing and/or approving procurement activities, meet appropriate Commonwealth Procurement Competency Standards' has been downgraded from 'mandatory' to 'best practice'.

The Commonwealth's reasons for downgrading the training requirement in the CPGs is in line with its devolved approach to purchasing and the focus on results rather than observance of detailed procedures.¹ What is apparent is the Commonwealth has gone too far in its preference for a devolved model. The lack of a systematic training regime is one manifestation of this approach. It is in contrast to the model used by the Victorian Government which also has devolved arrangements but ensured that there are systems in place to provide guidance and oversight. The Victorian Government Purchasing Board has placed a high priority on training and skills development and backed this up with the creation of the Procurement and Contracting Centre for Education and Research. At the Commonwealth level, the Department of Defence approach to training and achievement of competency standards articulated in its *Defence and Industry Strategic Policy Statement* is also notable.

In concluding this section, the Committee places a high priority on training needs and competency standards of government purchasing officers. The Committee, therefore, rejects the downgrading of the competency requirement from

1 Commonwealth Procurement Circular, *Changes to the Commonwealth Procurement Framework*, CPC 98/3, 7 August 1998.

'mandatory' to 'best practice' in Commonwealth Procurement Circular 98/3. This decision should be reversed immediately. A systems approach to training and competency standards should be developed for the Commonwealth using the Victorian Government Purchasing Board and Department of Defence initiatives as useful models for comparison.

If the purchasing culture is going to improve then the first place to start is the training and education of purchasing officers. In addition, the Committee received reports about the turnover rates of purchasing officers and insufficient career opportunities. CEOs should focus on these matters as part of their human resource management obligations.

Recommendation 4

The decision made in Commonwealth Procurement Circular 98/3 to change from mandatory to best practice the requirement that all persons undertaking procurement functions meet appropriate Commonwealth Procurement Competency Standards should be reversed immediately.

Contract management

During the inquiry, criticisms were made about errors and omissions in contracts, the failure of Commonwealth agencies to seek redress in cases where contractors fail to comply with the terms of a contract, and the inadequate level of contract management skills displayed by government purchasing officers. This is not the first time this Committee has dealt with these types of concerns. In recent times, the Auditor-General's performance audits have revealed significant inadequacies in the way contracts are managed. At the same time, it is the view of this Committee and the Auditor-General that contract management is one of the most challenging tasks facing the Australian Public Service.

The evidence received by the Committee confirms the need for agencies to focus on training and skill development of its purchasing officers so that they can meet the requirements of contract management. As suggested by MAB/MIAC, and this Committee in its report on the Jindalee Operational Radar Network Project, agencies should, depending on the skill base of the agency, consider bringing in external expertise for short or long term assistance.

In relation to performance and accountability to the Parliament, this Committee reaffirms its support for the Australian National Audit Office' (ANAO) to have access to contractors' records and premises and that this be provided for in contracts.

In relation to Australian content requirements, Commonwealth agencies must maximise the power of their contracts to include provisions for Australian industry development. In cases where agencies have little experience in this area, they should seek advice from, for example, the Australian Government Solicitor. *Model Industry Development Criteria for Major Projects* also provide information in relation to industry development criteria and non-compliance with contract arrangements. The *Model Industry Development Criteria for Major Projects* is discussed in more detail in Chapter 4.

The Committee is particularly concerned about allegations that Commonwealth agencies are reluctant to take action in cases where contractors fail to comply with their Australian industry involvement (AII) requirements. The ANAO should pay close attention to this issue in any relevant performance audits. In addition, if individuals or industry organisations have evidence that a contractor is breaching AII requirements then they should report this information to the Chief Executive Officer of the relevant agency or department so that a review can be undertaken.

Endorsed supplier arrangements

The Committee has noted the arguments for and against the phasing out of some common use arrangements (CUAs) and the expansion of the endorsed supplier arrangements (ESAs). The Australian National Audit Office reported in 1992 that CUAs saved the Commonwealth between \$58m and \$66m per year through demand aggregation and consequent lower prices. In the current inquiry, the Departments of Foreign Affairs and Trade (DFAT) and Defence both commented on the usefulness of CUAs and the additional resource expenditure that has been created since they were phased out. DFAT advocated the reintroduction of CUAs on certain products.

