Report of the

Controller and Auditor-General

Tumuaki o te Mana Arotake

on

Inquiry into the Ministry of Health's contracting with Allen and Clarke Policy and Regulatory Specialists Limited

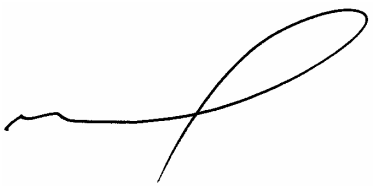
December 2005

Foreword

Public entities should procure services and manage conflicts of interest in a transparent manner, particularly when there is a risk of actual or perceived impropriety, or when potential conflict of interest issues arise. Public entities need to handle procurement with care and in accordance with expectations of good public sector practice.

My findings in this report are a reminder that public entities need to manage contracting for services to ensure two outcomes. The first is that they are receiving value for money. The second is that the risks of actual or perceived impropriety, especially those associated with concurrent or former employment with the entity, are managed in a transparent way.

I would like to thank the Director-General of Health and her staff, and the principals and staff of Allen and Clarke Policy and Regulatory Specialists Limited for their prompt and willing assistance with my inquiry.



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Contents

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Summary and recommendations

The Auditor-General decided in April 2005 to inquire into issues raised by the Hon Murray McCully MP about the contracting policies and procedures of the Ministry of Health (the Ministry).

In particular, the inquiry examined the Ministry's contracting with 2 former employees (Matthew Allen and David Clarke) and the company of which they were the principals. In a related review, the State Services Commission investigated and reported (on 22 July 2005) on issues related to the preparation of responses by the Ministry of Health to Parliamentary questions lodged by the Hon Murray McCully MP about these contracts.

Between June 2001 and February 2005, the Ministry entered into 60 contracts with Allen and Clarke Policy and Regulatory Specialists Limited (Allen & Clarke). The total value of all contracts was around $1,362,000 excluding GST, with 32 of the contracts being for $10,000 or less. Only 4 of the contracts involved a contestable process. The other 56 contracts were awarded on a "sole provider" basis.

Our inquiry focused primarily on the Ministry's contracting with Allen & Clarke, and our findings relate in the first instance to the management of contracts with that company. However, during the course of our inquiry, we found deficiencies in the Ministry's procurement and contract management practices that extended beyond the contracts with Allen & Clarke, and in a number of the Ministry's directorates. The report also addresses these concerns. The Ministry has been taking steps to improve its procurement and contracting policies and practices, but further work is required.

The Ministry of Health's procurement and contract management policy and practices

Several policies have applied in the Ministry to the procurement and contract management process. There was considerable confusion within the Ministry about which procurement policy applied. Without both a good awareness of the policies and clear understanding of how they apply, there is a risk of an inconsistent approach to procurement, that doesn't always conform to good practice.

The Ministry's management of contracts was not consistent with good practice in significant respects, such as accountabilities for contracts, documentation of progress, performance and delivery, ensuring value for money, and systematic management of key information for all the Ministry's contracting activities.

Our inquiry examined the period from June 2001 to February 2005. In 2002-03, the Chief Internal Auditor for the Ministry undertook a wider audit of the Ministry's contracting performance and had findings very similar to our own. The Ministry told us about a number of important initiatives it has since taken, to address the 2002-03 internal audit findings.

These include setting up a Contracting Support Office and a Contracting Advisory Group within the Ministry. These are positive steps, although it is too early to comment on this approach and whether it will improve the Ministry's contracting practices. Another recent initiative is a comprehensive profile of competencies required by staff for contract management, and the introduction of module-based training. On 17 November 2005, the Ministry's Executive approved a "refreshed" procurement policy, which will address several of the issues raised by our inquiry. It is important that the Ministry continues to monitor its progress on, and the effect of, these initiatives.

Contracts awarded to Allen & Clarke

Between June 2001 and 16 January 2002, the Ministry awarded 8 contracts to Allen & Clarke. At this time, both the principals were working for the Ministry on 3-year fixed term contracts. One of the principals – Mr Allen – was working only 30 hours a week, and used his spare time to work on the contracts. A ninth contract was awarded on 16 January 2002, the day before Mr Allen left the Ministry's employment.

Mr Allen had informed the Ministry of his wish to work for the Ministry as an employee part-time while also carrying out contract work for the Ministry and other entities. Some Ministry staff were aware of the concurrent employment and contracting arrangements that were subsequently entered into. However, the Ministry's procurement policies did not provide for such a situation arising, and the Ministry had not at the time developed its conflict of interest policy. Neither did the Ministry fully consider and apply its Code of Conduct, which contains relevant provisions.

We are satisfied that, although Mr Allen was contracting with the Ministry while working for the Ministry as an employee, the nature of the outputs provided in each case was different. In other words, Mr Allen was not contracted to provide the same outputs that he was concurrently employed by the Ministry to provide.

We found no evidence in the Ministry's award of contracts to Allen & Clarke of any inappropriate relationships between the principals of the company and staff of the Ministry. Contracts were generally awarded to Allen & Clarke because of the principals' experience in the specific areas of policy and regulatory advice, the principals' and their company's reputation for good performance, and their availability. Ministry officials spoke highly of the performance and quality of the services provided by Allen & Clarke.

The Ministry's policy is silent about engaging contractors who are former employees of the Ministry. Conflict of interest disclosures do not appear to have been required of, or made by, either of the principals. To ensure that risks of actual or perceived impropriety in relation to such engagements are properly addressed, there should be policy and procedures to manage these situations. A policy on conflicts of interest which covers such arrangements has since been completed, and was agreed by the Ministry's Executive Team on 17 November 2005.

Using a sole provider and ensuring value for money

The Ministry's policies refer to the need for value for money, and promote contestability as the best means of achieving this. However, the Ministry adopted a non-contestable or sole provider approach to all but 4 contracts with Allen & Clarke. The Ministry's procurement policy that applied to those 28 contracts of the Allen & Clarke contracts that had a value of more than $10,000 did not allow for a sole provider approach unless an exemption was sought and approved in accordance with the policy. However, 24 of the 28 contracts were not contested and, for most, approval for exemption from the policy was not obtained.

The use of the sole provider approach raised the issue of whether the Ministry had clearly demonstrated value for money with its procurement. We found limited documentation justifying a sole provider approach to the contracting with Allen & Clarke. We were told that the expertise, performance, and availability of Allen & Clarke, and the unavailability of other specialists in the market, were the main reasons for engaging Allen & Clarke. However, we were unclear how the Ministry satisfied itself about the performance of this sole provider, and there was no evidence that the Ministry kept a formal record of contract performance.

In addition, many contracts were awarded to Allen & Clarke on the basis of agreed hourly rates rather than a fixed price. Although the hourly rates for the services provided by Allen & Clarke were similar to the hourly rates for other contracts for services in the Ministry, we were not satisfied that the Ministry had a well-established practice of negotiating rates where sole provider procurement was proposed. We found it difficult to accept that the principle of value for money had been properly demonstrated in the practices adopted by the Ministry.

We were particularly concerned about a series of contracts entered into by the Ministry for the Joint Therapeutic Agency project (the JTA project). The first of these contracts was awarded to Allen & Clarke in January 2002. The contract was awarded on a non-contestable basis, and payments were made on an hourly rates basis. The value of the contract was $109,511. Three further contracts with Allen & Clarke in 2003 and 2004 had a combined value of more than $430,000, giving a total for the project of more than $539,000.

We had 2 concerns. First, there was no contestability for these contracts, either at the start of the JTA project or when it was extended, despite advice from the Ministry's internal auditor on 19 December 2003 that "once the current phase of the work is completed, and at a point convenient to the Ministry – we should not continue with Allen & Clarke without testing the market through a tender process". Second, there appeared to be a lack of succession planning and risk management by the Ministry, both with the initial contract, and at the extension of this project during the next 2 years.

In a number of instances, contracts with Allen & Clarke were renewed without any apparent re-examination of value for money or having gone to the market. This is not good practice. We would expect the Ministry to have examined why the extension was needed (especially as the contracts were usually on an hourly rate), to have evaluated the value for money, and to have reconsidered the alternatives to external contracting as the investment in such contracting increased.

Recommendations to improve the Ministry of Health's procurement and contract management

The approval of the Ministry's "refreshed" procurement policy has a bearing on several of our recommendations. This approval happened after we completed our inquiry, but before our report was finalised. We have nevertheless made our recommendations, while acknowledging the Ministry's initiative in the main body of our report.

