Auditing to build public confidence

AUDITOR-GENERAL
SOUTH AFRICA

BRIEFING TO THE PORTFOLIO COMMITEE ON CORRECTIONAL SERVICES

ON

OUTSOURCING SERVICES

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REPUTATION PROMISE / MISSION

The Auditor-General has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

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1. Introduction

The purpose of the briefing note is to provide an insight by the Auditor-General into the general issues relating to Outsourcing and Public Private Partnerships (PPP's) and lessons that could be learnt for and applied at the Department of Correctional Services (the department).

2. Background

2.1 Outsourcing Defined

Privatisation involves the provision of publicly funded services by non-governmental entities. .

Privatisation can take several forms, including:

- The cessation of services by government;
- The outsourcing of services by government;
- The divestiture of government assets; and
- The use of public-private partnerships

Outsourcing refers to the practice of contracting out the departmental services to an outside service provider.

Outsourcing has become a common approach to provide public services as the countries are facing budget crises and within the limited resources they have to take up the same level of services

The trend toward foreign "outsourcing" of service jobs is an extension of a longstanding practice of cutting costs by subcontracting parts of business operations to non-union shops in the United States. The practice has gone global because of technological changes.

2.2 History of Outsourcing

After the Second World War the thrust of public policy has been toward structuring national and local government institutions to provide a variety of services available to all. In delivering such services, public organisations assumed traditional, hierarchical structures.

Liberal governments of the last two decades (led by Britain) have been pressing for fundamental structural change. Since the mid-1980's, the vertically integrated philosophy and service of public administration have been replaced increasingly by the notion of public sector that should provide 'value for money" and thus governments have been under pressure to act more like a market-driven enterprise**.**

In response, politicians, party advisors and senior civil servants started looking for new ideas and solutions to the complex problems of cost management, organisational reconfiguration and service provision. As the key motivation for change in the public services has been the need to control costs while at the same time improving performance, private sector management techniques became ever more attractive.

Despite certain misgivings successive Western governments led by the UK and the USA have pursued this new management agenda with zeal. Other more conservative governments including, Japan, Sweden, Denmark, France and Spain, have followed suite. China also began with economic reforms in the late 1980's. The rest of the world has since joined with their own economic reforms to reduce costs and improve service delivery. These reforms have led to greater specialisation through the **outsourcing of particular non-core activities and the monitoring of service providers.** Another development among government agencies has been the "best value" or "value for money" approach to outsourcing. All these changes sweeping across the public services of both the developed and the developing world have reflected a privatization agenda

2.3 Services outsourced

The typical services outsourced are:

- IT
- Basic services
- Financial services, e.g. internal audit
- Telecommunications;
- Facilities management, e.g. canteens and information systems

2.4 Reasons for outsourcing

There are four main reasons for outsourcing that have been identified in public service organisations, viz.:

- To achieve best practice;
- To improve the cost discipline skills of managers;
- To improve the quality of the service; and
- To help senior managers focus more clearly on the core competencies of the organisations

2.5 Disadvantages of outsourcing

Some of the **negative impacts** of outsourcing, according to some public service managers, include**:**

- Loss of knowledge and skills for the Department in providing the particular services;
- Loss of technology and R&D capability;
- Less operational flexibility
- Lower operational effectiveness

- Poor use of in-house staff
- More demotivated staff;
- Greater number of staff reductions; and
- Lost opportunities – for recognizing and dealing with organisational needs and community needs

3. Outsourced services by the DCS

The following services have been outsourced by the DCS:

- Rendering of catering services at various regions **[R839.3 million]**
- Internal audit – co-sourced partner **[R20 million]**
- Training managers on Management Development Program (MDP) **[R4.95 million]**
- Leadership Development Program **[R4.6 million]**
- Survey on the organisational culture at DCS **[R2.4million]**
- Feasibility study for outsourcing **[R1.15 million]**
- Cleaning Services at Head Office **[R2.5 million]**
- SANAS for inspection and testing of textiles, clothing, footwear, etc **[R8.1 million]**
- Maintenance of control room after warranty **[R148 million]**
- Security fences and CCTV **[R436 million]**
- Maintenance of above for 48 months **[R50.7 million]**
- Installation and commissioning of television systems and monitors **[R159 million]**
- Maintenance of the system after warranty – 12 months **[R65.4 million]**
- Transaction advisor services for PPP's **[R20 million]**

4. PPP rationale

Overcrowding remained a huge challenge for the DCS for many years, which required the department to decide on a robust strategy in order to address this issue. In its effort to overcome this challenge DCS engaged in PPP’s as one of their best option, which by its nature entails:

- Targeted public spending, principally on outputs to agreed standards;
- Leveraging private sector finances and efficiencies; and
- Allocating risks to the party that is best able to manage them.

DCS has embraced the PPP’s to deliver the 5(five) 3,000 bed correctional centres at Paarl, East London, Port Shepstone, Nigel and Klerksdorp in line with the DCS White Paper, strategic plan and desired outputs in terms of the output specifications. Before this option was finally selected various other options, which potentially would provide solutions to the above mentioned challenge, were evaluated.

