KwaZulu Natal Provincial Treasury

ACCOUNTING OFFICERS/ CHIEF FINANCIAL OFFICERS/ SCM HEADS

PREFERENTIAL PROCUREMENT SYSTEM
Practice Note Number: SCM-06 of 2006

1   Preamble

1.1   On 20 December 2005 the KZN Procurement Act was repealed, and replaced with Treasury Regulations 16 A and the KZN SCM Policy Framework. This policy framework will regulate the preference point system to be applied in the Province, as well as the Bid Appeals Tribunal and the Provincial Treasury Supplier Database..

1.2   National Treasury are in the process of issuing revised Preferential Procurement Policy Framework Regulations (PPPFA Regulations). When these Regulations are issued, this practice note will be reviewed.

1.3   This practice note is therefore issued for the preference point system as contained in the KZN SCM Policy Framework, to remain in place until such time as the new Preferential Procurement Policy Framework Regulations (PPPFA Regulations) are promulgated by National Treasury. Provincial Treasury will advise Provincial Departments accordingly.

4. Background to the KwaZulu-Natal Preferential Procurement System

The Kwa-Zulu Natal Provincial Government promulgated new procurement legislation in 1997, which gave rise to transformation in the procurement process. The Preferential Procurement Policy Framework Act of 2000 commenced on the 3rd February 2000 nationally. The Regulations were subsequently issued on the 10th August 2001, which Regulations required that changes be effected to the preference point system applicable in Kwa-Zulu Natal. The main objective was to give effect to the Constitutional requirements by providing a framework for the implementation of the procurement policy in the procurement of goods and services that has to be conducted in a manner that is fair, transparent, equitable, competitive and cost effective. The implementation of Supply Chain Management (SCM) in terms of the Treasury Regulations 16 A, will enhance the application of preferential procurement mechanisms and the achievement of socio-economic goals. In addition thereto, the KwaZulu-Natal Cabinet approved the KZN Supply Chain Management Policy

Framework, which came into effect on 20 December 2005, and was implemented on 1 February 2006, in the interest of allowing for a smooth transition to SCM. This Policy introduced a preferential procurement system with a number of aspects unique thereto. Set out below are elaborations and explanations in respect thereof, which must be read in conjunction with the Policy itself.

5. DEFINITIONS

"black economic empowerment" means the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to-

(a)   increasing the number of black people that manage, own and control enterprises and productive assets;

(b)   facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;

(c)   human resource and skills development;

(d)   achieving equitable representation in all occupational categories and levels in the workforce;

(e)   preferential procurement; and

(f)   investment in enterprises that are owned or managed by black people.

"black" is a generic term which means Africans, Coloureds and Indians;

"co-operative" means an autonomous associations of persons united voluntarily to meet their common economic and social needs and aspirations through a jointly owned and democratically controlled enterprise organised and operated on co-operative principles.

"disability" means in respect of a person, a permanent impairment of a physical, intellectual, or sensory function, which results in restricted, or lack of, ability to perform an activity in the manner, or within the range, considered normal for a human being;

"Historically Disadvantaged Individual (HDI)" means a South African citizen –

a. who, due to the apartheid policy that had been in place, had no franchise in national elections prior to the introduction of the Constitution of the Republic of South Africa, 1983 (Act no 110 of 1983) or the Constitution of the Republic of South Africa, 1983 (Act No 200 of 1993) ('the Interim Constitution"); and/or

b. who is a female; and/or

c. who has a disability:

Provided that a person who obtained South African citizenship on or after the coming to effect of the Interim Constitution, is deemed not to be an HDI.

"Priority Population Group" means an individual/member of a targeted group who falls into a population group that had no franchise in national elections prior to the introduction of the 1984 constitution and the tricameral parliamentary system.

"small, medium and micro enterprises (SMME's)" bears the same meaning assigned to this expression in the National Small Business, Act 1996 (Act No 102 of 1996)

"youth" means a person between the ages of 18 and 35.

6. EXECUTIVE SUMMARY

Projects lending themselves to HDI upliftment are at present not fully exploited. This has led to the reviewing of certain current procurement practices and regulations used when preference points are allocated and when bids are evaluated and awarded.

