

## Audit Report No. 11 2010-11

### Direct Source Procurement

#### Introduction<sup>1</sup>

#### Legislative and policy framework

- 4.1 Effective procurement of property and services underpins the delivery of programs by Australian Government agencies. In 2009, the Australian Government purchased over \$23.5 billion in property and services using relatively straightforward or short-term procurement, through to more complex and longer term procurement.<sup>2</sup> Agencies purchased a wide variety of goods and services, including enabling assets such as buildings, printers and information and communications technology; and services such as consultancy advice on program management, and provision of government services to the public by external suppliers.

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1 The following information is taken from Audit Report No. 11 2010-11, *Direct Source Procurement*, pp. 15-18.

2 The value of purchased property and services was sourced from AusTender data for the 2009 calendar year. This data includes contracts valued at \$10 000 and over, based on a contract start date in 2009. Data was supplied by the Department of Finance and Deregulation on 7 January 2010, and includes agencies subject to the *Financial Management and Accountability Act* (FMA Act) 1997 and bodies subject to the *Commonwealth Companies and Authorities Act* (CAC Act) 1997.

- 4.2 Chief Executives of departments and agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act) must promote the proper use of Commonwealth resources.<sup>3</sup> To help achieve this, under the *Financial Management and Accountability Regulations 1997* (FMA Regulations), the Finance Minister issues Commonwealth Procurement Guidelines (CPGs) for officials to follow when performing duties in relation to procurement (Regulation 7).<sup>4</sup> FMA Regulation 9 also requires that approvers of spending proposals be satisfied, after undertaking reasonable inquiries, that the spending proposal provides for the proper use of Commonwealth resources.
- 4.3 The CPGs establish the core policy framework and articulate the Government's expectations for procurement.<sup>5</sup> The last substantial revision of the CPGs occurred in January 2005, and gave effect to the Australian Government's procurement obligations under the Australia-United States Free Trade Agreement.<sup>6</sup> Among the changes was a general presumption of open tendering for higher value procurements, which meant that selective and limited tendering was only available in specific and appropriately justified circumstances. It was anticipated that the dominant impact of the revised CPGs would be to increase the number and scope of procurement opportunities offered to the full market by Australian Government agencies.<sup>7</sup>
- 4.4 The current CPGs establish procurement principles that apply to all procurement processes, and promote value for money as the core principle of the Government's procurement policy framework.<sup>8</sup> Value for money is enhanced and complemented by other key principles – encouraging competition; efficient, effective and ethical use of resources; and accountability and transparency in decision-making. Applying these procurement principles is a requirement of the CPGs, and necessitates that

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3 Proper use of Commonwealth resources means efficient, effective and ethical use that is not inconsistent with the policies of the Commonwealth. FMA Act, section 44(3).

4 The CPGs are known as Department of Finance and Deregulation (Finance), Financial Management Guidance (FMG) No. 1 *Commonwealth Procurement Guidelines*, December 2008. The CPGs may also apply, following a direction by the Minister for Finance, to Commonwealth entities subject to the CAC Act listed in Schedule 1 of the *Commonwealth Authorities and Companies Regulations 1997* as being subject to Section 47A of the CAC Act. This audit did not include an examination of entities subject to the CAC Act.

5 Finance, CPGs, 2008, p. 2.

6 As outlined in footnote 4, the current version of the CPGs was issued in December 2008.

7 The Hon Dr Sharman Stone MP (the then Parliamentary Secretary to the Minister for Finance and Administration, Federal Member for Murray), Media Release 04/2004, *\$200 billion US procurement market open to Australian suppliers from January 1, 2005*, 31 December 2004.

8 Finance, CPGs, 2008, p. 9.

agencies take a considered approach when establishing arrangements for individual procurements.

- 4.5 For higher value procurements (known as covered procurements, and generally valued at more than \$80 000), the CPGs also establish Mandatory Procurement Procedures (MPPs).<sup>9</sup> The MPPs establish a range of prescriptive obligations that must be complied with when selecting a procurement method and managing the resultant procurement process.
- 4.6 Under the CPGs, agencies are obliged to maintain appropriate documentation for each procurement. The appropriate mix and level of documentation depends on the nature and risk profile of procurement being undertaken. Agencies need to ensure there is sufficient documentation to provide an understanding of the reasons for the procurement, the process that was followed and all relevant decisions, including approvals and authorisations, and the basis of those decisions.<sup>10</sup>
- 4.7 The CPGs guide agencies to establish Chief Executive Instructions (CEIs) and operational guidelines outlining their own approach to procurement, while at the same time encouraging agencies to adopt processes that are commensurate with the scale and risk profile of the procurement. This sentiment was also supported by Management Advisory Committee (MAC) Report No. 7,<sup>11</sup> which outlined the minimum requirements to meet the Government's legislative and policy framework applicable to procurement. The MAC suggested that agencies only adopt processes in addition to the CPGs in specific circumstances, where the benefits of doing so outweigh the associated costs.<sup>12</sup> More recently, the Advisory Group on Reform of Australian Government Administration reiterated that agencies need to reduce internal red tape to promote efficiency, including streamlining administrative and legislative compliance in areas such as financial management.<sup>13</sup>

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9 Covered procurement are generally procurements in excess of the procurement thresholds of \$80 000, or \$9 million for construction services, except where the property or services are exempted by Appendix A of the CPGs.

10 Finance, CPGs, 2008, p.18, paragraph 7.9. Refer also to Audit Report No. 11 2010-11, Appendix 6: Documentation obligations, requirements and sound practices.

11 MAC, Report No. 7, *Reducing Red Tape in the Australian Public Service*, 2007, pp. 25-26 and 30.

12 MAC, Report No. 7, *Reducing Red Tape in the Australian Public Service*, 2007, p. 26.

13 Advisory Group on Reform of Australian Government Administration, *Ahead of the Game – Blueprint for Reform of the Australian Government Administration*, March 2010, p. 66.

## Direct Source procurement

- 4.8 The CPGs and related Department of Finance and Deregulation (Finance) guidance define three procurement methods: Open Tender, Select Tender and Direct Source procurement. Direct Source procurement is a process in which an agency may invite a potential supplier or suppliers of its choice to make submissions such as quotes or tenders. By its nature, Direct Sourcing is less competitive than Open and Select Tendering as it does not provide the opportunity for all or, in many instances, a number of potential suppliers to compete for the provision of property and services.
- 4.9 For covered procurement, the CPGs require that Direct Sourcing only be undertaken in a limited number of specified circumstances, such as when an approach to the market has failed.<sup>14</sup> For non-covered procurement, agencies should conduct an appropriately competitive procurement process commensurate with the scale, scope and relative risk of the procurement.<sup>15</sup> In all cases, agencies need to be mindful that it is generally more difficult to adhere to the procurement principles such as value for money, encouraging competition and ethical use of resources when Direct Sourcing, but under the CPGs the onus is on them to do so.<sup>16</sup>

## The ANAO Audit

### Audit objective<sup>17</sup>

- 4.10 The objective of the audit was to assess how well agencies had implemented the CPGs and relevant FMA legislation when undertaking Direct Source procurement.

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14 The circumstances are outlined in paragraph 8.33 of the CPGs. A full list of the circumstances is provided in Audit Report No. 11 2010-11, Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing.

15 Finance, CPGs, 2008, p. 12, paragraph 5.7.

16 Finance, CPGs, 2008, p. 18. The CPGs require that agencies must maintain appropriate documentation for each procurement based on the nature and risk profile of the procurement being undertaken. Transparency provides assurance that the procurement processes undertaken by agencies are appropriate and that policy and legislative obligations are being met. Transparency involves agencies taking steps to support appropriate scrutiny of their procurement activity.