At the same time, there were groups such as the Commercial Furniture and Industry Association of Australia that supported ESAs. The Australian Information Industry Association welcomed the introduction of ESAs but noted its concern with anecdotal evidence that business was going to companies which were not endorsed.

The evidence before the Committee does not allow it to make a definitive decision about the merits or otherwise of scaling back CUAs and expanding ESAs. First, more time is needed to allow the new system to become established before it can be properly evaluated. Therefore, DoFA should proceed with an evaluation of the

CUA/ESA framework in the 1999–2000 financial year. The evaluation must include a needs assessment of both Commonwealth agencies and industry. The evaluation should also include an economic analysis of the savings being made through the current system. Only with this information will government be able to make strategic decisions regarding the effectiveness of the current system and consideration of longer term options.

In addition, the Australian National Audit Office should conduct a multi-agency performance audit focusing on the efficiency and effectiveness of the administration of the CUA/ESA arrangements. This would be an appropriate follow up audit to Audit Report No. 7, 1992–93, *Saving Time and Money with Common-use Contracts*.

4 AUSTRALIAN INDUSTRY DEVELOPMENT

The Commonwealth Procurement Guidelines

The Committee, in assessing the state of industry development objectives in the Commonwealth Procurement Guidelines (CPGs), suggests that the overall performance of government has improved since the Bevis Report made its findings in 1994. This is based on favourable reports about the performance of the Department of Defence that accounts for over half of government purchasing by Budget funded agencies. As noted in Chapter 3, anecdotal evidence suggests the attitude and culture of government purchasing officers has also improved. However, it is apparent from the divergent opinions on the effectiveness of industry development objectives of government purchasing that more can be done to harness the positive impact of government purchasing, particularly for small business.

The Office of Small Business (OSB) advised the Committee that more could be done to ensure that government purchasing helps to drive Australian industry development. OSB raised a number of concerns made by small business. These relate to the perception amongst government purchasing officers that there is more risk associated with using small business, concerns by small business about the cost of tendering, and difficulties for small business when vying for Commonwealth business. As stated in the CPGs, the onus is on government purchasing officers to establish or verify the competence, viability and capability of the prospective suppliers to perform the contract.

These issues can be dealt with at three levels. At the officer level, there is the need to enhance the training, education and culture of government purchasing officers. At the departmental level, Chief Executive Officers are responsible and

accountable for ensuring that the right systems are in place to maximise opportunities for Australian industry. These two issues were dealt with in Chapter 3. At the whole of government level, however, there is no specific organisation or agency that has a monitoring or oversight role in relation to the impact of government purchasing policies on small business. The OSB should take on additional responsibility and fill this gap. The Committee would support the expenditure of additional resources so that OSB could fulfil this role.

The Committee asserts that, in the current devolved purchasing arrangements, there is the need for an agency with an interest in small business to feature prominently in the centralised development of purchasing policy and practice. Under this arrangement, the Committee would see OSB's new responsibilities as including:

- joint responsibility with the Department of Finance and Administration (DoFA) for developing future versions of the Commonwealth Procurement Guidelines. OSB will have sole responsibility for drafting part 5 of the CPGs relating to National Competitiveness and Industry Development. In addition, OSB will provide an impact assessment of how other parts of the CPGs affect small business;
- developing consultative forums to receive feedback from, and help, small business to understand Commonwealth purchasing policies;
- perform an oversight role of Commonwealth procurement focusing on its impact on small business;
- promote and assist with the management and analysis of information arising from the Purchasing Complaints and Advisory Service; and
- produce annual statistical reports showing the proportion of purchasing awarded to small and medium enterprises at the whole of government level and by agency.

The Committee believes that these measures could help to enhance the industry development objectives of government procurement policy. OSB's knowledge and relationship with small business will complement DoFA's technical knowledge of purchasing.

The need for agreed and universally applied definitions

Agreed and universally applied definitions are essential for comparability and performance assessment across agencies. The Committee's investigation revealed that amongst agencies there was inconsistency in the use of definitions, and, in some cases, uncertainty and confusion. This is further evidence in support of the fact that, in a devolved environment, there must be an effective centrally

developed framework of policies and principles. In this case, an appropriate coordinating agency must be responsible for consulting, developing, circulating and monitoring the use of agreed definitions that are fundamental to the procurement function.