We recommend that the Ministry of Health:

1. review awareness and understanding of the Ministry's procurement and contract management policy and procedures of all staff involved in procurement and contract management;

2. ensure that the contract management competencies required of staff include a thorough knowledge of the Ministry's procurement policies and procedures;

3. assign responsibility for ensuring that all its contract monitoring processes are observed, and appropriate documentation retained, for each contract;

4. ensure that its policies on contract monitoring practices are followed in all of its contracting activities;

5. take a systematic approach to maintaining key documentation for individual contracts, and ensure that this documentation is readily accessible for contract management purposes and complements contract information held electronically;

6. urgently review its electronic management of contract information with a view to introducing a system or systems that will ensure that all appropriate information on the Ministry's contracts is readily accessible to support good contract management, and that the information is available for contract management purposes throughout the Ministry;

7. keep under review the procurement and contract management framework, and accountabilities within the Ministry, and ensure that its Contracting Support Office and Contracting Advisory Group can lead Ministry-wide improvements and maintain appropriate oversight of those policies and procedures throughout the Ministry;

8. apply its Code of Conduct and new Conflicts of Interests Policy to ensure that the risks associated with concurrent employee/contractor relationships with the Ministry are well-managed;

9. provide appropriate guidance to staff involved in the procurement of goods and services on the policies and procedures that apply to engaging contractors who are former employees of the Ministry;

10. consider its procurement policy for low value contracts, to ensure that consideration is given, among other things, to the cumulative value and number of contracts with a sole supplier when deciding on an appropriate procurement approach;

11. ensure that, when a decision is made to engage a sole provider, the business case to support this method of procurement is fully documented and records of the procurement decision-making process are maintained, and that this decision is reconsidered if it is proposed to roll over the contract with a sole provider;

12. carry out a formal, written end-of-contract performance assessment for all contracts for services the Ministry has entered into, and provide that feedback to the contractor;

13. actively negotiate hourly rates or costs when entering into a contract, as is required under its current procurement policies, and maintain a record of the negotiation process (which is particularly important when a sole provider procurement approach is adopted);

14. evaluate the effectiveness and efficiency of the contractual arrangement and the performance of a contractor before a contract is renewed or rolled over;

15. consider developing strategies for expanding the contracting market where appropriate, in the Ministry's own interest and to support the growth and development of new providers;

16. require approval for all departures from the procurement policy; and

17. make its managers aware that their financial delegations apply only to procurement undertaken in accordance with the Ministry's procurement policy.

Part 1 – Introduction

Events leading to our inquiry

1.1 During 2004, the Hon Murray McCully MP asked the Minister of Health a series of questions in Parliament about the contracting of Allen and Clarke Policy and Regulatory Specialists Limited (Allen & Clarke) by the Ministry of Health (the Ministry). The 2 principals of Allen & Clarke – Matthew Allen and David Clarke – are former employees of the Ministry.

1.2 Mr McCully raised a number of issues with the Auditor-General and with the State Services Commission (SSC) after he received responses to his Parliamentary questions, seeking an examination of:

- the probity of the Ministry's contracting practices with Allen & Clarke;
- the adequacy of the Ministry's contracting practices; and
- the adequacy of the Ministry's processes for responding to Parliamentary questions.

1.3 In March 2005, the SSC agreed to investigate the Ministry's processes for responding to Parliamentary questions. The SSC reported separately on this matter on 22 July 2005.

1.4 On 8 April 2005, the Auditor-General decided to look into issues relating to the Ministry's contracting practices. Audit New Zealand, a business unit of the Office of the Auditor-General, undertook the inquiry work.

Issues examined by our inquiry

1.5 Our inquiry examined:

- the adequacy of the Ministry's policies and procedures for procuring professional services, in particular as they related to:
  - employees undertaking contract work concurrent with their employment;
  - the Ministry contracting with former employees; and
  - the awarding of preferred/sole provider status in contracts;
- the Ministry's policies and procedures for documenting, managing, and monitoring contracts; and

- whether those policies and procedures were followed in respect of the contracts with Allen & Clarke.

How we carried out our inquiry

1.6 We took the following approach in the conduct of our inquiry:

- We reviewed the Ministry's documented procurement policies that were in place during the period that the contracts with Allen & Clarke were entered into.
- We reviewed documentation that had recently been collated by the Ministry on the contracts awarded to Allen & Clarke.
- We identified and reviewed other audit and assurance reports into the Ministry's contracting practices, and discussed them with Ministry staff.
- We reviewed documentation relating to initiatives taken by the Ministry to improve its contracting practices and, in particular, its monitoring standards project.
- We reviewed some personnel information, and researched company records for information about Allen & Clarke.
- We reviewed the Ministry's Code of Conduct, financial delegations policy, and other financial information.
- We interviewed 6 Ministry officials who had been involved in engaging Allen & Clarke as contractors to the Ministry. Some of these staff had known the principals while they were employees of the Ministry.
- We interviewed the principals of Allen & Clarke, and reviewed information Allen & Clarke provided to us after our interview with the principals.
- We provided a draft of this report to both the Ministry and to Allen & Clarke, to give them the opportunity to comment on the accuracy of the findings and balance of the views expressed.

1.7 We were also guided by the principles set out in our June 2001 report *Procurement – A Statement of Good Practice.*

Part 2 – Background

2.1 Our inquiry principally examined relationships between the Ministry of Health and:

- its former employees, Matthew Allen and David Clarke; and
- a company that was established by Mr Allen and Mr Clarke when they were employed by the Ministry, and which the Ministry contracted with a number of times during a 4-year period.

2.2 In this Part, we discuss the size and the scale of the Ministry's expenditure and contracting activity, the employment history of Mr Allen and Mr Clarke, the nature of the company in question, and its contracts with the Ministry.

The Ministry of Health

2.3 The Ministry is "the Government's primary adviser on health policy and issues and its contribution to improving health and independence is largely indirect. This contribution is through the Ministry's advice to, influence on and relationships with the government, District Health Boards, practitioners, iwi and Māori organisations, Pacific communities, providers, non-governmental organisations, other government sectors and the public."[1]

2.4 The Ministry has a Director-General, and is organised into 8 directorates[2] each under a Deputy Director-General, and a separate Risk and Assurance Unit reporting directly to the Director-General. There are also 8 business units, 4 attached to the Public Health Directorate, 3 to the Corporate and Information Directorate, and 1 to the DHB Funding and Performance Directorate.

2.5 The Ministry's annual appropriations for outputs in 2005-06 total $9,199 million.[3] The Ministry manages its output-related expenditure in 3 ways:

- $150.2 million of the 2005-06 expenditure is on departmental outputs provided by the Ministry. These outputs include policy advice, purchasing national health services, monitoring the performance of the funders and providers of health and disability services, developing and administering regulations, ministerial services, and information services (departmental output expenditure). These functions are performed either directly by Ministry staff (under an employment agreement) or by other parties such as consultants. Some of the work by Allen & Clarke was in this category.

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1 The *Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2006*, page 708.

2 These are described in the Ministry's Annual Report 2004/05, pages 9-13.

3 This figure and those immediately below are from the *Estimates of Appropriations for the Government of New Zealand for the year ending 30 June 2006*, pages 704 and 718.

- $1,807 million of the 2005-06 expenditure is for non-departmental outputs provided by third parties. These health outputs, managed at a national level by the Ministry, are delivered on contract by third parties (some of which are Crown entities). The Ministry has included in this category some externally contracted work to support the delivery of outputs by third parties. Some of the work by Allen & Clarke was in this category.

- $7,242 million of the 2005-06 expenditure is for non-departmental health and disability-support outputs provided by DHBs. None of the work by Allen & Clarke was in this category.

2.6 Much of the Ministry's expenditure is on contracts for goods and services. The Ministry therefore has a major procurement function, and the existence of sound and comprehensive policy and procedures for procurement and contract management is essential. Any significant shortcomings would represent a serious risk not only to the Ministry but also to the Government.

2.7 The Ministry has undergone significant organisational change during the last 5 years. In particular, the merger with the Health Funding Authority (the HFA) on 1 January 2001 and the absorption of parts of the Crown Company Monitoring and Advisory Unit had a significant effect on the policy environment and culture existing within the Ministry. The merger with the HFA involved a very significant increase in the Ministry's responsibility for expenditure on health services. The organisational changes also required the merging of administrative systems, and this affected the contract management systems.

2.8 The Ministry told us that the following significant initiatives have affected its ability to move as quickly as it would have liked to improve contracting and procurement practice:

- devolution of some disability services from the Ministry to DHBs;
- other major priorities, such as development of public health policy for tobacco control, meningococcal strategy, SARS response and the national immunisation register; and
- development and implementation of key government strategies, such as the Primary Health Care Strategy.