17 The following information is taken from Audit Report No. 11 2010-11, *Direct Source Procurement*, pp. 18-19.

- 4.11 The audit examined whether selected agencies had developed a sound procurement framework; appropriately classified procurement methods when meeting external reporting requirements; implemented the CPGs and relevant legislation when Direct Sourcing; and established effective procurement monitoring and review arrangements.
- 4.12 The ANAO selected four FMA Act agencies to provide a cross-section of the 104 agencies that reported procurement activity in AusTender in 2008 – 09. The agencies selected for audit were:
- the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA);
  - the Department of Innovation, Industry, Science and Research (Innovation);
  - the Department of Veterans' Affairs (DVA); and
  - the Australian Crime Commission (ACC).
- 4.13 The ANAO examined a stratified random sample of 645 procurements valued at \$10 000 and over, across the four agencies.<sup>18</sup> More detailed testing was undertaken for the 285 Direct Source procurements in the sample.<sup>19</sup>

## Overall audit conclusion

- 4.14 The ANAO made the following overall audit conclusion:

Procuring appropriate property and services, and being able to demonstrate value for money in such activities, is a prime consideration in the administration of Australian Government programs. Within the legislative and policy framework for government procurement, officials must be satisfied that decisions to procure property and services are proper and defensible. In this context, the [CPGs] facilitate sound decisions by establishing procurement policy, including the principles that apply to all

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18 For the purposes of the audit an extract was taken from the AusTender database on 29 September 2009. The audit sample is based on contract notices reported by the audited agencies in AusTender with a contract start date between 1 July 2008 and 13 August 2009. The audit scope and approach are outlined in Chapter 1 of Audit Report No. 11 2010-11, *Direct Source Procurement*.

19 Value for money, and efficiency, effectiveness and ethical tests were performed on 248 of these Direct Source procurements. For the other 37 Direct Source procurements, these principles were established through agency arrangements (rather than for each procurement) and it was not within the scope of the audit to test these arrangements.

procurement processes. The CPGs promote value for money as the core principle in all procurements. The other key principles – encouraging competition, efficient, effective and ethical use of resources, and accountability and transparency in decision-making – underpin the achievement of value for money. Agencies are required to have regard to all such considerations in their procurement activities. As the scale and risk profile of the procurement increases, the transparency and defensibility of procurement activities becomes increasingly important.

For covered procurements (generally those above \$80 000), the CPGs establish [MPPs] that agencies are obliged to comply with when procuring property and services. The prescriptive nature of these procedures means that agencies do not have discretion in their application. The [MPPs] limit the use of non-open approaches to the market (including Direct Source procurement) to a small number of specified circumstances, thereby encouraging competition.<sup>20</sup> In addition, for covered procurements, the rigour required in documenting the key processes, decisions, and the basis for those decisions, becomes more important given the increased scale and risk profile of procurement.

Where procurements are non-covered (generally less than \$80 000), there will be situations where the cost of participating in an open approach to the market is not commensurate with the scale or risk of the task. In such situations it is the responsibility of agencies to determine an appropriate process that will provide value for money without causing undue costs to the industry or the agency, or reducing program effectiveness.<sup>21</sup> These processes may include establishing panels for the provision of common property and services, accessing another agency's panel where possible, or seeking quotes from one or more potential suppliers.

Covered and non-covered procurements can be undertaken through either an Open Tender, Select Tender or Direct Source procurement process. Direct Source procurement involves an agency selecting one or more suppliers of its choice to make submissions, such as quotes or tenders, to provide property or services. While Direct Source procurement is, in practice,

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20 Finance, CPGs, 2008, p. 12, paragraph 5.8 refers to these mandatory procedures further encouraging competition.

21 Finance, CPGs, 2008, p. 12. In determining a procurement process, the CPGs refer to the selection of Direct Source, Select Tender or Open Tender procurement methods, as well as designing an appropriately competitive process when Direct Sourcing or Select Tendering.

undertaken for procurements of all scales and risk profiles, it should not be the default procurement approach as it is not conducive to open and effective competition and it is generally more difficult to demonstrate value for money.<sup>22</sup> The procurement principles reflected in the CPGs are expected to guide all Australian Government procurement activities. Where Direct Source procurement is overused, or perceived as the default method, agencies need to consider the implications this can have for reputational risks, not only for their agency but also for the wider public sector.<sup>23</sup>

In the 2009 calendar year, 48 per cent of all contracts entered into by the Government and reported on AusTender were Direct Sourced.<sup>24</sup> In addition, Direct Source procurement accounted for 43 per cent (or \$10.2 billion) of the total reported value of all of these contracts. These results are comparable to those of prior periods and, when considered in conjunction with other audit findings, suggest greater emphasis should be given to encouraging more open competition and access in Australian Government procurement, in balancing the range of requirements agencies are required to meet under the CPGs.

Overall, agencies were reasonably familiar with the Government's procurement framework and the CPGs. However, in practice, key elements of the CPGs were not consistently followed across the four audited agencies when choosing and conducting Direct Source procurements. For the majority of Direct Source procurements examined, from the circumstances of the procurement and/or procurement documentation, it was not evident that one or more CPG obligations, requirements or specified sound practices had been met, including for higher valued procurements.<sup>25</sup>

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- 22 The CPGs explain that effective competition requires non-discrimination in procurement and the use of competitive procurement processes. Finance, CPGs, 2008, p. 11.
- 23 Finance, FMG No. 14, *Guidance on Ethics and Probity in Government Procurement*, 2005, p. 12. Ethical behaviour and good probity practices enhance an agency's reputation in the marketplace, thereby increasing business confidence in procurement processes, and in turn are likely to maximise the number of suitable responses for future agency work.
- 24 For the ANAO audit sample, the level of Direct Sourcing reported by the audited agencies in AusTender was generally consistent with the actual level of Direct Sourcing. Misclassifications of Direct Source procurements (as Select Tenders) and panel procurements (as Direct Sourcing) had a net offsetting effect.
- 25 The CPGs specify obligations, requirements and sound practices, and variously use terms including 'must', 'need to' and 'should' to denote them, respectively.

While the agencies had all developed guidance material to assist staff in implementing sound procurement practices, it lacked sufficient focus on attaining value for money and encouraging competition in their procurement activities. Beyond this, under the principles based framework of the CPGs, agencies need to take a considered approach to establishing arrangements for individual procurements. Improvements in agency guidance material and procurement practices would be beneficial in assisting agencies in achieving better performance and levels of transparency in their procurement activities.<sup>26</sup>

## Agency guidance material

4.15 The ANAO commented on agency guidance material:

All four audited agencies had [CEIs] and operational guidance for procurement that covered the requirements of the requisite legal and policy framework. Nevertheless, these need to more clearly address Direct Sourcing arrangements and achieving competitive procurement processes. The agencies' procedures and delegates' decision-making tended to favour Direct Source procurement, limiting opportunities for competitive procurement processes. Agencies also experienced difficulties in distinguishing Direct Sourcing from Select Tendering. In part, this reflected a lack of clarity in Finance's definitions of methods for non-covered procurements; an issue which Finance recognises and had advised it intends to address. Strengthening of agency operational guidelines, together with additional clarity in Finance's procurement definitions, should improve the level of support provided to officials to aid them in selecting appropriate procurement methods.<sup>27</sup>

## Agency practices

4.16 The ANAO made the following assessment of agency practices:

The ANAO examined procurements valued between \$10 000 and \$305 million, for property ranging from stationery to buildings, and services such as research and development, information and communications technology support and management consultancies. Irrespective of the value or type of Direct Source

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26 Audit Report No. 11 2010-11, pp. 19-21.

27 Audit Report No. 11 2010-11, pp. 21-22.



procurements, there was often limited evidence to demonstrate that agencies' practices for individual procurements provided value for money. This does not necessarily mean that value for money was not achieved; rather that, in many cases, procurement practices applied to the particular circumstances, including the supporting documentation, did not engender confidence that value for money requirements of the CPGs were satisfied. The audit also highlighted issues in agencies' application of the other principles set out in the CPGs such as accountability and transparency in procurement decision-making.

Examination of Direct Source procurements across all four agencies provided evidence that, in 85 per cent of instances, agencies approached only one supplier and either did not seek, or only sought one quote prior to procurement.<sup>28</sup> The practical application of the CPGs can justify Direct Sourcing in certain instances, for example, for simple low cost items where market forces readily determine product price.

For complex procurements, there may not be an obvious competitive market. In these cases, where Direct Sourcing can be justified, it is prudent for agencies to obtain a small number of quotes from suppliers with a history of proven performance, and to increase the rigour applied to documenting key procurement decisions and the reasons for those decisions.