This document sets out the guidelines for the implementation of a targeted preferential procurement policy in the KwaZulu-Natal Province. The development of this targeted preferential procurement policy marks the consolidation of a number of National Treasury and Provincial Treasury initiatives to reform procurement and to address the systematic exclusion of the majority of South Africans (HDI) from full participation in the main stream economy.

This policy has been drawn up to give effect to the following legislative framework

(i)   Section 217(1) of the South African Constitution which requires that procurement be in accordance with a system, which is fair, equitable, transparent, competitive and cost effective. Section 217(2) allows for organs of state or institutions referred to in subsection (1) to provide for (a) categories of preference in the allocation of contracts and (b) the protection or advancement of persons or categories of persons, disadvantaged by unfair discrimination. Section 217(3) requires that national legislation must prescribe a framework within which a preferential procurement policy must be implemented.

(ii)   Section 76(4) of the PFMA permits National Treasury to make regulations or to issue instructions applicable to all institutions to which the PFMA applies concerning, inter alia, "the determination of a framework for an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective.' To this end, the Framework for Supply Chain Management was promulgated thereby regulating the current transition to Supply Chain Management.

This preferential procurement policy is based on the application of a preference points allocation approach, allowing for either a maximum of 10 or 20 points out of 100 to be awarded to bidders that comply with the objectives specified in this policy, with the balance of 80 or 90 points being determined by price and functionality.

In conclusion, this policy will provide general principles and guidelines for achieving the strategic long term objectives of our current dispensation, by ensuring equitable distribution of business opportunities, which are representative of the demographics of

our Province. This will ensure the participation of all races in the mainstream economy.

7. OBJECTIVES OF THE POLICY

To promote the utilisation of break-out/targeted procurement and make departments aware of the value of break-out procurement as a means to HDI and SMME development and upliftment, which have been identified in the PPPFA as follows:

- To make a positive impact on job creation and poverty alleviation.
- To increase participation of the HDI and SMME's in provincial procurement opportunities.
- The promotion of South African owned enterprises.
- The promotion of export orientated production to create jobs.
- The promotion of enterprises located in a specific province for work to be done or services rendered in the province.
- The promotion of enterprises located in a specific region for work to be done or services to be rendered in that region.
- The promotion of enterprises located in a municipal area for work to be done or services to be rendered in provincial municipal areas.
- The promotion of enterprises located in rural areas.
- The empowerment of the work force by standardising the level of skill and knowledge of workers.
- The development of human resources, including by assisting in tertiary and other advanced training programmes, in line with key indicators such as percentage of wage bill spent on education and training and improvement of management skills.
- The upliftment of communities through, but not limited to, housing, transport, schools, infrastructure donations, and charity organisations.
- To promote a uniform targeted and break-out procurement approach in all departments in the Province.

8. TARGETED GROUPS

The targeted groups listed below have to meet the following requirements in order to be considered in terms of the direct preference point system or the Contract Participation Goal. The enterprises/entities have to be legal, adhere to statutory labour practices and be registered with the South African Revenue Services. It is necessary to that these entities be continuing and Independent Enterprises which are operating for profit and are providing a Commercially Useful Function and:-

(i)   owned by one or more HDI's; and
(ii)   whose management and daily business operations are in the control of one or more HDI's who effectively own it.

Black Equity Ownership

The Equity ownership must bear a minimum of 40%. Should the entity have a 40% minimum equity ownership, it will immediately earn 7.5 points. This will be done in pursuance of the objectives of BEE.

Women Equity Ownership

A minimum of 25% equity ownership will qualify an entity for the prescribed preference points, which points will be calculated in terms of the formula in paragraph 9.1 below. The granting thereof will be on a pro-rata basis i.e. 100% ownership will earn 2.5 points.

Youth

A minimum of 25% equity ownership will qualify an entity for the prescribed preference points, which points will be calculated in terms of the formula in paragraph 9.1 below. The granting thereof will be on a pro-rata basis i.e. 100% ownership will earn 2.5 points.

Disabled Persons Equity Ownership

A minimum of 25% equity ownership will qualify an entity for the prescribed preference points, which may be calculated in terms of the formula highlighted in paragraph 9.1 below. The granting thereof will be on a pro-rata basis i.e. 100% ownership will earn 2.5 points.