The Ministry of Health's employment of Matthew Allen and David Clarke

2.9 The principals of Allen & Clarke – Matthew Allen and David Clarke – are both former employees of the Ministry.

2.10 Mr Allen was employed in a permanent position as Team Leader, National Drug Policy, within the Public Health Directorate of the Ministry. On 28 March 2001 he wrote to the Ministry advising his intention to resign to take a fixed-term employment position with Medsafe (a business unit of the Public Health Directorate), and inviting the Ministry to discuss other contract opportunities with him. He vacated his Team

Leader position on 11 May 2001. On 14 May 2001 he moved to the Joint Therapeutic Agency project (the JTA project) with Medsafe. His new employment agreement was for 30 hours a week for a 3-year fixed term.

2.11 On 20 December 2001 Mr Allen advised the Ministry he was resigning from his fixed-term position. In his resignation letter, he expressed a wish to focus on other opportunities including consultancy work. On 17 January 2002 he finished his duties as an employee with the Ministry.

2.12 Mr Clarke was initially employed in a permanent position as a solicitor in Health Legal. He resigned from this position with effect from 27 April 2001. On 30 April 2001 he began work on the JTA project, working with Medsafe. His new employment agreement was for a 3-year fixed term.

2.13 On 21 February 2002 Mr Clarke advised the Ministry he was resigning. This followed a communication with the Ministry on 17 January 2002, in which he had asked that his employment status be reviewed and had suggested that a contract arrangement might have benefits both for him and for the Ministry (including financial savings) in respect of the JTA project. Mr Clarke stressed in the letter the need to record the process by which such an arrangement might be reached. His resignation letter on 21 February 2002 referred to the contracting arrangement that had been agreed for him to provide services to the JTA project. On 15 March 2002 he finished his duties as an employee with the Ministry.

Allen and Clarke Policy and Regulatory Specialists Limited

2.14 The principals incorporated Allen & Clarke on 23 June 2000, while they were permanent employees of the Ministry. Allen & Clarke describes itself as a company specialising in policy and regulatory development in a number of sectors, including government, both in New Zealand and internationally.

2.15 Allen & Clarke did not start business until 2001. The company has grown in size since that time, from 2 principals to about 13 staff today. The company also subcontracts other specialists for projects, and at present has 9 other people working under contract. Allen & Clarke told us at the time we undertook our inquiry that work for the Ministry accounted for about 15% of the company's turnover.

Contracts between the Ministry of Health and Allen & Clarke

2.16 The Ministry's 8 directorates include Public Health, Disability Services, Mental Health, Corporate and Information, and Sector Policy, all of which Allen & Clarke did some work for. The company also had contracts with the Risk and Assurance Unit, and 3 of the business units under the Public Health Directorate – Medsafe, the National Screening Unit, and the National Radiation Laboratory.

2.17 Between 11 June 2001 and 1 February 2005, the Ministry entered into 60 contracts with Allen & Clarke. The total value of the 60 contracts was $1,362,000 (excluding GST). The value of the contracts was distributed as follows:

- Less than $10,000 — 28 contracts
- Exactly $10,000 — 4 contracts
- Greater than $10,000, but less than $50,000 — 23 contracts
- Greater than $50,000 — 5 contracts

2.18 Four of the contracts involved contestable or tendered processes. The other 56 contracts were awarded on a non-contestable basis.

2.19 Appendix 1 has been derived from information provided by the Ministry, and contains a schedule of the contracts entered into between the Ministry and Allen & Clarke during the period 11 June 2001 to 1 February 2005. It also indicates the duration of those contracts and whether the contracts were subject to a contestable procurement process. We have some reservations about the completeness of the information contained in the schedule, and these matters are noted in Appendix 1.

Part 3 – The Ministry of Health's approach to procurement and contract management

3.1 During our inquiry, we identified a number of general issues in relation to the Ministry's procurement and contract management policies and procedures.

3.2 In this Part, we discuss our expectations, findings, and recommendations in relation to these issues. We also consider a Ministry internal audit report that is relevant to our findings.

Approach to procuring goods and services

3.3 Public entities, and in particular government departments, are responsible for considerable amounts of public funds that are used to provide public services. It is important that appropriate policies are in place to govern the use of these resources.

What we expect

3.4 A public entity should have explicit procurement policies and procedures. Publishing and following an unambiguous policy reduces the risk of challenges to the decision-making process. It also helps retain credibility with suppliers. Clear procedures can help ensure that the procurement policy is consistently followed.

3.5 A public entity's policies and procedures should clearly identify the circumstances in which each type of procurement method applies.

The policies that applied

3.6 The Ministry had procurement policies in place throughout the period of contracting with Allen & Clarke. These policies were as follows:

- *Guidelines for Engaging and Managing Consultants* (effective from 1 July 1997) (the 1997 policy).
- *Procurement of Goods and Services* (effective from November 2001).
- *Procurement of Goods and Services* (this replaced the November 2001 policy, and was in effect from April 2002 to the present time).

3.7 The policy *Procurement of Goods and Services* (effective from November 2001) and the policy that replaced it (effective from April 2002) are virtually identical. We refer to these 2 policies together in this report as "the November 2001/April 2002 policy".

3.8 There was also a draft policy dated November 2003, *Procurement of Goods and Services,* which the Ministry does not appear to have used.

3.9 We also found a policy that the HFA had published for its procurement of health and disability funding, effective from 30 March 1999. The policy was entitled *Health Funding Authority Quality System: Contracts Policy Manual with Associated Guidelines for Contestable Processes* (the HFA policy).

3.10 The HFA was disestablished under the New Zealand Public Health and Disability Act 2000, and its functions were merged into the Ministry in 2001. As Allen & Clarke had not undertaken any contracting for the HFA, the HFA policy was not directly relevant to our inquiry. However, the policy appears to have remained available in the Ministry after the merger, and former HFA staff were aware of it. There were, therefore, features of it that may have had some bearing on the approach that was taken by the Ministry to some of its contracting with Allen & Clarke.

3.11 The 1997 policy applied to the engagement and management of consultants, as opposed to the later and broader policy, which applied to the procurement of goods and services. The 1997 policy was applicable to the first 4 contracts awarded to Allen & Clarke – those entered into before November 2001 – none of which was a contested contract. The 1997 policy was replaced by the November 2001/April 2002 policy, which was applicable to the subsequent contracts.

3.12 The November 2001/April 2002 policy applies to departmental output expenditure, and to non-departmental outputs where the expenditure is not for health or disability services. It applies to "all those involved in the procurement of goods and services or contracting for the Ministry of Health where the value of those goods and services exceeds $10,000". It also sets out monitoring requirements for contracts that are of a value between $10,000 and $25,000, and more than $25,000. Less demanding requirements apply to contracts in the $10,000-$25,000 range.

3.13 The November 2001/April 2002 policy is silent on the matter of contracts with a value of less than $10,000. For these lower-value contracts, the procurement approach appears to have been at the discretion of managers who held the requisite delegated financial authority.

What we found

3.14 The November 2001/April 2002 policy states that it applies to all departmental output expenditure, and to non-departmental expenditure except for health- and disability-related expenditure.

3.15 However, there was confusion within the Ministry about what policy applied to some of its procurement of non-departmental services, namely some of the expenditure that the Ministry "inherited" with the merger of the Ministry and the HFA, and which was previously covered by the HFA policy.

3.16 Some Ministry officials we spoke to said that the HFA policy applied to non-departmental expenditure, some that there was no applicable policy for non-departmental expenditure during the period of contracting with Allen & Clarke we examined, and others (including the Director-General) that the November 2001/April 2002 policy applied. In our view, there was an inconsistent understanding of the applicability of the policy.

3.17 There was also a general lack of awareness among officials we spoke to as to what the November 2001/April 2002 policy actually required for procurement. Most of the officials we interviewed did not have a copy of the procurement policy, and were somewhat vague as to where they might locate a copy. We were left with serious doubts as to the adequacy of the dissemination of procurement policy information within the Ministry, despite the Ministry's introduction of a contract management training module for managers.

3.18 In the absence of both a clear understanding about the applicability of the policy and good awareness of requirements of the policy, there is a risk that an inconsistent and inappropriate approach might be taken to procurement (as demonstrated by our findings in Part 4 of this report).

Recommendation 1
We recommend that the Ministry of Health review awareness and understanding of the Ministry's procurement and contract management policy and procedures of all staff involved in procurement and contract management.