For covered Direct Source procurements, agencies could not consistently assure that their procurements complied with the [MPPs]. That is, from the circumstances of the procurement and/or procurement documentation, it was not evident that a valid condition for Direct Sourcing had applied to their higher valued procurements (covered procurements), as required by the CPGs.<sup>29</sup> When CPUs were involved in decisions to Direct Source covered procurements, this generally had a positive impact on compliance.

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28 The ANAO examined a stratified random sample of 645 procurements valued at \$10 000 and over, across the four agencies. More detailed testing was undertaken for the 285 Direct Source procurements in the sample. Value for money (and the number of quotes sought), and efficiency, effectiveness and ethical tests were performed on 248 of these Direct Source procurements.

29 In the sample of 285 Direct Source procurements, the ANAO examined 105 covered Direct Sourced procurements. These procurements exceeded the threshold value of \$80 000, or \$9 million for construction services, and were not exempt procurements (see Audit Report No. 11 2010-11, Appendix 5: Mandatory Procurement Procedures: exemptions for details of exempt procurements).

In general, to improve the alignment of agency procurement practices with the requirements of the CPGs, agencies should give more consideration to the procurement need and risk level, how it may be met through an appropriately competitive procurement process (one that has regard to the current procurement market) and be able to clearly demonstrate that these considerations have taken place.<sup>30</sup>

## Improving procurement approaches

4.17 The ANAO gave the following suggestions for improving procurement approaches.

As previously indicated, the intent of the CPGs is that procurement opportunities for higher value procurements are offered to the full market except in selective circumstances. To achieve this, the 2005 revision of the CPGs introduced more prescriptive conditions for Direct Sourcing covered procurements. It also maintained the requirement for all procurement to achieve value for money. This has required agencies to implement better planning in their approach to procurement, through more disciplined agency guidelines and strategies that accommodate market conditions without compromising value for money, efficiency and ethics, or creating unnecessary red tape.

Having regard to the underpinning expectations for the CPGs and the scale of Australian Government procurement, agencies should strive to better balance the broader benefit of competitive tendering and streamlined procurement practices. Such a balance would see agencies giving greater consideration to the scope of the potential procurement need at the outset of a procurement; more often seeking opportunities to approach the market to enhance the potential to achieve value for money; and adopting more strategic approaches to procurement, such as greater use of panel and other standing offer arrangements. In general, a greater emphasis on earlier planning for procurement activities would improve the procurement outcomes. The ANAO has made four recommendations to improve agency procurement practices in this regard, and to bring greater clarity to the requirements of the CPGs.<sup>31</sup>

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30 Audit Report No. 11 2010-11, pp. 22-23.

31 Audit Report No. 11 2010-11, pp. 23-24.

## ANAO recommendations

Table 4.1 ANAO recommendations, Audit Report No. 11 2010-11

1.	<p>To improve the transparency of Commonwealth procurement, the ANAO <i>recommends</i> that:</p> <ul style="list-style-type: none"> <li>(a) Finance review the clarity of the CPGs, including classification of procurement methods, specifically Direct Source and Select Tender procurements, and</li> <li>(b) agencies review their policy and guidance on classifying procurement methods to ensure consistency with the CPGs and related guidance.</li> </ul>
<b>Agencies' responses:</b> <i>Agreed</i>	
2.	<p>Having regard to the scale and risk profile of different procurements, the ANAO <i>recommends</i> that agencies develop concise guidance and templates, covering:</p> <ul style="list-style-type: none"> <li>(a) methodology for estimating the value of procurements to inform decisions about whether the procurement should be treated as covered;</li> <li>(b) the expected level of documentation to support decisions to undertake Direct Source procurement (covered and non-covered); and</li> <li>(c) consideration of the level of risk and the existence of conflicts of interest for the Direct Source procurement, consistent with the CPGs and Management Advisory Committee Report No. 7.</li> </ul>
<b>Agencies' responses:</b> <i>Agreed</i>	
3.	<p>Having regard to the scale and risk profile of different procurements and to improve compliance with the CPGs, the ANAO <i>recommends</i> that agencies assist delegates to address reasonable inquiry requirements prior to procurement approval, by:</p> <ul style="list-style-type: none"> <li>(a) documenting the procurement need, the prevailing market circumstances and other matters that support the use of Direct Sourcing;</li> <li>(b) documenting value for money assessments when Direct Sourcing; and</li> <li>(c) reviewing, and where necessary strengthening, pre-approval compliance assurance mechanisms when Direct Sourcing.</li> </ul>
<b>Agencies' responses:</b> <i>Agreed</i>	
4.	<p>To enhance the annual procurement planning process and provide a basis for adopting more strategic and efficient procurement processes, the ANAO <i>recommends</i> that agencies regularly analyse their procurement activities with a view to streamlining multiple approaches to the market for similar types of property or services.</p>
<b>Agencies' responses:</b> <i>Agreed</i>	

## The Committee's Review

4.18 The Committee held a public hearing on Wednesday 2 March 2011, with the following witnesses:

- Australian National Audit Office (ANAO);
- Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA);
- Department of Finance and Deregulation (Finance);
- Department of Innovation, Industry, Science and Research (Innovation); and
- Department of Veterans' Affairs (DVA).

4.19 The Committee took evidence on the following issues:

- clarification of the Commonwealth Procurement Guidelines;
- complexity of the Commonwealth Procurement Guidelines;
- achieving value for money;
- United States Free Trade Agreement obligations;
- documentation;
- consequences of non-compliance;
- training and support;
- agency procurement procedures;
- the role of Central Procurement Units;
- other procurement approaches;
  - ⇒ multi-use lists;
  - ⇒ allied tendering;
  - ⇒ best and final offer;
  - ⇒ contract-splitting;
  - ⇒ cooperative procurement using panel arrangements; and
- further ANAO audits of government procurement.

## Clarification of the Commonwealth Procurement Guidelines

- 4.20 The ANAO found that the CPGs should be clarified to enhance correct reporting of procurement methods, and recommended that:
- Finance clarify the CPGs, particularly the classification of procurement methods; and
  - agencies review their policy and guidance to ensure consistency with the CPGs and other requirements.<sup>32</sup>
- 4.21 The Committee asked Finance about the timetable for this review. Finance stated that it is undertaking a consultative process which aims to rework the CPGs by 1 July 2011. This involves:
- ... working on providing greater clarity around the Commonwealth Procurement Guidelines and processes ... to ensure that we make those processes somewhat more transparent and easier to understand ...<sup>33</sup>
- 4.22 The Committee asked if Finance would formally review the changes it would make to the CPGs after they have been put in place. Finance assured the Committee that it constantly reviewed changes to ensure feasibility and functionality, incorporating ongoing meetings with staff at various levels in multiple agencies.<sup>34</sup>
- 4.23 The Committee raised concerns with the terminology used for the CPGs, and asked if they were *rules* rather than *guidelines*. Finance told the Committee that the CPGs were rules that are required to be followed, and said that part of the current review by Finance of the CPGs would examine whether the next document should be renamed to clarify this point.<sup>35</sup>
- 4.24 The Committee also noted confusion surrounding the procurement definitions. Finance provided the following definitions of the three methods of procurement:

Figure 1 Procurement Methods

Type	Definition
Open Tender	Publishing a request for tender on AusTender and evaluating all compliant submissions..

32 Audit Report No. 11 2010-11, pp. 80-81.

33 Mr Stein Helgeby, Deputy Secretary, Financial Management Group, Department of Finance and Deregulation (Finance), *Committee Hansard*, Canberra, 2 March 2011, p. 2.

34 Mr John Grant, First Assistant Secretary, Procurement Division, Department of Finance and Deregulation (Finance), *Committee Hansard*, Canberra, 2 March 2011, p. 13.

35 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 4.

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Select Tender	A two-stage process (where potential suppliers are shortlisted following an Expression of Interest process sought through an open approach to the market); selection from a multi-use list; or selection from a list of all potential suppliers with a specific licence or ability to meet a legal requirement that is essential to the procurement.
Direct Source	Approaching and receiving responses directly from one or more suppliers; it can be used only for procurements where it is specifically allowed under paragraph 8.33 of the CPGs and where the value and reasons for the direct source are documented (refer to paragraph 8.34 of the CPGs).