In relation to definitions for small and medium enterprises (SMEs) there was variation between agencies in the definitions that were being used. The Department of Agriculture, Fisheries and Forestry — Australia indicated that it had no definition for SMEs. Similarly the Australian Taxation Office has chosen not to define it and is waiting for guidance. The Office of Small Business relies on definitions used by the Australian Bureau of Statistics, but stresses that it is keen to see a standardised definition across government.

The Committee maintains that agreed and universally applied definitions for small and medium enterprises should be an essential part of the Commonwealth Procurement Guidelines (CPGs). A number of objectives in the CPGs relate to SMEs. Performance assessment against these objectives will be more effective if there is comparability of definitions and recording of data across agencies. Therefore, the Committee recommends that the Department of Finance and Administration (DoFA), and the Office of Small Business develop and agree on appropriate definitions to cover small and medium enterprises and circulate this information across government for universal application. The agreed definitions should be included in the next edition of the CPGs.

At the conclusion of this process, the Committee expects that all agencies should be using the same definition. The Australian National Audit Office should, in any relevant performance audits, assess whether agencies are complying with the use of agreed definitions.

In relation to definitions relating to Australian made and Australian content, again there was some confusion. These are essential definitions and relate to the industry development objective of government procurement in seeking to develop Australian New Zealand (ANZ) industry. Commonwealth agencies were, generally, able to report on the proportion of suppliers that were ANZ industry. Although all agencies that were asked could not provide detailed information on the country of origin from where goods and services were sourced. Most agencies suggested that it would be too costly and resource intensive to monitor all their contracts and report on the country of origin of goods and services.

The Committee is taking a realistic view on the monitoring and reporting of Australian content. There is a need for agencies to collect more informative data on Australian content. The Committee suggests that the tests for 'made in', 'produced in' and a 'product of Australia' as used in the *Trade Practices Amendment (Country of Origin Representations) Act 1998* are appropriate and should be used. Agencies must ensure that their procurement contracts are drafted appropriately

and include relevant clauses supporting Australian content. Next, the Committee does not expect agencies to monitor the local content provisions of all their contracts, but local content monitoring must be given the same regard as other aspects of contract management. Agencies should create a culture in which there is an expectation that all contracts are subject to random review and there will be penalties for non-compliance with aspects of a contract.

Recommendation 5

The Department of Finance and Administration and the Office of Small Business develop and agree on appropriate definitions to cover small and medium enterprises, and circulate this information across government for universal application. The agreed definitions should be included in the next edition of the Commonwealth Procurement Guidelines.

The 10% SME commitment

Statistics compiled by Dunn and Bradstreet show that the government's commitment to source at least 10 per cent of their purchases from small and medium enterprises (SMEs) has been achieved. In 1995–96 Commonwealth departments and agencies sourced 24.4% of their purchases from SMEs, with more than \$1.8 billion of Federal purchasing expenditure going to SMEs. For 1996–97 the figures were 33.9% and \$1.595 billion respectively. The Office of Small Business has proposed that the 10 per cent commitment be increased to 15 per cent for small business and 20 per cent for small and medium sized enterprises.

The Committee notes the performance of Commonwealth agencies against the 10 per cent commitment. In view of this and the proposal by OSB, the Committee recommends that the Government upgrade its commitment so that Commonwealth departments and agencies will source at least 20 per cent of their purchases from SMEs.

In making this recommendation, the Committee is aware of the recent history of Australian Government procurement and, in particular, preferential treatment and its implications for national competitiveness. The Government's current commitment that agencies should source at least 10% of their purchases from ANZ SMEs, and the Committee's recommended increases, are not preferential policies.

The Committee interprets the 10% commitment as a target that agencies should seek to achieve after applying the principles of value for money and open and effective competition. Agencies should seek to achieve the 10% commitment through non-discriminatory means. This includes being proactive in informing and educating SMEs in available purchasing opportunities and encouraging suppliers, as appropriate, to improve their performance in terms of cost, quality, time and responsiveness.

The Commonwealth Procurement Guidelines include a series of measures that agencies should apply in seeking to increase ANZ industry development. The Committee does not support preference margins like those that existed in the repealed *Procurement of Goods, Works and Services Act 1981*. These policies were flawed and did nothing to promote national competitiveness. The Committee, however, does support the principle raised by other Parliamentary Committees that where ANZ products are equal to overseas items in terms of value for money and other principles in the Commonwealth Procurement Guidelines, then the ANZ products must be purchased.

