



Australian National
Audit Office

Better Practice

Selecting Suppliers

MANAGING THE RISK

October 1998



Selecting Suppliers

MANAGING THE RISK

October 1998



Better Practice

The Australian National Audit Office (ANAO), as part of its audit-related services, produces better practice guides and handbooks. These are generally developed and issued in conjunction with an audit that is related to the subject matter of the guides.

In developing these guides, the ANAO aims to promote the adoption of better practices throughout the Australian Public Service and improve the efficiency and effectiveness of commonwealth agencies.

Information regarding ANAO audit reports, better practice guides and handbooks is available on the Internet at the following address:

<http://www.anao.gov.au>

The persons, organisations and events described in the case study presented in this guide are fictional. Any similarity with any actual person or organisation referred to in the case study is unintended. To the extent that there is any similarity with actual persons or organisations, no inference or conclusion should be drawn on the basis of the events described in the case study.

© Commonwealth of Australia

ISBN 0 644 38921 4

Designed by Art Attack, Canberra ACT

Foreword

Contracting is more prevalent than ever before in today's Australian Public Service (APS). While contracting-out the delivery of government services can offer significant benefits to the Commonwealth in terms of increased efficiency and effectiveness, the assessment of potential suppliers and the management of contracts also presents significant challenges to agencies. The effective administration of Commonwealth contracts with non-government suppliers requires the application of sound risk management practices aimed at protecting the interests of the Commonwealth and ensuring that contract outcomes are achieved. Thus assurance and performance are twin goals of contract management.

This better practice guide has its origins in an audit of matters relevant to a contract between the Department of Employment, Education, Training and Youth Affairs and South Pacific Cruise Lines Ltd (SPCL) (Audit Report No. 24 of 1997-98). In particular, the audit identified the need to apply accepted risk management practices to procurement activities, including assessing the financial and probity risks associated with non-government suppliers, as a critical factor affecting the administration and management of the contract.

The aim of this guide is to provide a framework which can be used by APS officers to assess some of the financial and probity risks associated with contracting with non-government suppliers. There are, of course, other risks that require assessment with respect to procurement activities. As well, the level and nature of risk assessment and management undertaken with respect to procurement activities will vary according to the size, type and complexity of the procurement. This guide is not intended to provide an exhaustive risk management framework for procurement activities; rather the guide focuses on **one aspect** of the procurement process and should be read in conjunction with the following publications:

- Department of Finance and Administration 'Commonwealth Procurement Guidelines: Core Policies and Principles', May 1998
- Purchasing Australia 'Managing Risk in Procurement - A Handbook' 1996
- Purchasing Australia 'Applying Risk Management Techniques to Complex Procurement', 1997
- MAB/MIAC Report No. 22 'Guidelines for Managing Risk in the Australian Public Service' October 1996

This guide is relevant to all APS officers involved in contracting and should be read in conjunction with:

- Commonwealth Procurement Guidelines
- Managing Risk in Procurement - A Handbook
- Applying Risk Management Techniques to Complex Procurement
- Guidelines for Managing Risk in the Australian Public Service
- Before You Sign the Dotted Line...Ensuring Contracts Can Be Managed
- Performance Information Principles
- Control Structures in the Commonwealth Public Sector

The sources of these documents are included in the text.

- MAB/MIAC Report No. 23 *'Before You Sign The Dotted Line...Ensuring Contracts Can Be Managed'* May 1997
- ANAO/DOFA Better Practice Guide *'Performance Information Principles'*, November 1996
- ANAO Better Practice Guide to Effective Control *'Control Structures in the Commonwealth Public Sector'*, December 1997.

Chapter 1.1 of the guide provides an overview of the importance of effectively managing risk and describes the fundamental elements of risk management, including the identification, analysis, evaluation and treatment of risks, relative to the stage of procurement where a preferred supplier is identified. A risk assessment matrix is presented that can be used to make an overall assessment of the ability of a potential supplier to deliver successfully the services/products contemplated under an intended contract.