Priority Population Group (PPG)

In terms of the definition above, those entities which have a 100% PPG equity ownership will qualify for 2.5 points. Any percentage of equity less than a 100% will not be awarded any points.

Co-operatives

For a business to qualify as a co-operative, it has to be formally constituted as a co-operative, in accordance with the definition contained in paragraph 2 above. Entities which satisfy the aforementioned criteria will earn an additional 2.5 points only in the event that such entities demonstrate a minimum of 100% equity ownership by blacks.

9. PROCESS

Departments may use the Direct Preference Point System or the Contract Participation Goal System, based on the contract/bid value, when implementing preferential procurement.

9.1 DIRECT PREFERENCE POINT SYSTEM: CONSIDERATION OF QUOTATIONS AND BIDS FOR THE PROCUREMENT OF GOODS AND SERVICES WITH AN ESTIMATED VALUE OF R 30 000 UP TO R 500 000 PER TRANSACTION.

ALLOCATION OF DIRECT PREFERENCE POINTS TO THE TARGETED GROUPS

PREFERENCE POINT SYSTEM		80/20
PRICE (including Capacity, Specific Resource Requirements, Qualitative Requirements and Functionality		80
PREFERNCE	**BLACK**	7.5
	WOMEN	2.5
	DISABLED PERSONS	2.5
	PRIORITY POPULATION GROUP	2.5
DIRECT POINTS	**CO-OPERATIVES**	2.5
	YOUTH	2.5
Total points for development objectives		20
Total adjudication points		100

9.1.1 FORMULA FOR ALLOCATING PREFERENCE POINTS FOR PRICE, USING THE DIRECT PREFERENCE POINT SYSTEM.

The following formula must be used to calculate the points for price in respect of all bids/procurement for goods and services with a Rand value equal to the aforementioned values.

$$Ps = 80 \left\{ 1 - \frac{Pt - Pmin}{Pmin} \right\}$$

Where

Ps = Points scored for price, functionality, etc. of bid under consideration

Pt   =   Rand value of bid under consideration.

Pmin =   Rand value of lowest acceptable bid.

The points scored by a bidder in respect of development objectives must be added to the points scored for price.

Only the bid with the highest number of points scored may be selected, except in those instances identified in the KZN SCM Policy Framework.

9.1.2 FORMULA FOR CALCULATING WOMEN EQUITY OWNERSHIP (EO) POINTS.

The following formula is for calculating WEO.

0, 0333 x (WEO – 25)

NB. This formula is applicable only if the WEO is greater than 25. If WEO is less than 25, the entity is allocated zero (0) points. If WEO is 100%, the formula will lead us to maximum points of 2.5.

Example is for WEO of 40%:

0.0333 (40 – 25)

0.0333 x 15 = 0, 5

9.1.3 FORMULA FOR CALCULATING DISABLED EQUITY OWNERSHIP (EO) POINTS.

The following formula is for calculating Disabled for Equity Ownership Points (DEO)

0, 0333 x (DEO – 25)

NB. This formula is applicable only if the DEO is greater than 25. If WEO is less than 25, the entity is allocated zero (0) points. If DEO is 100%, the formula will lead us to maximum points of 2.5.

Example is for DEO of 60%:

0.0333 (60 – 25)

0.0333 x 35 = 1.155

9.1.4 FORMULA FOR CALCULATING YOUTH EQUITY OWNERSHIP (EO) POINTS.

The following formula is for calculating YEO.

0, 0333 x (YEO – 25)

NB. This formula is applicable only if the YEO is greater than 25. If YEO is less than 25, the entity is allocated zero (0) points. If YEO is 100%, the formula will lead us to maximum points of 2.5.

Example is for YEO of 80%.

0.0333 (80 – 25)

0.0333 x 55 = 1.83

9.1.5   If the bidder is a **black business** with a minimum of **40%** black equity ownership, **7.5** points must be allocated. (If black equity ownership is less than 40%, no points may be allocated.)

9.1.6   If the bidder is a **black co-operative** with **100%** black ownership, **2.5** points must be allocated. (If black ownership is less than 100%, no points may be allocated.)

9.1.7   Entities which have a **100% PPG equity ownership** will qualify for **2.5** points. (If PPG equity ownership is less than 100 %, no points may be allocated.)

9.1.8   All purchases/bids/contracts with a rand value equal to or above R 30 000 and up to a rand value of R 500 000, must be executed in terms of the Direct Preference Point System.