Recommendation 6

That the Government upgrade its commitment so that Commonwealth departments and agencies will source at least 20 per cent of their purchases from SMEs.

Recommendation 7

That where Australian–New Zealand (ANZ) products are equal to overseas items in terms of value for money and other principles in the Commonwealth Procurement Guidelines, then the ANZ products must be purchased.

Industry development criteria for \$10m projects

For major procurement projects of \$10 million or more, Commonwealth agencies that come under the *Financial Management and Accountability Act 1997* are required to apply industry development criteria. The Department of Defence and AusAid are excluded from this requirement as they have developed their own industry development criteria.

Model Industry Development Criteria have been developed which set out six key industry development criteria for tender documentation. The model criteria provide guidance notes to assess tenderers against each criterion, mechanisms to monitor compliance of the successful tenderer against industry development commitments, and instructions in the event that a tenderer does not comply with their industry development criteria.

The focus of concern in the inquiry was the appropriateness of the \$10 million threshold. Australian Business and the Australian Chamber of Commerce and Industry suggested that the \$10 million threshold was too high and there were opportunities for Australian industry development outcomes with smaller contracts. For example, these groups suggested that tenders of the order of \$1 to \$2 million can have significant impact in regional areas.

The Office of Small Business also suggested that the \$10 million threshold was too high and proposed that a system be developed to ensure industry development for the high volume of purchases below the current threshold. Australia Post noted that Commonwealth Government Business Enterprises are subject to a \$30 million threshold for industry impact statements. Australia Post warned against lowering this amount because of the additional cost and time that would accrue in having to develop industry impact statements.

The Committee is encouraged by the development of the *Model Industry Development Criteria for Major Projects, Guidance Notes*, and its goals and objectives. The Guidance Notes provide a clear framework for agencies to maximise opportunities for Australian Industry. Further, the Guidance Notes provide advice on assessing tenderers against the criteria, monitoring, and compliance against Australian industry commitments.

The information and requirements in the Guidance Notes do, however, lose their influence because the threshold is too high. It is possible that more could be gained for Australian industry and the quality of government procurement from lowering the threshold such that the Model Industry Development Criteria apply to smaller value tenders. Therefore, the Committee recommends that, for agencies under the *Financial Management and Accountability Act 1997*, *Model Industry Development Criteria for Major Projects* should apply to procurement projects of \$5 million or more. The Committee notes that the Department of Defence is already using a threshold of \$5 million.

The Committee notes Australia Post's concerns regarding the \$30 million threshold for GBEs. The cost and time of applying Australian industry development criteria is noted, together with the market competition faced by some GBEs. However, weighted against this is the industry development outcomes that could accrue for Australian industry. No detailed costs and benefits have been provided to the Committee for it to consider, in detail, both sides of this argument.

In view of this, the Committee suggests that the Minister for Communications, Information Technology and the Arts, and the Minister for Finance and Administration review the \$30 million level for Australia Post at which Industry Impact Statements must be applied. In conducting this review the Ministers should focus on selecting a threshold which maximises Australian industry development.

Recommendation 8

That, for agencies under the *Financial Management and Accountability Act 1997*, Model Industry Development Criteria for Major Projects should apply to procurement projects of \$5 million or more.

Mega-contracting

Evidence to the inquiry suggested that public sector buying was tending towards mega-contracts whereby a single supplier provides a range of goods and services to an agency. The Australian Chamber of Commerce and Industry suggested this could have significant implications for Australian SMEs when contracts were won by multi-national enterprises that have no connections with, or interest in, smaller Australian enterprises seeking to sub-contract.

In August 1997, Procurement and Construction Ministers noted that changes in public sector buying were influencing the role, scope, scale and impact of government buying with a significant effect on SMEs seeking to supply to government. The Procurement Ministers encouraged greater participation by SMEs in the contract chain.

The Committee supports measures promoted by Procurement Ministers, and reminds Commonwealth agencies of their responsibility to encourage participation by SMEs as direct suppliers or as subcontractors. Agencies should, therefore, seek to develop initiatives that will enhance opportunities for Australian New Zealand SMEs. This will include greater use of contractual requirements on contractors to include ANZ SME participation. The Model Industry Development Criteria should be used for this purpose.