The project delivery options that were considered are as follows:

- *Maintain Status Quo*: Maintain Status Quo and implement recommendations by the Inspecting Judge of Prisons report dated 31 March 2002 In compliance with section 90(4) of the Correctional Services Act 111 of 1998 mainly aimed at reducing overcrowding;

- *Refurbish and Upgrade Existing Correctional Centres*: Maintain current status quo, refurbish and upgrade the existing correctional centres to provide additional beds and to enhance the unit management environment;

- *Conversion of Existing Buildings into Correctional Centres*: Identify existing buildings to be converted into correctional centres by refurbishing, converting and upgrading to accomplish a fully functional correctional centre; and

- *New Construction:* Design and construction of new a correctional centre.

Evaluation process of the above mentioned options proved that the following benefits will be realised from PPP option:

- It creates an opportunity to achieve DCS's objectives and outputs as envisaged in the White Paper, Strategic plan and output specifications.
- It creates an opportunity for risk transfer to the party that is best able to manage those risks to enhance value for money.
- It creates an opportunity for significant BEE benefits to be derived out of the project by HDI and HDEs and also creates opportunity for long term socio-economic benefits.
- It can be procured as PPP.

5. Compliance with laws and regulation

5.1 Treasury Regulations and PFMA

In terms of the Treasury Regulation 16 and the PFMA, the procurement process to be followed under a PPP transaction has the following distinctive phases that should be adhered to:

Project inception

As soon as the institution identifies a project that may be concluded as a PPP, the accounting officer or accounting authority must in writing—

(*a*) register the PPP with the relevant treasury;

(*b*) inform the relevant treasury of the expertise within that institution to proceed with a PPP;

(*c*) appoint a project officer from within or outside the institution; and

(*d*) appoint a transaction advisor if the relevant treasury so requests.

Feasibility study – Treasury Approval: I

To determine whether the proposed PPP is in the best interests of an institution, the accounting officer or the accounting authority of that institution must undertake a feasibility study that—

(*a*) explains the strategic and operational benefits of the proposed PPP for the institution in terms of its strategic objectives and government policy;

(*b*) describes in specific terms—

- in the case of a PPP involving the performance of an institutional function, the nature of the institutional function concerned and the extent to which this institutional function, both legally and by nature, may be performed by a private party; and

- in the case of a PPP involving the use of State property, a description of the State property concerned, the uses, if any, to which such State property has been subject prior to the registration of the proposed PPP and a description of the types of use that a private party may legally subject such State property to;

(*c*) in relation to a PPP pursuant to which an institution will incur any financial commitments, demonstrates the affordability of the PPP for the institution;

(*d*) sets out the proposed allocation of financial, technical and operational risks between the institution and the private party;

(*e*) demonstrates the anticipated value for money to be achieved by the PPP; and

(*f)* explains the capacity of the institution to procure, implement, manage, enforce, monitor and report on the PPP.

This means an institution may not proceed with the procurement phase of a PPP without prior written approval of the relevant treasury for the feasibility study.

Procurement – Treasury approvals: IIA and IIB

Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.

The procurement procedure—

(*a*) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and

(*b*) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.

Contracting PPP agreements – Treasury Approval: III

After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury—

(*a*) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or revised in terms of regulation 16.4.4;

(*b*) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and

(*c*) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.

Management of PPP agreements

The accounting officer or accounting authority of the institution that is party to a PPP agreement is responsible for ensuring that the PPP agreement is properly implemented, managed, enforced, monitored and reported on, and must maintain such mechanisms and procedures as approved by Treasury.

6. Process followed by the DCS

The process below was followed by the DCS after initial identification of a need to procure services through the PPP:

Feasibility stage

During the feasibility stage, the Transaction Adviser conducted an extensive feasibility study on the procurement of the Paarl, East London, Nigel, Klerksdorp and Port Shepstone Correctional Facilities. The feasibility report was submitted to National Treasury to apply for the Treasury Approval I (TAI).

Procurement Stage

The procurement of a PPP went through the following distinct stages.

- *Prequalification stage*

  During this stage a Request for Qualification (RFQ) documentation was prepared and submitted to National Treasury for authorisation (TAII A). This pre-qualified bidders as approved then went through the next stage of the procurement process.
- *Request for proposals*

  A Request For Proposal (RFP) documentation (including a draft PPP agreement) was prepared and submitted to National Treasury for approval (TAII A). The RFP was then issued to the pre-qualified bidders. The bidders were given a chance to prepare the bid documentation, thereafter the evaluation stage will commence. This stage will be completed with the announcement of a preferred bidder (TAII B).
- *Negotiations*

  Negotiations with the preferred bidder will commence and completed with a finalisation of a PPP agreement management plan and thereby reaching a financial close. A Treasury Approval III (TA III) will then be sought from National Treasury. The PPP agreement will then be signed by the Private Partner and DCS.
- *Construction*

  The construction of the facility is scheduled to take place immediately after the conclusion of the PPP agreement.

Currently the project is at the procurement stage which is under suspension since May 2009 due to the Minister's request to familiarise her self first, with the project details.