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Source *Finance, submission no. 2, p. 2.*

4.25 The ANAO found that incorrect or inconsistent reporting of procurement method in the audited agencies ranged from 6 per cent to 28 per cent.<sup>36</sup> The ANAO stated that incorrect reporting of procurement method could diminish the accountability and transparency of Australian government procurement.<sup>37</sup> The ANAO observed that in order to enhance correct reporting of procurement methods, staff require a clearer knowledge of procurement methods.<sup>38</sup> Improving staff comprehension of the three procurement methods will mean they are better able to correctly classify procurement. This would reduce the level of incorrect or inconsistent reporting of the procurement method.

4.26 The Committee asked Finance to comment on the ANAO's findings of incorrect classification of procurement. Finance described confusion in agencies when determining the type of procurement, particularly when undertaking procurement from panels:

When you buy off a panel you should actually then say it is an open approach or a select approach. What many people say is, 'Oh, I went directly to the panel, so it is direct procurement.'  
Informing is one thing, but we are looking at how we can make it easier to comply within the framework that we have.<sup>39</sup>

4.27 In addition, Finance raised the possibility of changing the procurement definitions to enhance comprehension:

... we are looking at options. One is: can we describe them better? The second is: do we actually need to have three or would two suffice? ... we are looking at what is actually in the free trade agreement and at how we can meet our obligations there without disrupting terribly departments' present understandings.<sup>40</sup>

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36 Audit Report No. 11 2010-11, p. 76.

37 Audit Report No. 11 2010-11, p. 80.

38 Audit Report No. 11 2010-11, p. 81.

39 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 3.

40 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 3.

## Complexity of the Commonwealth Procurement Guidelines

4.28 The Committee asked Finance for its views on the complexity of the CPGs. Finance stated that the CPGs comprised six basic rules:

One is value for money – achieving value for money – [...] second is that for above \$80,000 you are expected to approach the open market, and that selection process can be done through a panel. The third is that when you do go to the open market, advertise on AusTender. The fourth is to give at least 25 days [...] in the market for suppliers to respond. The fifth is the rule that no late tenders can be accepted unless the agency's system is at fault [...] the last one is that within six weeks of signing the contract – and the contract is above \$10,000 – you must put it on AusTender.<sup>41</sup>

4.29 Finance told the Committee that the six basic rules of the CPGs were not particularly complicated. However, additional layers of guidance and processes created by agencies make procurement more complex, as staff must give consideration to many different issues:

The complexity is really to do with the number of layers of guidance or advice that is provided to people and trying to navigate your way through all of those things.<sup>42</sup>

4.30 The Committee asked Finance if the procurement process could be made less complex. Finance told the Committee that staff undertaking procurement felt 'daunted' by large activities, and considered that making the process less complex would lead to higher levels of compliance and higher levels of achieving value for money.<sup>43</sup>

4.31 The Committee asked each agency for its views on the complexity of the CPGs and the additional guidance required to undertake procurement. The Committee queried if this could be addressed by increasing the number of rules in the CPGs or by adding another layer of guidance above the agency level.

4.32 Innovation stated that the CPGs have changed since 2005 and that this makes continual training necessary to remind staff involved in procurement of their roles and responsibilities. The Department told the Committee that this is particularly important when some staff are undertaking procurement irregularly. The Department stated that it has

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41 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, pp. 4-5.

42 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 6.

43 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 6.

processes, systems and guidance in place to support staff undertaking procurement.<sup>44</sup>

4.33 DVA responded that it had no issue with the CPGs, and accepted that they were refined as issues emerged. DVA stated that the process supporting the rules was essential to understand how to apply the rules. DVA noted that the audit highlighted the need for clarification in this manner and that agencies must ensure that staff involved in procurement understand the current rules.<sup>45</sup>

4.34 FaHCSIA supported these comments and stated that the fact that the CPGs were simpler meant they were more useable. FaHCSIA reiterated the importance of the procurement principles and was not certain that lengthier, more constraining rules would improve compliance or enhance the achievement of the procurement principles. Noting the devolved purchasing arrangements, FaHCSIA mentioned that this current arrangement works well and agencies understand the process.<sup>46</sup>

4.35 The Committee acknowledged the devolved approach for procurement, where agencies create their own chief executive instructions, procurement procedures and document templates from the CPGs. The Committee commented that when the revised CPGs are released, agencies will try to reapply the guidelines to their documents, tighten up their processes and create new templates. The Committee suggested that a standardised approach to procurement would remove agency interpretations of the CPGs. The Committee asked Finance to discuss the difficulties of agency interpretation, judgement and subjectivity and the potential benefits of a whole-of-government, standardised approach to procurement.

4.36 Finance updated the Committee concerning the work it is undertaking with regard to standardisation across the public service:

... we are looking to standardise the tender and contract processes around procurements below \$80,000 ... That would look like a set of common documentation that would be available and expected to be used across government as a whole for the three-quarters of procurements that are undertaken every year, so it is a very substantial group of things.

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44 Mrs Vanessa Graham, Head of Division, Corporate, Department of Innovation, Industry, Science and Research (Innovation), *Committee Hansard*, Canberra, 2 March 2011, p. 7.

45 Mrs Carolyn Spiers, National Manager, Business Integrity and Legal Services, Department of Veterans' Affairs (DVA), *Committee Hansard*, Canberra, 2 March 2011, pp. 7-8.

46 Mr Steve Jennaway, Chief Financial Officer and Group Manager, Business and Financial Services, Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA), *Committee Hansard*, Canberra, 2 March 2011, p. 8.



... To the extent that we have success with that we intend to take the same approach and apply it to contracts between \$80,000 and \$250,000, which is [the] next largest group. This is the group that takes us right up to the threshold where the free trade agreement essentially says that they must have an open tender type of process, except for the exempt category of processes.

... We have a project under way at the moment to try to streamline or harmonise a lot of [CEIs] in key areas, one of which is procurement, across the Public Service. ... That should drive some streamlining or commonality in processes as a whole.<sup>47</sup>

## Achieving value for money

4.37 The Committee were particularly concerned about the issue of achieving value for money in Commonwealth procurement. The ANAO emphasised that the core principle that Australian Government agencies must apply when undertaking procurement is *value for money*. This is enhanced by:

- encouraging competition;
- efficient, effective and ethical use of resources; and
- accountability and transparency in decision-making.<sup>48</sup>

4.38 The Auditor-General reiterated this to the Committee during the hearing:

... if the principles could particularly be in the forefront of every procurement officer's mind as they make their decisions on procurement, they would not go too far wrong – and that is open, effective competition leading to value for money and being able to justify the position you have taken in your procurement approach.<sup>49</sup>

4.39 The ANAO stated that agencies could demonstrate a value for money outcome by obtaining multiple quotes to provide a comparative analysis of costs and by taking into consideration the scale, scope and level of risk of the procurement.<sup>50</sup> The Committee asked the ANAO if the culture in agencies was to *achieve* value for money when undertaking procurement, or merely to *demonstrate* value for money by 'ticking the boxes'.

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47 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 10.

48 Audit Report No. 11 2010-11, p. 16.

49 Mr Ian McPhee, Auditor-General, Australian National Audit Office (ANAO), *Committee Hansard*, Canberra, 2 March 2011, p. 5.

50 Audit Report No. 11 2010-11, pp. 85-86.

4.40 The ANAO responded that staff involved in procurement must be reminded that they need to be able to justify their decisions:

[If you were asked] to explain this procurement action and whether it represented value for money, would you be comfortable to do so? If the answer is yes, because they followed a particular approach and documented their reasons succinctly – and it may only be a matter of lines – that is the right answer. But if you cannot and you find yourself floundering, you probably have not given enough thought to the approach and the adherence to the principles.<sup>51</sup>

4.41 The Committee raised concerns regarding the possibility that a fear of being non-compliant could suppress initiative and prevent staff from achieving value for money. The Committee asked Finance how a culture of compliance with strict regulations created enough space for judgement calls about value for money. Finance replied that there is a range of compliance issues, including some which are more minor and related to inadequate documentation.<sup>52</sup> However, Finance reiterated that:

... the fundamental issue is that public servants have an obligation in procurement processes to achieve value for money. They have to make judgements along the way about how best to achieve that value for money ... when you make a judgement to go one way or the other way, you write it down and you make explicit why you have chosen one path rather than the other.<sup>53</sup>

## United States Free Trade Agreement obligations

4.42 The ANAO reported that the last review of the CPGs occurred in January 2005, and encompassed the changes to procurement obligations in the United States Free Trade Agreement (USFTA).<sup>54</sup> The Committee asked Finance if only the USFTA was reflected in the CPGs. Finance responded that the CPGs also broadly incorporated the Chile and Singapore agreements, thus reflecting Australia's free trade agreement obligations.<sup>55</sup> These incorporations mean that staff do not have to consult any free trade agreements when undertaking procurement.<sup>56</sup>

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51 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 5.