The Committee asserts that analytical information is needed regarding market patterns and trends in government buying. This would provide indicative information on how market conditions are affecting Australian and New Zealand SMEs. With this information, government will be able to develop more effective strategies to maximise opportunities for ANZ SMEs. The Committee, therefore,

recommends that the Office of Small Business and the Department of Industry, Science and Resources conduct research into Commonwealth Government buying trends and their implications for Australian New Zealand small and medium enterprises.

Recommendation 9

That the Office of Small Business and the Department of Industry, Science and Resources conduct research into Commonwealth Government buying trends and their implications for Australian New Zealand small and medium enterprises.

ISONETS

The Committee supports the role and work of the Industrial Supplies Office Network (ISONET). Commonwealth agencies, in promoting Australian New Zealand industry, should wherever possible use the services provided by ISONET. However, ISONET did not indicate, apart from the Department of Defence, that it was having a productive relationship with Commonwealth agencies.

In order to rectify this situation, the Committee recommends that all Commonwealth agencies, if they have not already done so, sign a memorandum of understanding (MOU) with ISONET. This MOU, among other things, must guarantee lines of communication between the agency and ISONET, and include commitments to maximising the involvement of ISONET in the purchasing process. An agency will be expected to include, in its Annual Report, confirmation of its MOU, initiatives that it will be taking to increase the involvement of ISONET in agency procurement, and an appraisal by ISONET of the agency's performance against objectives set out in the MOU. This will provide ISONET with an opportunity to report on the performance of Commonwealth agencies and provide further information for parliamentary scrutiny of agency performance.

In addition, the Department of Finance and Administration should amend the Commonwealth Purchasing Guidelines to reflect the need for all agencies to sign an MOU with ISONET, and to develop initiatives to maximise the involvement of ISONET in agency procurement.

Recommendation 10

That all Commonwealth agencies, if they have not already done so, sign a memorandum of understanding (MOU) with ISONET. This MOU, among other things, must:

**guarantee lines of communication between agencies and ISONET;
and**

**include commitments to maximising the involvement of ISONET
in the purchasing process.**

An agency will be expected to include, in its Annual Report, confirmation of its MOU, initiatives that it will be taking to increase the involvement of ISONET in its procurement, and an appraisal by ISONET of the agency's performance against objectives set out in the MOU.

The Defence and industry strategic policy statement

The Department of Defence (Defence) accounts for over half of all government purchasing by government funded agencies. In 1997–98, Defence purchasing was \$5.5 billion which accounted for 62.5% of the total value of purchasing by the Commonwealth, exclusive of government business enterprises.

Defence, through the *Defence and Industry Strategic Policy Statement*, has sought to enhance its industry policy and reform its procurement processes. Defence is seeking to create a procurement process which is flexible, responsive, innovative and efficient.

The Committee supports Defence initiatives to better understand and apply the value for money principle, provide procurement competency training and, in order to help improve access by SMEs, publish electronically the reasons its officers have gone offshore for goods and services for all purchases worth \$100 000 or more. The Committee supports the accountability aspects of this initiative and recommends that all Commonwealth agencies be required to account for why goods and services over \$100 000 are purchased from overseas suppliers.

In addition, the Committee supports the use of annual surveys of its military and civilian officers to help evaluate the success of initiatives outlined in its statement as drivers for cultural change.

During the inquiry, it was suggested by some groups that elements of Defence procurement could be adopted by other agencies. There is merit in this proposal. Defence has because of the scale of its purchasing had greater opportunity, than smaller agencies, to enhance and seek to perfect its purchasing processes. It is logical, therefore, that other agencies should benefit from this experience and knowledge. There are two approaches to achieving this result. First, individual agencies on their own discretion could consult with Defence on an ad-hoc basis. This could be administratively time-consuming and lack standardisation. The second approach is for the Department of Finance and Administration to consult with Defence and amend the next version of the Commonwealth Procurement Guidelines to incorporate superior elements of the *Defence and Industry Strategic Policy Statement*.

The Committee supports the second approach and maintains that it is totally appropriate for the Department of Finance and Administration to conduct this coordinating role. As outlined in Chapter 2, the Commonwealth's devolved arrangements still require a range of centrally developed policies and principles. The Department of Finance and Administration as the author of the Commonwealth Procurement Guidelines must seek to develop a highly regarded product. The Committee asserts that the Commonwealth Procurement Guidelines will be improved by the inclusion of Defence procurement processes. Therefore, the Department of Finance and Administration should consult with the Department of Defence regarding Defence procurement initiatives, and amend the next edition of the Commonwealth Procurement Guidelines to incorporate superior elements of the *Defence and Industry Strategic Policy Statement*.