Approach to contract management

3.19 We identified a range of issues in relation to the Ministry's management of contracts for services generally, including contracts with Allen & Clarke. Our concerns arose in the following areas:

- the level of staff competence in contract management;
- the approach adopted for monitoring contracts; and
- the processes for managing key contract information.

Staff competence in contract management

3.20 Contract management is a specialised task – it requires a certain skill set and approach that must complement a public entity's contract management policies and procedures.

What we expect

3.21 A public entity should have staff who are trained and experienced in the systems, policies, and procedures that apply to each type and level of procurement it undertakes.

What we found

3.22 The November 2001/April 2002 policy has a provision for Ministry employees involved in procurement processes to have the necessary competencies for the type and level of procurement.

3.23 In recognition of the need for competent staff, the Ministry has implemented a number of initiatives. These include writing a comprehensive profile of competencies required for contract management, and introducing module-based training for staff. The Ministry requires staff involved in contract management to undertake its course "Contract Management 101". These are useful and important initiatives.

3.24 However, as discussed in paragraphs 3.14 to 3.18, we found a general lack of awareness by Ministry officials about the particular requirements of the Ministry's procurement policy. It was also apparent from our interviews with Ministry officials who had undertaken the training that it had not provided them with a good knowledge of the Ministry's own procurement policies and procedures, although material was included in the training. Consequently, the Ministry has the dual dilemma of lack of clarity about the applicability of the policy, and limited knowledge by staff of the policy that does exist.

Recommendation 2
We recommend that the Ministry of Health ensure that the contract management competencies required of staff include a thorough knowledge of the Ministry's procurement policies and procedures.

Contract monitoring

3.25 Contract monitoring by a competent contract manager is essential to ensure that a public entity delivers a contracted service efficiently and effectively, the associated risks are managed, and effective communication is maintained between all parties.

What we expect

3.26 A public entity should monitor a contractor's performance to ensure that it meets all standards in accordance with the contract. The extent of monitoring undertaken, and the amount of resources applied, should depend on the level of risk and the nature of the goods or services. Documenting the contract's progress, performance, and delivery is essential to good contract management. This is necessary to verify the service delivery against the requirements of the contract, and to confirm effectiveness, performance, and value for money.

3.27 A public entity should assess the contractor's performance against criteria that it has:

- included in its policies and procedures;
- developed as part of the specification for the procurement;
- included in the tender documents; and
- if contract negotiations took place, confirmed during the negotiations.

3.28 The monitoring procedures should enable an entity to:

- take prompt action if a contractor's performance falls below the agreed criteria;
- make the contractor aware of problems as they occur – in writing, if necessary;
- clearly identify issues to be addressed by all parties, providing an opportunity for the contractor to improve performance during the period of the contract; and
- collect information to inform any subsequent extension or renewal of the existing contract, or the contractor's suitability for any other engagement.

What we found

3.29 With one exception, the contract files we looked at for the Allen & Clarke contracts did not contain contract monitoring information, such as documentation of the contract progress, performance, or delivery. We were advised that monitoring information is recorded in the Contract Management System (CMS) that is used for many of the contracts for non-departmental outputs. (The CMS is discussed further in paragraphs 3.35, and 3.42–3.47). However, the Allen & Clarke contracts were generally managed outside the CMS.

3.30 We were told that the Ministry implemented an extensive project in 2004 to improve its contract monitoring practices. This project had been completed before our inquiry took place, but its effects were not apparent for the contracts and timeframe that we considered in our inquiry. For example, we were told by some of those interviewed that accountability was not clearly assigned in all contracts, and that it was therefore unclear who was responsible for the management of and reporting on the contract. Furthermore, the contract improvement project largely relates to contracts managed through the CMS. We consider there would be benefits for the Ministry if it were to extend this project to cover all of its contracting activities.

Recommendation 3
We recommend that the Ministry of Health assign responsibility for ensuring that all its contract monitoring processes are observed, and appropriate documentation retained, for each contract.

Recommendation 4
We recommend that the Ministry of Health ensure that its policies on contract monitoring practices are followed in all of its contracting activities.

Managing contract information

3.31 Our concerns about managing contract information focus on:

- the management of documentation relevant to the contracts in question; and
- the use of an appropriate solution to facilitate information management.

What we expect

3.32 Public entities need to maintain complete information about the procurement of services and the management of subsequent contracts for services.

3.33 Good practice would usually involve the assignment of responsibility for each contract to a contract manager, who would ensure that all the contract management processes are observed and the appropriate documentation retained for each contract. We also expect to find files with a record of each contract at a level of detail appropriate for the value of the contract and the level of risk involved in the contract, and to ensure its good management. This information would be readily accessible for contract management purposes.

3.34 The records maintained for the contracts may include information on:

- the procurement process (including the tender process or the justification for using a sole provider approach, tender evaluation, the recommendation of a preferred candidate, and negotiation and award of the contract);
- the cost of the project;
- technical aspects, including standards of reliability, safety, availability of equipment, and other performance criteria; and
- performance against specifications, allocation of resources, and other contractor evaluation reports.

What we found

3.35 As mentioned in paragraph 3.29, the Allen & Clarke contracts were generally managed outside the CMS. Given this situation, we expected that an alternative manual-based system of filing and recording contract information would have been used. Such systems, if well managed, are quite adequate for these purposes.

3.36 The Ministry did not maintain contract-related files for its contracts with Allen & Clarke. For each contract, we were presented with files that had been created recently and specifically for the purposes of our inquiry. Many files were incomplete in terms of what would normally be considered good practice for the documentation of a commercial undertaking. Many files contained minimal information, and the documentation that did exist was often a miscellaneous collection of e-mail messages and contract agreements, some of which were unsigned.

3.37 Even the files for significant contracts were almost completely devoid of business case, tender evaluation (where applicable), rate negotiation, progress and completion reports, and performance- or payment-related documentation – information that is required by the November 2001/April 2002 policy.

3.38 Officials involved in contracting with Allen & Clarke confirmed that it was not their usual practice to maintain individual contract files either in the traditional hard copy form or electronically.

3.39 We understand that some documentation had existed and might have been filed on subject-related files, but this documentation was not readily accessible for each contract in our inquiry. We were told that some information might have been lost with the passage of time. However, because of the practices noted throughout this report, we concluded that much of the expected documentation probably never existed.

3.40 This situation appeared to extend wider than the contracting with Allen & Clarke. The Ministry told us that a lot of contracts are filed by provider or project rather than by contract. Despite this, there does not appear to be a systematic approach to maintaining key documentation for individual contracts for all the Ministry's contracting activities. The absence of a systematic approach, particularly to contracts of substance, does not accord with good contract management practice.

3.41 The Ministry told us that it is part of the business plan of its new Contracting Support Office to work with directorates to put together sensible filing structures.

Recommendation 5
We recommend that the Ministry of Health take a systematic approach to maintaining key documentation for individual contracts, and ensure that this documentation is readily accessible for contract management purposes and complements contract information held electronically.

3.42 The CMS is essentially an electronic system for filing contract agreements, arranging payments, and recording contract monitoring information. The CMS is not being used for all Ministry outputs. The Ministry told us that it does not run contracts funded as departmental outputs through the CMS, as that would result in mixing departmental expenditure with the non-departmental expenditure of the DHBs.

3.43 We did not examine DHB expenditure. But the consequences of the Ministry not having an effective and comprehensive system covering all its contracting are illustrated by the following example.

3.44 When we began our inquiry, we understood from the response given by the Minister of Health in answer to a Parliamentary question that the Ministry had entered into 42 contracts with Allen & Clarke between 2001 and 2004. However, during the course of our inquiry, the Ministry identified a further 18 contracts. The Ministry asked Allen & Clarke to assist in the identification of the contracts. A number of contracts, although quite small in value, were identified only as a result of Allen & Clarke's assistance. The absence of readily available information for the Allen & Clarke contracts impeded the Ministry's efforts to respond to our inquiry, and compromised its ability to demonstrate the adequacy of its contracting practices. An electronic system of recording contract information for all contracts would have greatly assisted the Ministry's response.

3.45 We understand that the CMS allocates a unique contract number for each contract, which then provides the mechanism to link various contract-related documents, such as agreements, invoices, payment records, and reports. However, as noted above, this system is not used for all Ministry contracts, and was not used for the Allen & Clarke contracts. The absence of an effective management system, that allocates contract

numbers or the use of a register for all contracts, is a significant shortcoming in the Ministry's present contract management arrangements.

3.46 We note that the present CMS may have some shortcomings. Ministry officials expressed some concern to us during interviews about perceived difficulties with the present CMS. Our review of documentation relating to the Ministry's contract monitoring project (see paragraph 3.30) showed that some directorates within the Ministry have been reluctant to fully adopt the CMS because of their concerns about the system.