52 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 4.

53 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 4.

54 Audit Report No. 11 2010-11, p. 16.

55 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 3.

56 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 14.

4.43 The Committee asked Finance if there had been any significant changes to the CPGs as a result of the USFTA. Finance explained the implications to the Committee:

... the free trade agreements clarified some processes and brought in a couple of clear rules. For example, you must go to the market above \$80,000. That is very clearly a free trade agreement rule. The US free trade agreement is now a benchmark.<sup>57</sup>

4.44 The Committee asked the ANAO how the CPGs differed from previous procurement guidance. The ANAO responded:

... before we had the \$80,000 rule, a lot of these direct sourcing arrangements used to apply at a much higher level. One of the things that the US free trade agreement brought in was the discipline that said once you get above \$80,000 you need to be able to demonstrate much more easily and readily the open process that you have employed.<sup>58</sup>

4.45 The Committee asked if there had been any domestic and international purchasing change in relation to the USFTA, and if there had been any internal audits of purchasing change. Finance responded that it was not aware of any such reviews but stated that agencies consider that the threshold has improved assessment and oversight mechanisms for procurement.<sup>59</sup> Finance added that government procurement was open to domestic and internal competition prior to the USFTA, and that small and medium enterprises do win contracts:

In fact, of the total contracts reported on AusTender for 2009-10 (procurement contracts valued at more than \$10,000), the SME share was approximately 56 percent by volume and 32 percent by value, worth approximately \$13.8 billion.<sup>60</sup>

## Documentation

4.46 The ANAO found that the audited agencies did not retain adequate documentation to demonstrate how they had assessed and achieved value for money for direct source procurements. No documentation was provided to the ANAO for 74 per cent of the audited direct source procurements.<sup>61</sup> The Committee asked the ANAO how many cases of non-

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57 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 14.

58 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 14.

59 Finance, submission no. 8, p. [2].

60 Finance, submission no. 8, p. [2].

61 Audit Report No. 11 2010-11, p. 87.

compliance were serious issues and how many were due to a lack of documentation. The ANAO responded that it is difficult to determine whether procurements complied with the CPGs or achieved value for money without a clear paper trail.<sup>62</sup>

- 4.47 The ANAO reiterated that the procurement principles include documenting key procurement decisions and actions.<sup>63</sup> The ANAO found that there was considerable scope for improving the documentation of such decisions.<sup>64</sup> The ANAO stated that:

Irrespective of the value or type of Direct Source procurements, there was often limited evidence to demonstrate that agencies' practices for individual procurements provided value for money. This does not necessarily mean that value for money was not achieved; rather that, in many cases, procurement practices applied to the particular circumstances, including the supporting documentation, did not engender confidence that value for money requirements of the CPGs were satisfied.<sup>65</sup>

- 4.48 In order to support recordkeeping requirements, improve the transparency and accountability of government procurement, and increase compliance with the CPGs, the ANAO recommended that agencies assist delegates to adequately document the decisions they make when undertaking Direct Source procurement.<sup>66</sup> The Committee asked each agency to detail the steps they had taken to address the ANAO's recommendation.

- 4.49 FaHCSIA stated that it had reviewed all of its procurement and contract management policies, guidelines and templates since the audit. FaHCSIA reiterated that:

The ANAO Audit found that FaHCSIA's process for the approval of departures from the [MPPs] of the CPG[s] as "good practice". This process, which has been mandated within the agency, requires all proposals for Direct Sourcing of goods or services above the procurement threshold of \$80,000 to be approved by the Branch Manager with responsibility for the CPU prior to approval by the relevant delegate.<sup>67</sup>

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62 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 5.

63 Audit Report No. 11 2010-11, p. 83.

64 Audit Report No. 11 2010-11, p. 121.

65 ANAO, submission no. 1, p. [3].

66 Audit Report No. 11 2010-11, p. 123.

67 FaHCSIA, submission no. 10, p. [2].

- 4.50 Innovation stated that the Department is reviewing its procurement guidance material and expects this process to be completed by 1 July 2011. Innovation has also developed procurement checklists and an internal quarterly reporting process. In 2009, Innovation implemented a module on contracts into its financial management information system, which utilises an automatic workflow to process procurement documentation. In 2010, Innovation commenced half-day and two-day procurement and contract related training.<sup>68</sup>
- 4.51 DVA reported a number of steps the Department has taken to improve the documentation process:
- the development of a suite of procurement templates covering: value for money, level of risk, Direct Sourcing justification, procurement plans;
  - increased emphasis on explaining the importance of procurement documentation in all training and internal publications to all staff;
  - a software upgrade of the Department's internal contract register application has occurred to make the application more user friendly for business areas and modifications were made to ensure that [FMA Regulation 9] authority was easily identifiable to the user; and
  - the promotion of the use of standard templates issued by the Department of Finance and Deregulation for low risk procurements.<sup>69</sup>
- 4.52 The ANAO also noted that agencies often appeared to be obtaining one or no quotes when undertaking direct source procurement, demonstrating minimal process despite varied scale and risk levels.<sup>70</sup> The ANAO found that:
- ... for 85 per cent of the audit sample, from available evidence only one, or no quotes were sought, with many of these procurements being covered or of considerable value ...<sup>71</sup>
- 4.53 The Committee asked each agency to explain why this may have occurred in their agency.
- 4.54 FaHCSIA responded that:
- The majority of these procurements were contracts for:

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68 Innovation, submission no. 6, p. [4].

69 DVA, submission no. 7, p. [3].

70 Audit Report No. 11 2010-11, p. 88.

71 Audit Report No. 11 2010-11, p. 87.

- software licensing, postal services and utility services where there is only one provider of the services; and
- accommodation and venue hire, training and research services where there is a limited number of providers. In these cases, selection is primarily made following a request for quotation process.

In these cases, Direct Source was considered an appropriate procurement solution. In addition, FaHCSIA has established a number of panel arrangements to allow business areas to streamline procurement processes.<sup>72</sup>

4.55 Innovation told the Committee that:

We have anecdotal evidence to suggest that, in a number of cases, multiple quotes were obtained, however this was not adequately documented. Notwithstanding, it is acknowledged that the number of quotes obtained may be an issue ...<sup>73</sup>

4.56 DVA stated that at the time of the ANAO's audit, the Department's:

... procurement practices in respect of non-covered procurements (<\$80,000) were consistent with the requirements in the Commonwealth Procurement Guidelines and Finance guidelines at the time that did not specify the requirement for more than one quote. As a result of this audit and the recommendations for clarity in procurement guidelines, the Department has amended its document and online training to ensure all procurements demonstrate value for money by obtaining multiple quotes.<sup>74</sup>

4.57 The Committee asked Finance if it could provide information on instances of non-compliance with the CPGs and how the Department responded to such cases. Finance explained that the present devolved working environment meant that Finance did not receive this information from government agencies so was not able to report on breaches,<sup>75</sup> however annual reports tabled in parliament contained these figures.<sup>76</sup>

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72 FaHCSIA, submission no. 10, p. [3].

73 Innovation, submission no, 6, p. [6].

74 DVA, submission no. 7, p. [4].

75 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 3.

76 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 3-4.