Recommendation 11

To improve access by SMEs to smaller purchases, all Commonwealth departments and agencies will publish electronically the reasons why officers have gone offshore for goods and services for all purchases worth \$100 000 or more.

5 ELECTRONIC COMMERCE AND THE STATISTICAL DATA BASE

An effective, efficient and user friendly electronic commerce system is an essential part of the modern government procurement process. If the system is developed correctly, in consultation with buyers and suppliers, then major benefits will accrue. The lesson of Transigo should be put to good use in developing the next generation electronic commerce model.

Transigo was first released in March 1997. Its key objectives included helping the private sector identify opportunities within the government marketplace, access tender documents, and match their goods and services to business opportunities. Transigo was also designed to provide a statistical collection function. Transigo was introduced in a rapidly changing environment and has been plagued by an insufficient take-up rate by suppliers. This led the government, in January 1999, to announce that agencies would no longer be limited to using Transigo. The Office for Government Online (OGO) is currently responsible for the electronic purchasing and payment framework including development of an implementation strategy.

OGO reported that of the roughly 30 000 suppliers that are doing business on a regular basis with government, less than one per cent actually signed up and subscribed to Transigo. Government will have to ensure that the reasons for this low-take up rate are accurately documented and addressed in the development and implementation of the next electronic commerce model. The Committee supports the current strategy to develop a 'distributed model' electronic commerce system in which agencies will be free to select the electronic commerce service provider of their choice. However, this support is based on the condition that there are basic standards which ensure interoperability and consistency so that suppliers are not faced with having to deal with a range of incompatible systems.

In conjunction with the development of the new electronic commerce model, government must ensure that there is an appropriate and effective statistical data collection system. Government, the Parliament and industry need timely statistics for review, evaluation and performance assessment. Chief Executive Officers of Commonwealth agencies should, in particular, ensure that they have an effective suite of statistical indicators to assess their agencies' purchasing performance.

Throughout the inquiry, the quality and timeliness of purchasing statistics was heavily criticised. Most agencies, for example, could not report independently on the proportion of their purchasing that was awarded to Australian and New

Zealand small and medium enterprises. A key commitment in the Commonwealth Procurement Guidelines requires agencies and departments to source at least 10% of their purchasing from SMEs. This objective was reported in an aggregate way across government. The Committee expects that the new electronic commerce model will be able to provide each agency with this type of purchasing data at an on call basis. Therefore, OGO should ensure that the statistical data collection system has sufficient data entry fields to record a range of industry development criteria by agency.

In concluding this section, the Committee maintains that the current state of departmental reporting of purchasing activities is not acceptable. The Committee's examination of a selection of annual reports indicated that reporting of this function rated a low priority. Some agencies stated their acknowledgment of certain parts of the CPGs, but, in the majority of cases, there was no reporting of performance against objectives. The Committee, therefore, recommends that all Commonwealth agencies under the *Financial Management and Accountability Act 1997*, and government business enterprises report, on an annual basis in their Annual Reports, their performance against key purchasing objectives. Performance information should also be available on agency internet websites and be accessible through the purchasing electronic commerce system.

In making this recommendation, the Committee acknowledges advice from the Australian National Audit Office that there is a trend against requiring agencies to provide detailed reporting on a wide range of issues in their annual reports. The Committee accepts this but maintains that information about purchasing objectives and outcomes is currently under reported, is significant in nature and, therefore, should be given greater priority in agency reporting requirements.

In assessing the impact of this recommendation, the Committee suggests that three key positive outcomes will arise. First, the Committee considers that with more effective reporting of performance, there comes greater scrutiny, feedback and through this greater incentive for agencies to improve their performance. Second, performance information reported in agency annual reports provides an opportunity for House of Representatives Standing Committees to review agency performance without the need for a Ministerial reference. This power provides these committees with enormous opportunities to scrutinise the purchasing performance of agencies on an ad hoc basis. The third outcome relates to the opportunity for industry and relevant organisations to be more informed and aware of how agencies are performing.

Recommendation 12

That all Commonwealth agencies under the *Financial Management and Accountability Act 1997*, and government business enterprises report, on an annual basis in their Annual Reports, their performance against key purchasing objectives. This information should also be made available on agency internet websites and be linked to purchasing electronic commerce systems.