3.47 The Ministry told us that it commissioned work in April 2005 to identify the best options for Ministry-wide electronic contract management. The resulting options were under consideration at the time of writing our report.

Recommendation 6
We recommend that the Ministry of Health urgently review its electronic management of contract information with a view to introducing a system or systems that will ensure that all appropriate information on the Ministry's contracts is readily accessible to support good contract management, and that the information is available for contract management purposes throughout the Ministry.

Internal audit report 2002-03

3.48 During 2002-03, the Ministry's Chief Internal Auditor undertook an audit of the Ministry's contracting performance. The audit focused on the Ministry's contracting for non-departmental outputs, with objectives to review and evaluate the performance of a number of Directorates in concluding agreements and monitoring contractor performance. One hundred contracts were selected for the audit from the Ministry's Directorates.

3.49 Some of the more significant findings from this audit were:

- Directorates were making limited use of the CMS (see paragraph 3.46 above).
- Directorate staff said they were aware that Ministry guidelines for procurement existed, but believed that they did not apply to non-departmental output services.
- Although asked, other Directorate managers did not indicate what, if any, contracting guidelines they used.
- Where policies existed within a Directorate, they were not consistently followed.
- The vast majority of agreements audited were rollover variations to existing agreements or new agreements with preferred providers that were not contested.
- There is no mechanism in place, or used by any Directorate, to challenge or contest the current preferred providers of the majority of non-departmental output services.
- A commercial approach to negotiation for the purchase of non-departmental output services was not widely apparent during the audit.

- Since the majority of agreements audited were rollover variations, the evidence observed of negotiations was merely of an administrative nature.
- A frequent approach cited by managers was for them to advise providers that the Ministry had a specific amount of funding available, and to ask providers to tell the Ministry what they would deliver for that funding.
- 33% of agreements were adequately monitored.

3.50 We obtained this internal audit report at a late stage in our inquiry, at a time when our initial findings had been identified. The findings of the 2002-03 internal audit and our own findings are very similar.

3.51 The Ministry told us that it treated the internal audit report's concerns seriously, and that the report led to a wide-ranging review of contract management, together with a focus on continuous improvement. We accept that the Ministry implemented a number of important initiatives to address the 2002-03 audit findings, but the expected improvement has not yet been achieved.

3.52 We understand that the Ministry has now established contract management infrastructure and accountabilities which include the Contracting Advisory Group and the Contracting Support Office. The Ministry has an opportunity to make the Contracting Support Office a "centre of excellence" to lead the much-needed improvement in the Ministry's contracting practices.

Recommendation 7
We recommend that the Ministry of Health keep under review the procurement and contract management framework, and accountabilities within the Ministry, and ensure that its Contracting Support Office and Contracting Advisory Group can lead Ministry-wide improvements and maintain appropriate oversight of those policies and procedures throughout the Ministry.

Part 4 – The Ministry of Health's dealings with Allen & Clarke

4.1 In this Part, we discuss our expectations, findings, and recommendations in relation to the Ministry's dealings with Allen & Clarke. In particular, we address these key concerns:

- the Ministry's contracting with Allen & Clarke:
  - while the principals were employed by the Ministry; and
  - immediately after the principals had left the Ministry's employment;
- the use of a sole provider procurement approach when contracting with Allen & Clarke;
- how value-for-money considerations were managed in relation to the Allen & Clarke contracts; and
- whether the Ministry complied with its internal financial delegation policies when it contracted with Allen & Clarke.

Concurrent employment and contract work

4.2 Concurrent employment and contracting arrangements can potentially give rise to performance issues, conflicts of interest, and probity concerns. These issues can be significant and any arrangements for concurrent employment and contracting require both careful consideration before they are agreed and careful management for the full period that they exist.

What we expect

4.3 We have separate expectations of both employees and employers who consider concurrent employment and contracting arrangements.

4.4 We expect an employee who is considering entering a concurrent employment and contracting arrangement to inform their employer of their intentions, and advise their employer of any potential conflicts of interest that may arise. This expectation is closely aligned to the Public Service Code of Conduct expectation that employees "should inform their chief executive where any actual or potential conflict of interest arises that impairs the full, effective, and impartial discharge of their official duties".

4.5 We expect employers to ensure that:

- appropriate policies – such as a code of conduct, procurement policies and/or conflict of interest policies – are in place for approving and monitoring any concurrent employment and contracting arrangement;
- the procedures required by the policy are properly implemented, to ensure compliance;
- they have considered any potential conflicts of interest associated with an employee's proposed concurrent employment and contracting arrangements; and
- they have considered any potential effect on the performance of the employee that might arise from concurrent employment and contracting arrangements.

What we found

4.6 Neither of the relevant policies (the 1997 policy and the November 2001/April 2002 policy) had provisions relating to concurrent employment. The Ministry did not have a conflict of interest policy in place at the time it contracted with Allen & Clarke. The Ministry subsequently issued a limited conflict of interest policy on 26 July 2004, in which it signalled that a full conflict of interest policy was being drafted.[4]

4.7 However, the Ministry has a Code of Conduct that applied throughout the time of its contracting with Allen & Clarke. It includes a general and typical provision requiring formal approval for secondary employment. This provision is usually applied to secondary employment with another organisation.

4.8 In considering the concurrent working relationship that existed, it is important to recognise the following sequence of events:

- On 28 March 2001, when Mr Allen resigned from permanent employment with the Ministry, he advised the Ministry of his desire to discuss other contracting opportunities.
- On 14 May 2001 Mr Allen began work on the JTA project with Medsafe, a business unit of the Ministry. He was employed for 30 hours a week for a 3-year fixed term.
- The company Allen & Clarke started contracting with the Ministry in June 2001. Between June 2001 and 16 January 2002, a total of 8 contracts were awarded to Allen & Clarke. We understand that Mr Allen undertook the work for these contracts. As noted above, Mr Allen was working 30 hours a week at that time on the JTA project. He told us that he used his remaining work capacity for the contract work. The 8 contracts did not involve work on the JTA project.
- On 16 January 2002 the first JTA contract was executed between the Ministry and Allen & Clarke. On 17 January 2002 Mr Allen ceased employment with the Ministry. Mr Clarke resigned from the Ministry a month later.

[4] This policy has since been completed, and was agreed by the Ministry's Executive Team on 17 November 2005.

4.9 Some Ministry officials could not recall approval having been given for Mr Allen to undertake contract work for the Ministry. However, other officials told us that the Ministry was aware of the concurrent employment and contract work by Mr Allen at the time it occurred. As we note in paragraph 4.8, Mr Allen had advised the Ministry on 28 March 2001 that he would be willing to discuss such contracting opportunities with the Ministry. From our discussions with Ministry staff, the Ministry was aware of these intentions.

4.10 When the Ministry responded to Mr Allen's advice that he wished to undertake secondary employment, it told him that he needed his manager's permission and that any secondary employment must not conflict with the Ministry's interests. Mr Allen acknowledged that direction in writing. We did not find any evidence that the approval required for secondary employment under the Code of Conduct had been obtained. Nor did we find evidence of any subsequent reviews and approvals in relation to conflicts of interest arising from secondary employment.

4.11 The Ministry did not fully apply its Code of Conduct in this instance. The Ministry should have more fully considered the risk of any actual or perceived conflict of interest or impropriety in establishing concurrent contracting and employment arrangements with Mr Allen and Mr Clarke.

4.12 We are satisfied that, though Mr Allen was contracting with the Ministry while working for the Ministry as an employee, the nature of the outputs provided in each case was different. In other words, Mr Allen was not contracted to provide the same outputs that he was concurrently employed by the Ministry to provide.

4.13 We received unconfirmed assertions that there were other instances of concurrent employment and contract work with other persons working for the Ministry. The Ministry later told us that it had reviewed the current situation and found no existing instances of concurrent employment and contract work.

4.14 We note that the Ministry has reviewed the application of its Code of Conduct provision regarding secondary employment. It has developed a conflict of interest policy to ensure that the risks associated with concurrent employee/contractor relationships with the Ministry are considered. The policy requires approval by the Director-General for such arrangements on a case-by-case basis.

Recommendation 8
We recommend that the Ministry of Health apply its Code of Conduct and new Conflicts of Interests Policy to ensure that the risks associated with concurrent employee/contractor relationships with the Ministry are well-managed.

Awarding contracts to former employees

4.15 The primary concern underlying the original questions from Mr McCully was whether Allen & Clarke had been given favourable treatment in obtaining contracts because of the principals' status as former employees.