## Consequences of non-compliance

- 4.58 The ANAO found that internal agency audits identified similar issues with compliance, documentation and reporting as the Auditor-General.<sup>77</sup> The Committee asked each agency to provide details of the internal consequences for individual staff who demonstrated non-compliance with the CPGs and agency requirements, given that previously identified issues did not seem to have been adequately rectified.
- 4.59 FaHCSIA stated that it reports non-compliance through the Certificate of Compliance process, and addresses identified issues by bringing them to the attention of the relevant delegate and ensuring the delegate undertakes appropriate training to prevent reoccurrence.<sup>78</sup>
- 4.60 Innovation responded that it:
- ... reports instances of non compliance with Regulation 7 (Commonwealth Procurement Guidelines), Regulation 9 (approval of spending proposals) and Regulation 10 (arrangements beyond available appropriation) as part of the Certificate of Compliance process. Part of the Certificate of Compliance process is to include remedial action to be taken against any identified breaches.
- All performance agreements at the SES Level include compliance as a standard criterion. Therefore, compliance is taken into account when assessing performance at this level.<sup>79</sup>
- 4.61 DVA stated that when a staff member has breached the CPGs:
- ... the Department works at improving that staff member's understanding of the procedures and the importance and need for compliance ...<sup>80</sup>

## Training and support

- 4.62 The ANAO found that strengthening agency guidance would improve compliance with the CPGs by raising awareness of its procurement requirements.<sup>81</sup> The Committee suggested a lack of awareness of the requirements in the CPGs could be addressed through training and support.

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77 Audit Report No. 11 2010-11, pp. 128-129.

78 FaHCSIA, submission no. 10, p. [2].

79 Innovation, submission no. 6, p. [5].

80 DVA, submission no. 7, p. [3].

81 Audit Report No. 11 2010-11, p. 35.

4.63 The Committee asked Finance to explain its provision of training and support to agencies, and state whether or not this was happening regardless of, or in response to, the audit. Finance provided information to the Committee on its ongoing commitment to procurement training and support:

... Finance considers that procurement capability – that is skills, competency and experience – needs to be improved to promote better compliance in agencies with procurement requirements. In this respect, Finance has introduced a range of initiatives, many of which were initiated before the Audit Report, but are adjusted to take account of changes in policies and areas in which compliance with the CPGs can be improved. These initiatives include:

- Procurement Foundations Seminars – and introduction to the Procurement Framework (held 4-5 times a year);
- Procurement Discussion Forum (held about every 6 weeks);
- Agency visits;
- Procurement Update (a weekly update on the procurement component of the Finance website);
- Procurement Newsletter (issued monthly); and
- Working with key agencies to ensure availability of Certification 4 and degree courses dealing with procurement.<sup>82</sup>

4.64 Finance stated that procurement training would happen regardless of the audit, but that:

... it has been given a new focus and sense of purpose, if you like, by the audit findings, which essentially tell us that there are some issues that we have to address and give us a bit of a handle about what those problems are.<sup>83</sup>

4.65 The Committee asked if Finance had the resources to implement the ANAO's recommendations. Finance confirmed that it had the required skills set for procurement policy and agency outreach.<sup>84</sup>

4.66 The ANAO also recommended that agencies improve training and support to staff undertaking procurement.<sup>85</sup> The Committee asked the audited agencies to provide details of the steps they had taken to implement this recommendation. The Committee particularly asked each agency to:

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82 Finance, submission no. 2, p. 4.

83 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 2.

84 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 12.

85 Audit Report No. 11 2010-11, p. 81.



- provide details of its procurement training programs;
- state who provides this training; and
- state if procurement training is compulsory for all delegates involved in procurement.

4.67 FaHCSIA stated that it undertakes regular reviews of policies and guidance, which are easily accessible on the agency's intranet. The Department also stated that all CPU staff have, or are acquiring, nationally recognised qualifications in government procurement. FaHCSIA noted the difficulty in attracting and retaining senior procurement staff.<sup>86</sup> The Department advised that internal training is available to all staff and delegates are encouraged to attend these courses and others delivered by Finance, the Australian Public Service Commission and other private training providers.<sup>87</sup> Shane Carroll and Associates developed FaHCSIA's current two-day training course, with the Department's CPU. FaHCSIA also delivers internal one- and two-day training courses on financial management.<sup>88</sup> However, the Department stated that procurement training is not mandatory:

FaHCSIA considers policy and guidelines available on the Agency's Intranet, coupled with guidance from the CPU, is sufficient to support delegates when exercising their financial delegations.<sup>89</sup>

4.68 Innovation stated that it has an online procurement toolkit and has commenced further procurement and contract-related training, all of which are reviewed on an ongoing basis. These include half- and two-day training courses for staff and delegates.<sup>90</sup> Innovation stated that CIT Solutions and its internal procurement team developed the Department's current procurement training suite, however the suite is now being delivered by Major Training Solutions.<sup>91</sup> Innovation stated that procurement training is not mandatory, however procurement training is available, and:

The department requires all delegates who approve spending proposals to undertake a Financial Accreditation test prior to becoming a delegate. This mandatory test is designed to test a

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86 FaHCSIA, submission no. 10, p. [1].

87 FaHCSIA, submission no. 10, p. [1].

88 FaHCSIA, submission no. 10, p. [2].

89 FaHCSIA, submission no. 10, p. [1].

90 Innovation, submission no. 6, p. [2].

91 Innovation, submission no. 6, p. [3].

delegates [sic] understanding of approving spending proposals including questions on procurement.

Additionally, the department has developed a series of checklists for managers which outline key considerations when approving a spending proposal.<sup>92</sup>

4.69 DVA stated that its internal Contract Advisory Unit provides procurement training services to its staff.<sup>93</sup> DVA advised that it is moving to introduce mandatory training, in addition to its regular internal procurement training sessions.<sup>94</sup> DVA provided the following details of steps the Department has taken to improve procurement training:

- extensive one-on-one discussions with individual managers and Senior Executives as well as a special awareness session for all Senior Executives in order to establish a top-down approach underlining the importance of procurement practices;
- updates to the procurement Chief Executive Instructions;
- internal instructions issued to emphasise the importance of [FMA Regulation 9] compliance and use of procurement templates;
- publication on the departmental intranet of a suite of templates covering procurement activities;
- increased emphasis on procurement process / documentation in internal publications to staff involved in procurement activities;
- implementation of on-line training package to supplement national training sessions; and
- [DVA's internal Contract Advisory Unit] conducting quality checks of all contract information uploaded to the departmental contracts register and referral back to business area if not compliant.<sup>95</sup>

## Agency procurement procedures

4.70 The ANAO recommended that agencies develop guidance and templates that concisely cover the following aspects of the procurement process, in order to improve compliance with the CPGs:

- methodology for estimating the value of procurement;

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92 Innovation, submission no. 6, p. [2].

93 DVA, submission no. 7, p. [3].

94 DVA, submission no. 7, p. [3].

95 DVA, submission no. 7, p. [2].

- the expected level of required documentation for direct source procurement;
  - consideration of risks; and
  - consideration of conflicts of interest.<sup>96</sup>
- 4.71 The Committee asked each agency if it had developed a long-term, concrete action plan to ensure future compliance with this recommendation, and to detail the steps it had taken to implement these plans.
- 4.72 FaHCSIA stated that in addition to periodic documentation reviews, it is currently developing an enhanced procurement management system called Procure-to-Pay. This system is scheduled for introduction in the 2011-12 financial year.<sup>97</sup>
- 4.73 Innovation stated that it had implemented measures to improve compliance with the CPGs. Innovation is currently reviewing its procurement guidance material (to be completed by 1 July 2011) and has undertaken the following steps:
- commenced delivery of a procurement and contract-related training course to procurement officers and financial delegates;
  - instituted a mandatory quality assurance stream through its financial management information systems;
  - developed checklists for approval documents; and
  - introduced an internal quarterly reporting framework.<sup>98</sup>
- 4.74 DVA stated that it is developing its Quality Management Framework to assist in complying with the CPGs. This will reiterate the importance of compliance. DVA also noted that:
- In addition, the Division that is responsible for managing the majority of high value procurement activities within the Department has consolidated its procurement function into one area within the Division to strengthen procurement expertise and streamline procurement activities.<sup>99</sup>

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96 Audit Report No. 11 2010-11, p. 122.