The six areas of risk contained in the matrix are discussed in Part 2, Chapters 2.1 to 2.6, of the guide. Each chapter includes an explanation of the objective of assessing the area of risk, points to consider in undertaking the risk assessment and a list of sources of publicly available information that can be used to assist in making such an assessment. These latter sources of publicly available information are described in detail at Appendix B. Chapter 2.7 discusses the treatment of identified risks. Throughout the guide, a case study is used to illustrate the specific concepts discussed.

In developing this better practice guide, the ANAO sought the assistance of the accounting firm, KPMG, in deriving a checklist of some of the important financial and probity risks that need to be assessed with respect to non-government suppliers. The Department of Finance and Administration and the Department of Employment, Education, Training and Youth Affairs also contributed to the guide. The ANAO very much appreciates the assistance which these various organisations provided to enhance this project.



P.J.Barrett

Auditor-General

October 1998

Contents

This part of the guide provides an overview of the importance of managing risk and describes the main elements of risk management.

A risk assessment matrix is presented that can be used by agencies to make an overall assessment of the ability of a supplier to deliver the services being contracted.

Part 2 of the guide provides detailed guidance on how to use the risk assessment matrix presented in Chapter 1.1 to determine the overall level of risk associated with using a supplier. The treatment of identified risks is also discussed. The case study provided in Chapter 1.1 is used throughout this part of the guide to illustrate the concepts discussed.

Part 3 of the guide summarises the key risk management concepts. The importance of effectively managing the risks associated with contracting non-government suppliers is emphasised.

PART 1 OVERVIEW

Chapter 1.1 Managing Risk	9
• Introduction	9
• Risk Management - Fundamental elements	10
• Managing risks associated with suppliers	16
• Assessing the risk of using a non-government supplier - A case study	18

PART 2 RISK ASSESSMENT AND TREATMENT

Chapter 2.1 History and Development of the Supplier's Business	22
Chapter 2.2 Legal Background and Capital Structure	24
Chapter 2.3 Critical Performance Elements of the Contract	26
Chapter 2.4 Management and Employees	28
Chapter 2.5 Commitment, Contingencies and Litigation	30
Chapter 2.6 Financial Viability	32
Chapter 2.7 Risk Treatments	34

PART 3 CONCLUSION

Chapter 3.1 Managing Supplier Risk - Key Concepts	38
---	----

PART 4

APPENDICES

Appendix A	Business Structure of the Supplier	42
Appendix B	Sources of Relevant Publicly Available Information	44
Appendix C	Information Available from the Supplier	46
Appendix D	Glossary of Terms	48

Part 1

OVERVIEW

1.1 Managing Risk

Introduction

Risk Management -
Fundamental elements

Managing risks associated
with suppliers

Assessing the risk of using a
non-government supplier -
A case study



1.1 Managing Risk

Introduction

Managing risk is an essential element of good management practice. The benefits of effective risk management include improved transparency in decision-making (thereby increasing accountability); effective and efficient allocation of resources; more creative and innovative management practice; increased standards of client service; and the capacity to manage in the face of competing obligations.

It is also important to note, however, that effective risk management encompasses the acceptance of small mistakes while encouraging managers to consider what lessons can be learned and how to avoid the same mistakes in the future.

In an environment increasingly characterised by contracts with non-government suppliers for the provision of goods and/or services on behalf of the Commonwealth, the application of sound risk management practices by APS officers, aimed at protecting the interests of the Commonwealth and ensuring that contract outcomes are effectively achieved, is vital. The key to such an approach is being proactive, well informed and having an appropriate control environment in place.

This guide focuses on risk with respect to **one aspect** of procurement. For the purposes of this guide, procurement is defined as the entire process by which all classes of resources - that is, human, material, facilities and services- are obtained, generally for a specific project¹. Against the background of the increasing use of a range of different service delivery arrangements by the Commonwealth, risk management in relation to procurement activities can only become more important for agency management at all levels.

Risks should be identified at the earliest stages of procurement planning. However, the identification of risks is not an end in itself. Nor does the existence of risk indicate that a procurement or contract should not proceed. The challenge to managers lies in deciding whether or not risks are acceptable, that is, whether they can be managed efficiently and effectively.