What we expect

4.16 Public entities often find that former employees have knowledge and experience that the entity may need to use. However, engaging former employees as contractors raises risks of actual or perceived impropriety in procurement situations. Policy and procedures need to recognise these risks and provide guidance on managing these situations appropriately.

4.17 In order to minimise the risk of actual or perceived impropriety in such procurement situations, we expect public entities to be able to demonstrate that:

- the employee had departed under normal circumstances (as opposed to departing from an organisation for performance, disciplinary, or similar reasons, and being re-engaged as part of a negotiated exit package); and
- the benefits to the employer of re-engaging the former employee as a contractor can be objectively justified.

What we found

4.18 We did not find any evidence to suggest that inappropriate relationships existed between the principals of Allen & Clarke and staff of the Ministry that might have affected the Ministry's awarding of contracts to Allen & Clarke.

4.19 Contracts were generally awarded to Allen & Clarke because of the principals' and their company's experience in the specific areas of policy and regulatory advice, their reputation for good performance, and their availability. Ministry officials spoke highly of the performance and quality of the services provided by Allen & Clarke.

4.20 However, we did identify the following areas of concern:

- Neither the 1997 policy nor the November 2001/April 2002 policy deals with the engagement of contractors who are former employees of the Ministry.
- In our discussions with Ministry staff, we were given oral explanations as to why Allen & Clarke was engaged after the principals' resignations. However, we found no documentation to demonstrate that the Ministry had specifically considered any perceived or actual risks inherent in that approach. Given that the principals were – among other things – to work on contracts associated with the JTA project – a project they had previously been employed to work on in the Ministry, the risk of a perception of impropriety arising in the award of the JTA contracts would have been high.
- Conflict of interest disclosures do not appear to have been required of, or made by, either of the principals.

4.21 We consider none of these to be good practice. However, we note that the Ministry has since reviewed its policy.[5] The "refreshed" policy specifically requires staff to comply with its new Conflicts of Interests Policy.

[5] The new policy was approved on 17 November 2005.

Recommendation 9
We recommend that the Ministry of Health provide appropriate guidance to staff involved in the procurement of goods and services on the policies and procedures that apply to engaging contractors who are former employees of the Ministry.

Use of sole provider approach

4.22 A public entity has considerable discretion as to how it procures goods or services. However, when conducting procurement processes, the public entity must treat all parties involved in those processes fairly, and manage its resources effectively and efficiently.

What we expect

4.23 Non-contested procurement from a selected supplier ("sole provider procurement") should be justified only in certain circumstances, for example where:

- tendering is not practicable – for example, in an emergency;
- the required goods or services are available from only one source, or only one supplier has the capacity to deliver at the time required, and this can be adequately attested;
- standardisation or compatibility with existing equipment or services is essential, and can be achieved only through one supplier;
- there is a legal requirement or directive to use one supplier;[6] or
- the cost associated with any other form of procurement would be out of proportion to the value of the procurement or the benefits likely to be gained.

4.24 The low value of individual contracts does not of itself remove the need to consider contestability. Value for money could still be achieved with low-cost approaches such as seeking quotations. Where sole provider procurement is repeatedly used with one provider, we would expect consideration to be given to the cumulative value of the contracts when considering the cost of alternative forms of procurement.

What we found

4.25 The Ministry's 1997 and November 2001/April 2002 policies both emphasised the need for a competitive approach to procurement, and set out the method options and the financial thresholds that applied to the options. The November 2001/April 2002 policy included a specific provision requiring a written request for exemption where it was proposed not to follow the policy. Non-contestable and sole provider procurement would have required such an exemption.

6 For example, legal services from the Crown Law Office.

4.26 However, the Ministry adopted a sole provider procurement approach for 56 of the 60 contracts awarded to Allen and Clarke between June 2001 and February 2005. Twenty-eight of these contracts had a value of more than $10,000 and were therefore subject to the full provisions of the Ministry's procurement policy. Four of the 28 contracts were contested in accordance with policy. The other 24 contracts were not contested and, for most of them, an exemption from policy was not obtained.

4.27 Thirty-two contracts had a value of $10,000 or less. None of these contracts appears to have been contested.

4.28 As noted in paragraph 3.13, the Ministry's policy is silent on the approach to be taken with low value procurement. We do not consider the low value of these contracts precludes the necessity for a contestable approach, and would have expected to see some consideration given in this case, and in the Ministry's policy generally, to the cumulative value of contracts, and to low-cost ways to achieve contestability.

4.29 One contract that was not contested was of an urgent nature as a consequence of a Ministerial request. The use of a non-contestable approach was appropriate in this circumstance, and allowed for under the November 2001/April 2002 policy.

4.30 If anything, the approach the Ministry took to contracting with Allen & Clarke was more consistent with the old HFA policy. This policy had no formal application to the contracts with Allen & Clarke. Nevertheless, the sole provider procurement approach referred to in that policy appears to have guided Ministry staff in the contracting with Allen & Clarke between 2001 and 2005. This may be a reflection of the level of staff familiarity with the HFA policy – some had been employed by the HFA before it merged with the Ministry.

Recommendation 10
We recommend that the Ministry of Health consider its procurement policy for low value contracts, to ensure that consideration is given, among other things, to the cumulative value and number of contracts with a sole supplier when deciding on an appropriate procurement approach.

Adopting the sole provider procurement approach

4.31 In most instances, we were unable to establish the Ministry's reasons for adopting a sole provider procurement approach. We were told that the expertise, performance, and availability of Allen & Clarke, and the unavailability of other specialists in the market, were the main reasons for engaging Allen & Clarke. However, it was unclear how the Ministry had reached this conclusion.

4.32 During an interview with the principals of Allen & Clarke, we were told that, for some of the sole provider work that Allen & Clarke had undertaken for the Ministry, there had been other specialists in the market capable of undertaking the work. For example, for one of the 4 contracts that were competitively tendered, both Allen & Clarke's tender and that of another potential contractor were highly regarded in the evaluation. From the evaluation report for this contract, it was evident to us that Allen

& Clarke was awarded this contract, appropriately, on merit. However, the tender did confirm that there were other competent potential contractors for some of the work.

4.33 We were particularly concerned about a series of contracts entered into by the Ministry for the JTA project. The first of these contracts was awarded in January 2002 on a non-contestable basis. Payments were made on an hourly rate basis, and the value of the contract was $109,511. Three further contracts were awarded in 2003 and 2004 on a non-contestable basis, with a combined value in excess of $430,000. The provisions of the November 2001/April 2002 policy should have applied to these contracts.

4.34 It was explained to us during an interview with a Ministry official that, because of the experience of Mr Allen and Mr Clarke with the JTA project, the Ministry wished to ensure continuity of their involvement. To achieve this, the Ministry agreed to enter into a contract with Allen & Clarke. The Ministry official advised us that the resignations of Mr Allen and Mr Clarke had come as a surprise to the Ministry, and the Ministry felt it had no choice but to re-engage them on a contract basis.

4.35 However (as noted previously in this report), we found evidence that Mr Allen and Mr Clarke had been looking for opportunities to build a consultancy business and that this was known to the Ministry. The Ministry should, therefore, have been well aware of the risk of their resignations and the likely effect of that on the JTA project. The necessity to enter into a non-contested contract in January 2002 suggests a lack of succession planning and risk management by the Ministry.

4.36 This situation became even more acute with the further JTA contracts that were entered into as an extension of this project during the next 2 years. Again, there was no contestability for these contracts, despite advice from the Ministry's internal auditor during this period that contestability should be considered.

4.37 The Ministry accepted these shortcomings in its practice, but reiterated that its current guidelines on contracting require business cases for all procurement of more than $10,000, and that records be kept. Its "refreshed" policies, procedures and guidance material will continue to make those points, and to emphasise that business cases need to be reviewed at the time of any extension.

Recommendation 11
We recommend that the Ministry of Health ensure that, when a decision is made to engage a sole provider, the business case to support this method of procurement is fully documented and records of the procurement decision-making process are maintained, and that this decision is reconsidered if it is proposed to roll over the contract with a sole provider.

Continuing the sole provider procurement approach

4.38 It was also unclear how the Ministry satisfied itself about the performance of Allen & Clarke to justify continuing the sole provider procurement approach. The November 2001/April 2002 policy specifically refers to the need to provide a contractor with feedback on its performance under the contract. Good practice would usually require a

formal, written end-of-contract performance assessment, with feedback to the contractor.