97 FaHCSIA, submission no. 10, p. [3].

98 Innovation, submission no. 6, pp. [8-9].

99 DVA, submission no. 7, p. [4].

## The role of Central Procurement Units

4.75 The ANAO found that Central Procurement Unit (CPU) involvement in individual direct source procurement decisions improved compliance with the Mandatory Procurement Procedures (MPPs) of the CPGs:

The timely involvement of CPU staff in decisions to Direct Source, generally had a positive impact on compliance with the [MPPs of the CPGs]. In this regard, a good practice implemented by FaHCSIA required clearance by the CPU Branch Head of decisions to Direct Source procurements in excess of \$80 000.<sup>100</sup>

4.76 The ANAO also reported that the role of the CPU in the audited agencies included:

- provision of legal and commercial advice and support, including advice on agency and Commonwealth procurement policies;
- development and maintenance of agency procurement policy and guidance;
- management of agencies' contract registers, and internal and external reporting; and
- provision of procurement training.<sup>101</sup>

4.77 The Committee asked the ANAO if, given their effectiveness, CPUs should be more involved in procurement activities. The ANAO told the Committee that it is important that staff who procure irregularly are able to contact a CPU or an officer with expertise to assist them in the process.<sup>102</sup> Finance added that the Department encouraged the involvement of CPUs in procurement.<sup>103</sup> FaHCSIA, Innovation and DVA agreed that expertise and advice in CPUs were valuable to the procurement process.<sup>104</sup> The Committee asked each agency to explain how it structures and manages its procurement processes.

4.78 FaHCSIA told the Committee that the Department had a CPU to provide advice to staff, in addition to guidance. The Department noted that irregular procurement is also an issue within its Department, but that staff understand the value for money principle and where to find procurement

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100 Audit Report No. 11 2010-11, pp. 24-25.

101 Audit Report No. 11 2010-11, p. 62.

102 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 12.

103 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 12.

104 Mrs Graham, Innovation, *Committee Hansard*, Canberra, 2 March 2011, p. 7; Mrs Spiers, DVA, *Committee Hansard*, Canberra, 2 March 2011, p. 7; Mr Jennaway, FaHCSIA, *Committee Hansard*, Canberra, 2 March 2011, p. 8.

advice. FaHCSIA also noted improvements it had made during the audit process.<sup>105</sup>

- 4.79 Innovation reported that it is ensuring that procurements are undertaken by staff who understand and can comply with the CPGs and departmental processes. Innovation stated that staff procure with differing frequencies, so increasing awareness and ensuring training is undertaken improves compliance with the CPGs and departmental requirements.<sup>106</sup> Innovation provided further detail on procurement processes to the Committee, emphasising the pressure imposed by time constraints:

... it comes down to an interpretation of the rules. There is always an interpretation of the rules when you are talking about specific situations and about procurements that may have to happen within a short time frame.

... it is very much driven by timing interpretation ...<sup>107</sup>

- 4.80 DVA noted that it expected staff to contact the Department's CPU for advice and support when undertaking procurement, and agreed with Innovation's comments regarding time constraints. DVA mentioned that the focus on documentation to prove compliance required staff to understand the process and definitions. It stated that confusion about directly approaching a provider on a panel established by an open tender process (which should be recorded as open tender, not direct sourcing) had been an issue.<sup>108</sup> DVA provided further information regarding how it changed its procurement processes during the audit process, which included advising managers individually, renewing procurement information, updating the CEIs, addressing non-compliance and reviewing AusTender listings.<sup>109</sup> DVA increased the visibility of a key mantra:

... 'If it's not documented, it's not done' ...<sup>110</sup>

## Other procurement approaches

- 4.81 The Committee sought clarification from Finance on various types of procurement approaches during this review. These included:

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105 Mr Jennaway, FaHCSIA, *Committee Hansard*, Canberra, 2 March 2011, p. 8.

106 Mrs Graham, Innovation, *Committee Hansard*, Canberra, 2 March 2011, p. 7.

107 Mrs Graham, Innovation, *Committee Hansard*, Canberra, 2 March 2011, p. 7.

108 Mrs Spiers, DVA, *Committee Hansard*, Canberra, 2 March 2011, p. 7-8.

109 Mrs Spiers, DVA, *Committee Hansard*, Canberra, 2 March 2011, p. 8.

110 Mrs Spiers, DVA, *Committee Hansard*, Canberra, 2 March 2011, p. 8.

- multi-use lists;
- allied tendering;
- best and final offer (BAFO);
- contract splitting; and
- cooperative procurement using panel arrangements.

### Multi-use lists

4.82 The Committee noted past use of multi-use lists for procurement, highlighting that micro-businesses (typically operating with four or fewer people) were unable to participate in the process, and stating concerns that some lists lacked quality assurance or risk management, yet the completed list could be deemed the only option for providers to use. A multi-use list is a list, intended for use in more than one procurement process, of pre-qualified suppliers who have satisfied the conditions for inclusion on the list.

4.83 The Committee asked Finance to comment on this procurement method. Finance stated that there is presently a multi-use list for advertising, containing approximately 230 firms. Finance confirmed that this was a prequalification list, established with appropriate checks, and that it was fluid, so businesses could be added or removed if their eligibility changed. These processes included referee checks. Agencies were encouraged to engage with suppliers on the list that have not been previously engaged with government.<sup>111</sup>

### Allied tendering

4.84 The Committee asked Finance for feedback as to how allied tendering fitted into the CPGs and the procurement principles. The Committee asked if allied tendering could be used as a value for money judgement, and if this would be acceptable if it was adequately documented. Allied tendering is a procurement process, where organisations respond to an open tender, and an agency may select two tenders and ask the organisations to 'cut a deal' to share the procurement.

4.85 Finance explained to the Committee that allied tendering was an acceptable process:

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111 Mr Helgeby and Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, pp. 10-11.

The procurement guidelines do not prohibit that sort of approach. Alliance contracting is quite common in places. What you want to do is make sure you understand who has the risk and who is responsible. That is the key issue when you undertake those types of approaches. There is nothing that says you cannot do it. If it makes good business sense and achieves value for money, it is fine.<sup>112</sup>

## Best and Final Offer

4.86 The Committee noted that the best and final offer approach frustrated many organisations, who felt they had gone through a genuine procurement process, but been undermined at the end of it. The best and final offer (BAFO) procurement process is where organisations respond to a tender, then the agency asks some organisations if they could improve their offer.

4.87 The Committee asked Finance to comment on this process. Finance made two points:

- that value for money is much broader than price; and
- that there will always be final negotiations with significant contracts.<sup>113</sup>

4.88 The Committee asked Finance if using BAFO could make the initial tender process questionable. Finance responded to this concern:

If it is built into the process and it is quite clear that you might go to best and final offers, there is no problem at all. If you think about it, there are other mechanisms that other jurisdictions use for simple procurements – buying computers or something like that – where they use a Dutch auction, essentially, and you actually see the prices, though not necessarily who is putting them in. Is that a best and final offer approach – it is in the end.<sup>114</sup>

4.89 The Committee commented that such a Dutch auction process would be more transparent than a closed BAFO process.

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112 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 13.

113 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 13.

114 Mr Grant, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 13.

## Contract-splitting

4.90 The ANAO found that seven procurements of the audited sample had been divided into separate smaller procurements. This is an instance of contract-splitting:

The MPPs state that procurements must not be divided into separate smaller procurements to circumvent a threshold ... [where seven] procurements were reported as contract notices with values of \$80,000 or less, the agencies had procured the same services from the same supplier on a continuing basis, and the cumulative value of services exceeded the procurement thresholds. In these instances the MPPs should have been applied to the procurement.<sup>115</sup>

4.91 The Committee asked the ANAO for its assessment of the incidence of contract splitting in the sample and in government agencies more widely. The ANAO noted that contract splitting had been found to occur in this and other recent audits, and that this was not an acceptable practice for government procurement.<sup>116</sup> The ANAO added:

... we saw a small number of examples of behaviour that sought to get around the covered procurement thresholds or that did not address those thresholds properly ...