A total of 100 adjudication points should be allocated for Price, Black, Women, Youth, Disabled, PPG's and co-operatives.This would essentially signify that bidders who do not meet the specified criteria will obtain fewer points but are however not prohibited from bidding. Conversely, those entities that fall within the targeted groups and meet all the relevant requirements cannot hold a contract to ransom in terms of price as the reward for compliance will be outweighed by the loss of points incurred through uncompetitive bid prices.

EXAMPLE: 1

Three bids received from three bidders, Bidder A, Bidder B and Bidder C which are registered on the Provincial Suppliers Database.
Their structure for HDI equity ownership and preference points for development objectives are as follows:

No	Bid	Bid amount	Black/Indian/ Coloured			Women Equity			Disabled person			Priority Population Group		Co-operatives		Price Pts	Total Pts
			Y/N	%	Pts	Y/N	%	Pts	Y/N	%	Pts	Y/N	Pts	Y/N	Pts		
1	Bidder A	R300 000	N			N			N			N		Y		80	80
2	Bidder B	R310 000	Y	100	7.5	Y	60	1.2	Y	40	0.5	Y	2.5	Y	2.5	77	91.2
3	Bidder C	R330 000	Y	70	7.5	Y	75	1.7	N			Y		Y		72	81.2

SCHEDULE OF BIDS ON COMPARATIVE BASIS AND CALCULATION OF POINTS

Bidder A is a White owned entity which does not qualify for socio-economic development points, but for Price only.
Bidder B is 100% Black owned with 60% WEO, 40% DEO, 100% PPG's and 100% Co-ops.
Bidder C is 70% Black owned, with 75% WEO.

The first step is to list all bids received in a price comparative schedule as shown above, from the lowest to the highest bid.

The second step is to allocate points in accordance with the composition of equity ownership, in terms of women, youth, disabled and whether the business entity is a Co-operative, a Black owned business or a PPG owned business.

The third step is to calculate points on price using the prescribed formula.

The fourth step is to add together all points (i.e. points for development objectives and price) given per each and every bidder.

The fifth step is to select the highest scoring bidder for the award of contract.

The results based on the above example are as follows:

(i)   Bidder A, which is the lowest bid on price, scored the lowest points as a result of the application of the preference point system.

(ii)   Bidder B, the second lowest bid scores the highest points and is thus the first bid to be selected for consideration of the award of the contract.

(iii)   The Bid Evaluation Committee, after further consideration of the bid submitted by Bidder B, found that the item tendered did not comply with the specification. In such cases the Bid Evaluation Committee may pass over Bidder B and must record reasons for their decision.
        (The recording of reasons is important when the decision of the Bid Adjudication Committee needs to be defended in the event of an appeal being lodged against the decision taken.)

(iv)   The second bid selected for further consideration was Bidder C, who is the **highest in price** and **scored the second highest points**. This bid complied with the specification and was thus recommended for acceptance to the Bid Adjudication Committee.

(v)   The Bid Adjudication Committee approved the recommendations of the Bid Evaluation Committee and awarded the contract to Bidder C.

(vi)   The results of the award were advertised in the Provincial Gazette and participating Bidders were notified, allowing an opportunity for any appeals to be lodged.

(vii)   After the cut-off date for the lodging of appeals had passed, the Supply Chain Management Office sent a facsimile to the department that had awarded the contract, confirming that no appeals had been received.

(viii) The department then sent the letter of award of contract to Bidder C. Thus concluding the contract.

10. **CONTRACT PARTICIPATION GOAL SYSTEM: CONSIDERATION OF BIDS FOR THE PROCUREMENT OF GOODS AND SERVICES WITH AN ESTIMATED VALUE ABOVE R 500 000.**

In respect of all bids/procurement/contracts with a rand value above R 500 000, the principle of Contract Participation Goals must be applied. This would entail a Prime Contractor engaging HDI's, women, youth, disabled and PPG's directly or indirectly in due fulfilment of the contract. This would be to the extent that the total rand value of such engagements, (exclusive of VAT, and all allowances for escalation to be paid), expressed as a percentage of the total Award value of the Contract is not less than the Contract Participation Goal provided for in the bid conditions.