4.39 Ministry officials told us that the documenting of contractor performance has not been their usual practice. Instead, informal e-mail and verbal advice has been provided to contractors. Allen & Clarke confirmed that it had often received such informal e-mail and verbal feedback on its assignments. Ministry officials spoke highly of the performance and quality of the services provided by Allen & Clarke. We viewed e-mail messages from Ministry officials to Allen & Clarke that described its services on a number of contracts as excellent.

4.40 However, Allen & Clarke advised us that, on a number of occasions, they had specifically asked the Ministry to formally record the company's performance. It appears that the Ministry did not do so. As a consequence, the Ministry does not have a documented formal record of performance, available to all the Ministry's contracting staff, to use as a basis for repeatedly contracting with Allen & Clarke as a preferred sole provider.

4.41 The Ministry accepted these shortcomings, and told us that the requirement for post-contract performance assessment was specifically included in its "refreshed" policies.

Recommendation 12
We recommend that the Ministry of Health carry out a formal, written end-of-contract performance assessment for all contracts for services the Ministry has entered into, and provide that feedback to the contractor.

Getting value for money in the contracts

4.42 The use of a sole provider procurement approach raises questions about whether the Ministry has demonstrated it got "value for money" by contracting with Allen & Clarke. This proposition applies to any contracts with an external provider.

What we expect

4.43 We expect all public entities to adopt and be able to demonstrate a value-for-money approach when procuring goods or services. By "value for money", we mean the best possible outcome for the total cost of ownership. Value for money does not necessarily mean selecting the lowest price. Rather, public entities should achieve the right quality, quantity, and price, at the right place and time.

4.44 We would expect value-for-money considerations to be a key part of negotiations between a public entity and a prospective contractor before a contract is entered into or renewed.

What we found

4.45 The 1997 and November 2001/April 2002 policies promoted contestability as the best means of achieving value for money in the Ministry's procurement processes. However, as we discuss in paragraphs 4.26 and 4.27, a sole provider approach was adopted for the majority of the contracts with Allen & Clarke. Many of these contracts also required the contractor to be reimbursed on the basis of time on the project, at agreed hourly rates. A budget limit was often also written into the contracts.

4.46 The 1997 and November 2001/April 2002 policies required the Ministry, when it enters into a contract, to actively negotiate the hourly rates or cost to ensure value for money. We found little evidence that the staff directly involved in the procurement were aware of, or sought information on, typical hourly rates applying in the policy and regulatory advisory market. One Ministry official told us that information of this nature was available to his Directorate's Funding Board. However, other Ministry officials told us that they had no knowledge of any information of this nature. On reviewing the contract files and interviewing Ministry officials, we found limited evidence that negotiation of hourly rates or costs had taken place.

4.47 Allen & Clarke provided information demonstrating that it had often provided quite detailed proposals for the work it had been engaged in, and that there had been negotiation of rates on occasions.

4.48 However, the evidence provided by the Ministry was insufficient to satisfy us that it had a well-established practice of negotiating rates where sole provider procurement was proposed. We concluded that, at best, there was an inconsistent approach to hourly rate negotiation for all the contracts with Allen & Clarke. Further, hourly rates need to be considered in the context of time taken, and there was insufficient information in this respect for a view to be formed on value for money.

4.49 During our inquiry we found that the hourly rates proposed by Allen & Clarke and agreed to by the Ministry for the period in question were similar to the rates for contracts for services provided by other consultants to the Ministry at that time. However, there was no documentation to demonstrate that the Ministry had considered the value for money aspect of the Allen & Clarke contracts. We therefore find it difficult to accept that the principle of value for money had been properly demonstrated in the practices adopted by the Ministry.

Recommendation 13
We recommend that the Ministry of Health actively negotiate hourly rates or costs when entering into a contract, as is required under its current procurement policies, and maintain a record of the negotiation process (which is particularly important when a sole provider procurement approach is adopted).

4.50 Six contracts had been rolled over into new contracts, or existing contracts had been extended, apparently without any re-examination of value for money or having a contestable tender process. Staff offered a number of explanations for this, including the impracticality of engaging a new contractor part-way through a project, budget

limits having been reached necessitating a new contract, and unanticipated changes in the scope of the work.

4.51 While the rollover of contracts may have been necessary in some instances, we noted that the Ministry's 2002-03 internal audit report (see paragraph 3.49) commented unfavourably on this practice elsewhere in the Ministry's contracting.

4.52 In our view, the Ministry should have in place a procedure for ensuring that the effectiveness and efficiency of the contractual arrangement and the performance of a contractor have been evaluated before a contract is renewed or rolled over.

4.53 The situation with all 4 contracts for the JTA project discussed in paragraphs 4.33-4.36, and the 6 other contracts with Allen & Clarke discussed in paragraph 4.50 that were rolled over or extended, raise several concerns about:

- the Ministry's compliance with its own policy;
- its risk management practices;
- the possibility of a lack of planning by the Ministry in its procurement arrangements;
- the Ministry's inability to properly forecast the scope of work;
- how the Ministry ensures value for money; and
- whether there was any intention to circumvent budget or financial delegation limits.

4.54 The Ministry accepted these shortcomings, and told us that the requirement for evaluation of a contractor's performance before a contract is renewed or rolled over was specifically included in its "refreshed" policies.

Recommendation 14
We recommend that the Ministry of Health evaluate the effectiveness and efficiency of the contractual arrangement and the performance of a contractor before a contract is renewed or rolled over.

4.55 We noted that the internal audit report of 2002-03 referred to the opportunity that contestability provided to "grow the market". We also noted that the redundant March 1999 HFA policy specifically referred to competition as "an essential element in the efficient working of markets for goods and services".

4.56 Even if there did not appear to be other specialists in the market capable of undertaking some of the services provided by Allen & Clarke, it would be in the Ministry's interests to expand the market of potential providers. This would have the benefit of helping to ensure value for money and "levelling the playing field" for other potential participants.

4.57 There are a number of recognised strategies for doing this, such as providing an opportunity for new or emergent providers to tender for small contracts. However, we did not identify any practice or operating culture in the Ministry relating to this.

Recommendation 15
We recommend that the Ministry of Health consider developing strategies for expanding the contracting market where appropriate, in the Ministry's own interest and to support the growth and development of new providers.

Compliance with delegations

4.58 For government departments, there are limits on the authority of chief executives to commit to particular types of expenditure. These delegations raise specific issues for public entities.

What we expect

4.59 We expect public entities to comply with any applicable financial delegations when they procure goods or services. A public entity must also comply with legislation that:

- limits its procurement authority; or
- governs its internal delegation practices.

What we found

4.60 The financial delegations applying to Ministry staff are set out in a Delegations Policy document dated October 2002. This document sets a $250,000 limit to the amounts that may be approved by Deputy Directors-General for departmental output expenditure contracts and non-departmental output expenditure contracts except those for the provision of health and disability services.

4.61 All of the contracts awarded to Allen & Clarke were within this delegation limit. We were satisfied that the Ministry's financial delegations policy had been complied with in the awarding of contracts to Allen & Clarke.

4.62 However, one significant issue did arise in relation to delegations. The November 2001/April 2002 policy stated that, whenever it was proposed not to follow the policy for procurement, a written request for exemption must be made to the Group Manager, Corporate and Sector Finance. We did not find any evidence of this having occurred for most sole provider contracts awarded to Allen & Clarke.

4.63 Often, we found evidence of contract approval by a manager, but no evidence of a specific exemption from the policy. There was a practice of approving the procurement, provided it was within a manager's financial delegation, regardless of the fact that it was non-compliant with the policy.

4.64 The Ministry told us that its current policies and guidance contain the expectation that all staff with delegations be aware of all current Ministry and government policies when making any financial decisions. It intends to strengthen this statement to refer explicitly to the "refreshed" procurement and contracting policy.

4.65 The Ministry will need to reinforce to staff that delegations apply only to procurement that is within policy, and that where the procurement is outside policy, some other process will need to apply to both the procurement action and the application of delegations.

Recommendation 16
We recommend that the Ministry of Health require approval for all departures from the procurement policy.

Recommendation 17
We recommend that the Ministry of Health make its managers aware that their financial delegations apply only to procurement undertaken in accordance with the Ministry's procurement policy.

Appendix 1 – Schedule of contracts

The schedule of contracts table provides data on the contracts between the Ministry of Health and Allen & Clarke. We note the following matters with regard to this schedule:

- The contract data has been sourced from the Ministry of Health. The Ministry's information was incomplete or could not be reconciled in all instances.
- The value of contracts 22, 40, 41, and 42 was not confirmed.
- Contracts 30, 44, 45, 46, 58, and 60 were undertaken concurrently with Mr Allen's employment by Medsafe.
- A contestable process was used for 4 contracts of the 60 awarded to Allen & Clarke (contracts 5, 15, 29, and 42).
- The contract values shown total $1,350,137. This total does not correspond with the total value of all contracts advised by the Ministry. However, the discrepancy in the Ministry's contract records and financial system information could not be reconciled easily and the effort to reconcile it could not be justified for this inquiry.