Managing risk is a dynamic exercise. To be effective, the risk management process needs to be rigorous and systematic. It demands that a plan of action be developed in relation to identified risks that minimises the likelihood and consequences of these occurring. As well, the plan needs to be continually monitored and reviewed

Risk is defined as 'the chance of something happening that will have an impact upon objectives. It is measured in terms of consequences and likelihood'.²

To be effective, the risk management process needs to be rigorous and systematic.

¹ Purchasing Australia, *Managing Risk in Procurement - A Handbook*, 1996 p5

² Australian Standard, AS/NZS 4360:1995

The management of risks involves

'The systematic application of management policies, procedures and practices to the tasks of identifying, analysing, assessing, treating and monitoring risk'.⁴

Information discovered at one stage of the risk management process may require a review of previous stages.

Costs incurred in managing risk should be commensurate with benefits in terms of reduced levels of risk.

because risks not only change over time but their relative significance may also change, as may the mechanisms and tools required to manage the risks efficiently and effectively.

Additionally, a key to the risk management process is maintaining and improving the transparency of the decision-making process. This does not mean additional bureaucracy, but clearly stating decisions and factors which led to those decisions as part of the assurance process. This is a discipline that promotes probity³ and openness of decision-making within the APS and is critical to the successful application of risk management by agencies and to the confidence of the various stakeholders, such as Parliament.

Agencies can assist employees in retaining appropriate levels of documentation through developing risk management guidelines which indicate the nature, type and extent of information to be maintained. Such documentation should be easily accessible in corporate data systems with appropriate search facilities.

Risk management - Fundamental elements

Figure 1 (page 14) outlines the fundamental elements of the risk management process⁵ and relates these to the stage of procurement where tenders are evaluated and a preferred supplier is identified. Although the model may seem to present risk management as six sequential stages, in practice they are not necessarily strictly sequential. Certainly there are six separate and definable processes, but information discovered at one stage may require the agency to return to previous stages. The sixth stage, monitoring and review, is a continuing process and is therefore shown in Figure 1 as relating to each of the other five stages of the risk management process.

The identification, analysis, assessment, treatment and monitoring of risks associated with contracting with non-government suppliers will contribute significantly to successful outputs and outcomes.⁶ However, the costs incurred in managing risk should be commensurate with the size, type and complexity of the procurement or contract and the benefits in terms of reduced levels of risk. This principle supports achieving the primary value for money objective.⁷

³ The term probity is used to refer to the integrity of processes, such as the tendering and contracting or risk management process. In this guide, the ANAO has also used the term probity to refer to the examination of aspects of a supplier's business for the purpose of establishing the integrity and capability of the supplier to deliver the services contracted.

⁴ AS/NZS 4360:1995, loc.cit.

⁵ These elements are based on those articulated by MAB/MIAC in Report No. 22, Guidelines for Managing Risk in the Australian Public Service

⁶ Commonwealth Procurement Guidelines, July 1997, p87

⁷ *ibid.*

The extent of risk management required depends on such aspects as the nature, value and complexity of the procurement.

The outcome of the risk management process will be a risk management plan, or other appropriate documentation, that identifies and ranks all risks as to their priority and impact and documents the strategy/s to treat the risk.

It should be noted that contracting with government suppliers is not risk free and the contract documents should incorporate effective treatments for the identified key risks. However, the type and level of risk encountered will usually be of a different nature than when contracting with non-government suppliers. For example, the financial viability of a government supplier will normally be low risk and readily established as such.

Context and identification of risk

During the initial stages of procurement planning, that is when the need for a procurement is identified and specifications for the purchase/contract are determined, the extent of risk management required in relation to the procurement project needs to be established. The extent of risk management required can range from:

- minimal - that is, simple process checks and random accounting tests; to
- significant - that is, engaging in a high level of strategic planning, analysis and documentation.⁸

The decision regarding the extent of risk management required depends on the context of the procurement, including the agency's internal and external operating environment, the outcomes to be achieved through the procurement project and such things as the nature, value and complexity of the procurement. As a guide, all major or complex purchases of goods and services should have a documented risk management plan.