We saw some other examples where agencies had not estimated the value of the procurement with any degree of accuracy. They had estimated the value at under \$80,000 and there were a couple of cases where at the end of the day the procurement was well in excess of the \$80,000 threshold.<sup>117</sup>

4.92 However, the ANAO emphasised that:

... these examples were very much in the minority; there were only a few in that large sample [of 280 Direct Source procurements audited for the report].<sup>118</sup>

## Cooperative procurement using panel arrangements

4.93 The ANAO noted that cooperative panel arrangements, whereby multiple agencies access suppliers from the same panel, increased the efficiency of

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115 Audit Report No. 11 2010-11, p. 119.

116 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 11.

117 Mr Stuart Turnbull, Executive Director, ANAO, *Committee Hansard*, Canberra, 2 March 2011, pp. 11-12.

118 Mr Turnbull, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 12.



procurement processes. Processes that incorporate whole-of-government panels or intra-agency cooperative panels provide:

... an opportunity for the agencies to better appreciate their overall procurement requirements, as a basis for adopting more strategic approaches to procurement ...<sup>119</sup>

- 4.94 The Committee noted that many agencies sign up to 'co-panel' and suggested that the procurement of standard government services and standard capabilities required by multiple government agencies could be facilitated through a whole-of-government panel.
- 4.95 Finance noted that this approach could reduce the cost of procurement for businesses as well as agencies and indicated that it supported and endorsed the use of cooperative procurement, in appropriate circumstances:

If one or more agencies goes out to tender for a particular type of service or good, they may choose to do that with a clause that essentially allows other agencies to look at that list and access that panel or that contract. From a whole-of-government perspective that is one of the ways that you can achieve value for money ... The addition of cooperative procurement clauses in these processes is a welcome development from a whole-of-government perspective.<sup>120</sup>

## Further ANAO audits of government procurement

- 4.96 The Committee asked the ANAO if it intended to undertake further audits of procurement. The ANAO stated that it would not repeat work on Direct Source procurement, but would examine other aspects and issues relating to procurement as the audit had identified broader issues.<sup>121</sup> For example, the ANAO informed the Committee that it is currently undertaking an audit on the use of panel arrangements in procurement, to gauge how effective the process is.<sup>122</sup> The ANAO further indicated that it intended to undertake a program of audits on various aspects of government procurement in the future.<sup>123</sup>

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119 Audit Report No. 11 2010-11, p. 35.

120 Mr Helgeby, Finance, *Committee Hansard*, Canberra, 2 March 2011, p. 11.

121 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 2.

122 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 2.

123 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 2 March 2011, p. 3.

## Committee comment

- 4.97 The Committee is gravely concerned about the findings of the ANAO audit, and many of these concerns were not alleviated during the Committee's review. The Committee was particularly concerned to see the high level of direct source procurement instead of more competitive procurement options; the insufficient governance mechanisms; the lack of documentation and the possibility that value for money is not always being achieved. If these results are indicative of procurement practices in the wider APS, the Committee finds this even more worrying.
- 4.98 Regarding value for money, the Committee considers, as indicated in the CPGs, that this is the paramount goal of procurement. The Committee reiterated throughout the review that government agencies have an obligation to achieve value for money in procurement processes. The review linked low levels of compliance with the CPGs to the perceived lack of achieving value for money. However, the Committee raised concerns that having a culture of compliance might not leave enough space for judgement calls about value for money.
- 4.99 The ANAO stated that a lack of documentation does not indicate that value for money has not been achieved; however the Committee considers that undocumented processes should be viewed with high levels of suspicion. In these circumstances, the Committee is of the opinion that the default assumption should be that 'if it's not documented, it's not done', hence value for money is unlikely to have been achieved.
- 4.100 Although a range of issues were covered during the inquiry, the Committee considers that the following areas warrant specific comment:
- revision of the CPGs;
  - CPUs and approval processes;
  - whole-of-government templates and training;
  - delegation conditions, including training and testing; and
  - consequences of non-compliance.
- 4.101 The Committee anticipates a timely release of the revised CPGs and urges Finance to address the Committee's concerns in the Department's ongoing review processes. The Committee encourages Finance to make the CPGs easier to understand for the broader APS, in order to facilitate

compliance. The Committee sees the revision of the CPGs as imperative to improving practices and compliance in government procurement.

- 4.102 The Committee recognises the important role that CPUs play in improving compliance with the CPGs. The Committee therefore encourages CPU involvement in procurement activity above set thresholds, in an advisory, support and compliance capacity. In addition, the Committee sees benefit in strengthening approval processes, to improve accountability. This could include a central officer, such as the head of the CPU, being required to formally endorse that correct procurement processes have been followed.
- 4.103 Regarding whole-of-government approaches, the Committee accepts that the procurement process is complex. Despite this, the Committee considers that a whole-of-government approach to support procurement at an agency level could improve compliance with the CPGs and the efficiency of procurement. The Committee suggests that standardised whole-of-government templates and training could provide examples of best practice and ensure staff undertaking procurement understand their responsibilities. The Committee commends Finance for providing procurement training and support to government agencies. However, the Committee would like to encourage Finance to more broadly promote the training opportunities it provides for both CPU and non-CPU staff. The Committee encourages appropriate evaluation of this training material to test if it is leading to value for money outcomes.
- 4.104 The Committee notes that as agencies interpret the CPGs, different processes and templates could cause difficulties with subjectivity and judgement. The Committee sees benefit in having a standardised whole-of-government set of templates and checklists, to assist procurement. This would provide a generic foundation that agencies can expand on as required. This in turn should improve outcomes and efficiency.
- 4.105 Regarding delegation conditions, the Committee is of the opinion that there may be merit in obliging individuals with official delegation to undergo compulsory procurement training, or at a minimum, testing. This would ensure that responsible officers meet a minimum level of competency to spend taxpayer's money and that their skills remain current.
- 4.106 Regarding the consequences of non-compliance, the Committee was not provided with sufficient evidence to give it confidence that the consequences of non-compliance are adequate or are being applied. The Committee does commend Innovation's practice of incorporating

compliance into SES performance agreements as a novel and beneficial approach. However, the Committee would have liked to have seen more evidence of a compliance structure. If this does not exist, the Committee would encourage agencies to develop such a structure to ensure that non-compliance is taken seriously and is adequately addressed.

- 4.107 The Committee thanks the agencies for their involvement in this review process and would like to acknowledge those agencies that demonstrated areas of good practice. The Committee is encouraged by the improvements made during, and subsequent to, the ANAO audit. The Committee notes that all audited agencies agreed with the ANAO's recommendations, and anticipates further improvements in light of this review.
- 4.108 However, the Committee remains concerned that while agencies have improved their documentation procedures and training, they have not given the Committee confidence that they have adequately addressed the ANAO's recommendations on estimation methodology, risk analysis and conflicts of interest in their guidance. Furthermore, the Committee reiterates that it does not accept that time constraints are an excuse for non-compliance.
- 4.109 Finally, the Committee supports the ANAO's intention to conduct further audits into a range of government procurement processes. The Committee retains an ongoing interest in this area of public sector administration and will continue to scrutinise it. Due to the significance of the findings in this review, the Committee sees benefit in the ANAO conducting another audit into Direct Source Procurement in the near term.
- 4.110 The Committee understands that achieving value for money involves active judgement as well as rigorous processes and compliance with the CPGs. It is in this context that the following recommendations are made.

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## **Recommendation 2**

**The Committee recommends that the Department of Finance and Deregulation actively promote and culturally address the use of CPUs across the Australian Public Service.**

### **Recommendation 3**

The Committee recommends that the Department of Finance and Deregulation investigate the viability of developing and implementing whole-of-government templates and checklists for use across the Australian Public Service and report back to the Joint Committee of Public Accounts and Audit within six months of the tabling of this report.

### **Recommendation 4**

The Committee recommends that the Department of Finance and Deregulation investigate the feasibility of implementing a process of regular, mandatory testing and/or training for all Australian Public Service officers with delegation authority above \$10 000, with the aim of ensuring currency and competency. Finance should report back to the Joint Committee of Public Accounts and Audit within six months of the tabling of this report.

The investigation should include, but not be limited to, consideration of:

- implementation at agency or whole-of-government level;
- alternative mechanisms to achieve outcomes (see paragraph 4.105 above); and
- the costs and benefits of the scenarios considered.