Schedule of contracts table

Start date	End date	Directorate	Ministry of Health reference	Value $	Contestable process
11 Jun 2001	30 Aug 2001	Public Health	60	4,882	No
11 Jun 2001	19 Oct 2001	Public Health	44	5,000	No
15 Aug 2001	30 Sep 2001	Public Health	30	4,375	No
29 Oct 2001	15 Nov 2001	Public Health	45	700	No
3 Dec 2001	30 Jun 2002	Public Health	47	10,000	No
10 Dec 2001	15 Dec 2001	Public Health	46	700	No
Dec 2001	Jan 2002	Disability Services	58	3,866	No
16 Jan 2002	16 Jan 2003	Public Health	23	36,000	No
Jan 2002	31 Dec 2002	Medsafe	1	109,511	No
1 Feb 2002?	21 Mar 2002	Public Health	43	8,890	No
Mar 2002	May 2002	Mental Health	57	4,554	No
Apr 2002		Internal Audit	48	7,650	No
Jun 2002		Sector Regulation	49	3,500	No
17 Jun 2002	31 Oct 2003	Public Health	27	15,000	No
20 Jun 2002	30 Jun 2002	Public Health - National Immunisation Register	50	11,475	No
22 Jun 2002	31 Dec 2002	Mental Health	33	22,222	No
27 Jun 2002	29 Nov 2002	Public Health	32	35,000	No
25 Jul 2002	14 Aug 2002	Public Health - National Immunisation Register	22	11,475	No
Oct 2002?		Health Legal	51	1,200	No
8 Nov 2002	30 Jun 2003	Public Health	5	114,649	Yes
Dec 2002	Jun 2004	Medsafe	2	211,405	No
17 Jan 2003	30 Jun 2004	Public Health	24	23,000	No
?	Jun 2003	Disability Services	36	4,375	No
1 Mar 2003	30 Jun 2003	Public Health - National Screening Unit	21	17,500	No

Schedule of contracts table (continued)

Start date	End date	Directorate	Ministry of Health reference	Value $	Contestable process
1 Apr 2003	30 Jun 2003	Public Health	25	10,000	No
1 Apr 2003	30 Jun 2004	Public Health - National Radiation Laboratory	18	30,754	No
Apr 2003	Jul 2003	Mental Health	59	600	No
1 Jun 2003	31 Aug 2003	Public Health	6	10,000	No
Jun 2003	14 Aug 2003	Risk and Assurance	39	16,350	No
13 Jun 2003	30 Nov 2003	Mental Health	34	12,500	No
16 Jun 2003	31 Aug 2003	Sector Policy - National Health Committee	42	10,666	Yes
24 Jun 2003	30 Jun 2003	Public Health	9	4,889	No
Jun 2003?	12 Dec 2003	Public Health	10	8,040	No
1 Jul 2003	30 Jun 2003	Public Health	26	10,000	No
1 Sep 2003	31 Oct 2003	Public Health	15	4,444	Yes
16 Sep 2003	31 Oct 2003	Public Health	12	2,133	No
1 Oct 2003	28 Feb 2004	Public Health	28	55,000	No
7 Oct 2003	30 Nov 2003	Public Health	11	3,000	No
14 Oct 2003	30 Oct 2003	Public Health	31	4,375	No
1 Dec 2003	13 Dec 2003	Disability Services	35	8,750	No
Dec 2003	31 Jan 2004	Public Health	8	2,222	No
15 Dec 2003	7 May 2004	Public Health	17	48,000	No
5 Jan 2004	30 Jun 2004	Risk and Assurance	40	14,050	No
5 Jan 2004	30 Jun 2004	Risk and Assurance	52	4,050	No
16 Jan 2004	31 Dec 2004	Medsafe	3	213,693	No
27 Jan 2004	31 Aug 2004	Disability Services	37	48,125	No
29 Mar 2004	7 May 2004	Medsafe	4	5,558	No
29 Mar 2004	30 Nov 2004	Public Health	29	40,500	Yes
20 Apr 2004	30 Jun 2004	Public Health - National Radiation Laboratory	20	14,832	No
21 Apr 2004	30 Sep 2004	Public Health	Part of 15	14,832	No
8 Jun 2004	30 Jun 2004	Sector Policy - Workforce	41	12,000	No
14 Jun 2004	30 Jun 2004	Public Health - National Radiation Laboratory	19	2,310	No
21 Jun 2004	30 Sep 2004	Public Health	7	20,000	No
Jul 2004	?	Medsafe	54	8,147	No
1 Aug 2004	31 Dec 2004	Medsafe	53	19,125	No
6 Aug 2004	20 Aug 2004	Public Health	16	5,000	No
1 Sep 2004	31 Dec 2004	Public Health	13	8,250	No
1 Sep 2004	31 Dec 2004	Disability Services	38	8,750	No
10 Sep 2004	30 Sep 2004	Public Health	55	13,263	No
1 Feb 2005	30 Jun 2005	Public Health	14	13,500	No
	30 Jun 2005	Public Health	Part of 29	28,500	No
		Public Health - National Radiation Laboratory	56	2,000	No

Appendix 2 – Extracts from Ministry of Health procurement policies

July 1997 Guidelines for Engaging and Managing Consultants

This policy document referred to:

- "A need for greater openness in the tendering process for engaging consultants."
- "A need for written contracts."
- "Contracts need to be negotiated and concluded prior to the service provider commencing work."
- "A system of effective consultant management is required."
- "As a general rule there must be some competition in the tender process."
- "There are two basic types of selection process approved by the Ministry ... these are the competitive supplier method and the open public tender method."
- "Where the cost is estimated to be less than $25,000 it may be appropriate to grant the assignment to a known supplier from a list of competitive suppliers."
- "Once a consultant is engaged a procedure must be established for the review of the work produced."
- "A Ministry Project Manager is to be appointed for each consultant at the very start of the project."
- "At the completion of the project, a review or evaluation of the assignment must be completed."

November 2001/April 2002 Procurement of Goods and Services

The November 2001/April 2002 policy document, which is still in effect, had similar provisions to the 1997 document and, among other things, referred to:

- "The policies and instructions in this document must be followed without exception ... where the value of the goods and services exceeds $10,000."
- "Where it is considered that the procurement and contracting process should not be followed, a written request for an exemption must be made."
- "Achieving value for money depends upon competition between suppliers of goods and services."

- "A business case must be prepared where the value of goods and services are in excess of $10,000."
- "Keep sufficient records to show that due process has been followed ... and the process has been fair and equitable."
- "As a general rule there must be competition in the tender process."
- "In the case of contracts for relatively small amounts of money (less than $25,000) the minimum reporting requirements should relate to performance against an agreed set of milestones. These milestones should be specified in a letter of agreement or in the contract."
- "Contracts in excess of $25,000 will require reporting against the factors specified above at agreed intervals."
- "There are four types of selection process approved by the Ministry of Health. These are emergency procurement, quote, closed tender, open tender."

March 1999 HFA Quality Services: Contracts Manual and Associated Guidelines

Key provisions are:

- "HFA has a considerable discretion in deciding what services to purchase, how to purchase, and who to purchase services from."
- "While fully competitive purchasing processes are not always appropriate or possible, some element of competition (whether existing or potential) can often enhance..."
- "The HFA must ensure that its processes for determining how to purchase and who to purchase services from are robust, fair, reasonable and defendable."
- "...decisions about the purchasing process and/or selecting a preferred provider must not purposefully discriminate against new entrants to the market."
- "Competitive purchasing processes can be costly."
- "In certain circumstances the HFA may wish to purchase services without conducting a contestable process. For example, the HFA may wish to award 'preferred provider' status to a particular provider in a certain area, for certain services and for a set period – without giving other providers the opportunity to compete for this opportunity. The HFA may contemplate doing this because, for example, it believes there is only one provider capable of providing the relevant services..."
- "...if competition exists in a market for services (or is likely to exist), it is usually prudent to purchase that service under a contestable process."
- "A further risk is that a complaint by a disaffected provider who misses out on the opportunity to provide services could prompt an investigation by the Office of Auditor-General."
- "One of the best ways to manage and mitigate the above risks is to consult potentially interested parties prior to making a decision to adopt a non-contestable process."