Once the basic risk management requirements are determined through indicators such as dollar value, complexity of the project and length (time) of the contract, the risk management process outlined in Figure 1 should be applied to each stage of the procurement process. The outcome of this process will be a risk management plan, or other appropriate documentation, that identifies and ranks all of the risks associated with a procurement and documents the way/s in which these risks will be treated in order to protect the interests of the Commonwealth and ensure that contract outputs and outcomes are achieved.

As previously stressed, this guide focuses on **one stage** of the procurement process, that is the stage at which tenders are evaluated and a preferred supplier is identified. During this stage of the procurement process, a typical risk to the Commonwealth is the selection of an inappropriate supplier. The consequence may be the failure of that supplier to fulfil the contract. Selection risk

⁸ Purchasing Australia, op.cit., p. 8

There are many factors which need to be considered when deciding to accept a risk.

Expert advice may be needed in order to assess the level of risk.

would be identified in the 'identify risks' step after the context of the purchase has been established. This risk should then be analysed, evaluated and prioritised along with all other risks identified for the procurement. It should be noted that in complex or highly sensitive procurement processes, the identification, analysis and evaluation of the risks associated with contracting an unsuitable supplier should also be considered at the time the request for tender documentation is being developed.

Analysing, evaluating and prioritising risks

These important, but difficult stages of risk management involve deciding, for example, whether risks are acceptable or unacceptable. There are many factors which need to be considered when deciding to accept a risk. These include the:

- degree of control that the agency has over the risk;
- cost, impact, benefits and opportunities afforded by the risk;
- level of risk determined in the analysis stage;
- resources available to treat the risk; and
- availability of treatment options.

It is critical that any risk assessment be performed by people who have the expertise to gather the necessary information upon which to base a realistic assessment, as well as the evaluation skills required to determine the level and nature of the risk being treated and its relative priority.

Careful consideration is required to determine the extent of evidence necessary to validate findings and conclusions regarding the level and nature of an identified risk. Adequate consideration should therefore be given as to whether an outside expert is required to assist in this process. This expertise may need to be sought locally or internationally depending on the nature and complexity of the project.

While expert advice may need to be sought at any stage of the risk management process, those stages that deal with the analysis of a potential supplier's legal background, capital structure, financial commitments and viability are more likely to involve expert assessment of highly complex information. Therefore, agencies are most likely to require external assistance when assessing these areas of risk. As a result, this aspect has been highlighted in appropriate sections of the guide.

In major procurement exercises agencies should also evaluate the need to centralise the more technical and complex areas of analysis, for example the assessment of financial viability.

Aim to reduce risk to a level that is acceptable to the agency.

Insert appropriate contract clauses to reduce risk.

Seek adequate and timely legal advice when constructing the contract.

Treating risks

Treating risks involves considering alternative options for dealing with those risks that are assessed as unacceptable. The aim is to reduce the risk to a level that is acceptable by the agency. Broadly speaking, there are three options for the treatment of risk:

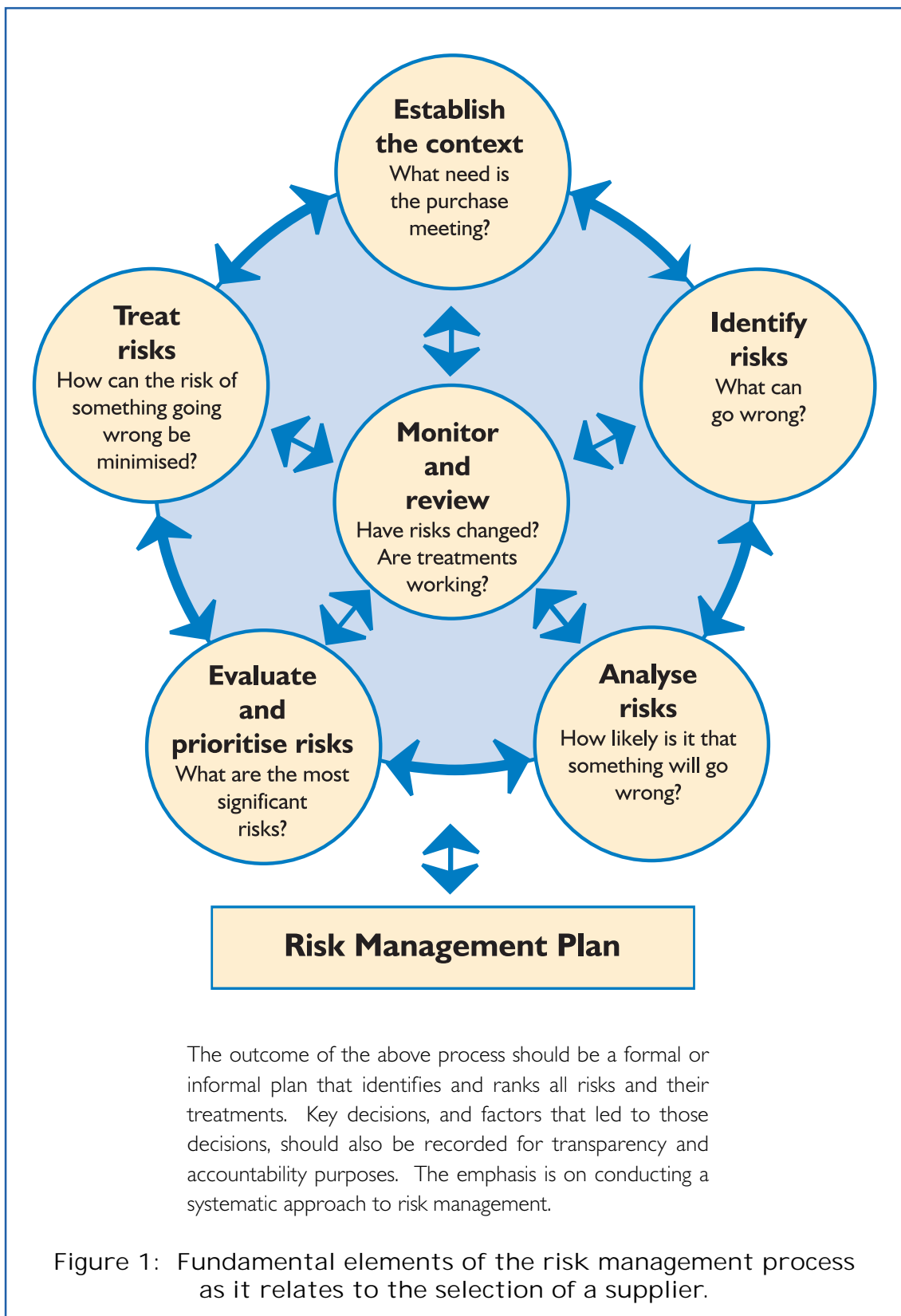
- avoid the risk;
- reduce the level of risk by reducing the consequence or likelihood (or both); and
- transfer the risk.

To treat the risk of contracting an inappropriate supplier, offers from high risk suppliers can be rejected (avoid risk). On the other hand, appropriate steps would need to be taken to fully protect the Commonwealth's interests if a decision were made to proceed with a particular supplier on other grounds even though there would be some risk that those concerned would not be able to fulfil the contract. These steps could include:

- the insertion of appropriate clauses in the contract linking payments to the achievement of identified milestones and/or standards of service delivery, for example making payment only when services are provided rather than in advance; and
- a provision in the contract requiring regular performance reporting in order to monitor risks to the achievement of contract outputs and outcomes.

In each case adequate and timely legal advice should be sought in order to ensure that such clauses achieve the intended effect and do not conflict with another clause, or clauses, of the contract.

The Risk Management Process



1. Establish the context

What need is the purchase meeting?

- • **review agency's goal, objectives and management systems, and strategies to achieve these**

For example, in selecting the preferred supplier, review the agency goal or program objective/s that are to be met by the procurement, including any relevant program guidelines relating to the selection of suppliers. Identify the relevant Commonwealth and agency guidelines relating to procurement, financial and contract management to be followed in assessing such things as value for money. This process will contribute to the establishment of criteria against which to analyse risks.
- • **establish the framework to be applied to the procurement**

A consistent, strategic approach, based on common criteria, understanding, methodology and procedures, should be developed in order to minimise unnecessary subjectivity in the decision-making process and to ensure that risk management is comprehensive. This should enable risks to be compared across projects and prioritised according to a common measurement scale.