The participation parameter should be at between a minimum Contract Participation Goal of 10% and 40% for HDI's and between 0% and 20% for PPG's.

This should be done in order to promote the participation of HDI's and PPG's and to enhance the achievement of socio-economic development objectives.

A contractor may achieve his Contract Participation Goal obligations as follows:

(i)   By virtue of HDI status as a Prime Contractor.
(ii)   By virtue of PPG status as a Prime Contractor.
(iii)   By virtue of joint venture status as a Prime Contractor.
(iv)   By awarding/subcontracting to HDI's/PPG's
(v)   By awarding/subcontracting to joint ventures which have HDI/PPG partners.

10.1 FORMULA FOR ALLOCATING PREFERENCE POINTS ON PRICE

The following formula must be used to calculate the points for price in respect of all tenders/procurement for goods and services with a Rand value above R 500 000.

$$Ps = 90 \left\{ 1 - \frac{Pt - Pmin}{Pmin} \right\}$$

Where

Ps   =   Points scored for price of bid under consideration

Pt   =   Rand value of bid under consideration.

Pmin   =   Rand value of lower acceptable bid.

The points scored by a bidder in respect of development objectives must be added to the points scored for price.

Only the bid with the highest number of points scored may be selected.

10.2 METHODOLOGY OF CALCULATING POINTS FOR CONTRACT PARTICIPATION GOAL.

The contractor shall engage the Target Groups directly or indirectly in due fulfilment of the contract to the extent that the total Rand value of such engagements,(exclusive of VAT and escalation), be paid, expressed as a percentage of the total award value of the contract.

N = 10 (D – Ds) / (X – Ds)

Where
D = Tendered Participation Goal
Ds = Minimum Participation Goal set by Department (10%)
X = Participation Goal above which no further points are awarded (40%)

E**XAMPLE: 2**

Company A indicates a Joint Venture with an HDI which has 25% of the contract value assigned to it. (Therefore D = 25)

$$N = 10 \frac{(D - Ds)}{(X - Ds)}$$

$$N = 10 \frac{(25 - 10)}{(40 - 10)}$$

$$N = 10 \frac{(15)}{(30)}$$

N = 5 points

SCHEDULE OF BIDDERS ON A COMPARATIVE BASIS AND CALCULATION OF POINTS							
					CONTRACT PARTICIPATION GOAL		
					MINIMUM	10.00%	
NO	BIDDER	HDI YES/NO	BID AMOUNT	PRICE POINTS	MAXIMUM	40.OO%	TOTAL POINTS
				Np	CLAIMED	POINTS Nc (neg sign indicate non compliance)	Np+Nc
1	Bidder A	YES	R 3.000 000.00	90	25.00%	5	95
2	Bidder B	YES	R 3 100 000.00	87	40.00%	10	97
3	Bidder C	YES	R 3 300 000.00	81	15.00%	2	83

Np=Number of bid adjudication points awarded for price
Nc=Number of bid adjudication points awarded for contract participation goal

The first step is to list all bids received in a price comparative schedule as shown above, from the lowest to the highest bid.

The second step is to calculate points on price using the prescribed formula.

The third step is to calculate points for contract participation goals claimed by a bidder.

The fourth step is to add together all points (i.e. points on price and points for contract participation goal claimed by each and every bidder).

The fifth step is to select the highest scoring bidder for the award of contract.

The results based on the above example are as follows:

(i)   Bidder A, which submitted the lowest bid on price, scored fewer points than bidder B as a result of the application of the contract participation goal system.

(ii)   Bidder B, submitted the second lowest bid, scores the highest points and is thus the first bid to be selected for consideration of the award of the contract by the Bid Evaluation Committee.

(iii)   The Bid Adjudication Committee approved the recommendations of the Bid Evaluation Committee and awarded the contract to bidder B.

(iv)   The results of the award were advertised in the Provincial Gazette and participating bidders were notified, allowing an opportunity for any appeals to be lodged.

(v)   After the cut-off date for the lodging of appeals had passed, the Supply Chain Management Office sent a facsimile to the Department that had awarded the contract, confirming that no appeals had been received.

(vi)   The Department then send the letter of award of contract to bidder B, thus concluding the contract, which signals the completion of the bid award process.

11.   Effective Date

This practice note takes effect from 1st February 2006.

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