In order to integrate risk management effectively into the procurement process, the broad stages of the procurement process should be identified. The identification and analysis of risks at each stage in the process would then be undertaken with reference to the established criteria. For example, when planning the procurement, risks identified could be analysed against criteria derived from program objectives or guidelines.
- • **identify the stakeholders and their objectives**
- • **specifically define each stage of the procurement process and the tasks that need to be undertaken during each stage**

For example, a critical task leading to the identification of a preferred supplier is the assessment of the tender or proposal submitted, including an assessment of the commercial viability and relevant experience of the supplier in relation to the proposed contract.
- • **specify the critical success factors for measuring the success of the procurement**

Establish performance measures such as milestones, standards of service delivery, and the outputs and outcomes to be achieved to allow effective monitoring of the success of the procurement.

2. Identify risks

What can go wrong?

- • **identify all of the risks associated with selecting the supplier**

For example, chapters 2.1 to 2.6 of this guide discuss six potential areas of risk, including financial viability, commercial/legal relationships and management and staff capabilities, that should be assessed when selecting a supplier. Within each chapter the 'points to consider' identify specific risks that may be relevant to your procurement, and therefore need to be assessed. If an inappropriate supplier is selected, the consequence may be that the supplier is unable to deliver the services contracted.
- • **outline the resources and research required to analyse risks (next step)**

For example, careful consideration should be given to the type and quantity of information required to undertake an adequate risk assessment.

3. Analyse risks

How likely is it that something will go wrong and how serious are the consequences?

- • **determine the level of risk, that is the likelihood and consequences of an event occurring**

For example, what is the likelihood and consequence of a change in the financial situation or management structure of the potential supplier? How would such a change affect the supplier's ability to fulfil the terms of the contract?
- • **determine the current controls which may detect or prevent the likelihood and consequence of a risk occurring**

For example, what authorisation, approval and checking procedures are in place to minimise the risk of contracting an inappropriate supplier? Are contracts managed by a project officer who monitors performance and approves payments under the contract?

Assess the ability of the supplier to successfully deliver the contracted services.

Managing risks associated with suppliers

The remaining chapters of this guide provide a framework, based on the risk assessment matrix shown in Figure 2 below, that is intended to assist agencies to reduce the risk of the Commonwealth contracting with an inappropriate supplier. The matrix can be used to make an overall assessment of the ability of a potential supplier to deliver successfully the services/products contemplated under an intended contract, after individual areas of risk are evaluated. Upon completion of this risk matrix it should become apparent whether the potential supplier constitutes a high, medium or low risk.

In assigning an overall risk rating, a 'high risk' rating may arise where, for example, a critical element of the transaction cannot be confirmed at the time of completing the matrix. However, if it is possible to mitigate this factor by altering the conditions of the contract commensurately, then the level of risk may be reassessed and a lower risk rating assigned.

Figure 2: Risk assessment matrix

Summary of Risk Escalation	Low	Med	High
1. History and development of the supplier's business			
2. Legal background and capital structure			
3. Critical performance elements of the contract			
4. Management and employees			
5. Commitment, contingencies and litigation			
6. Financial viability			

A 'high risk' rating on a particular aspect of the matrix may also be compensated for by the demonstrated ability of the supplier's business to manage this risk. For example, changes in management may be considered high risk. However this may be overcome by examining the expertise of any new management and their background and experience in relation to the proposed contract.

Higher risk should result in a higher level of control through contract clauses.

If it is decided that a potential supplier is high/moderate risk, it will be necessary to consider strategies to mitigate any possible adverse consequence that may arise if the decision is made to proceed further with the supplier. Such measures may include some combination of the following:

- providing a guarantee by an entity related to the supplier;
- regular performance reporting and access to all the supplier's financial and other relevant records;
- inserting conditions in the contract relating to the timing/standard of service delivery;
- linking progress payments to the achievement of clearly identified contract milestones, that is, payment to the supplier only for work successfully completed; and
- making contingent events conditional within any contract entered into by the parties.

In general, as supplier risk increases, treatments required to manage the risk to the Commonwealth are more complex. Thus, if the decision is taken to enter a contractual relationship, higher risk could well require more onerous conditions to be built into the contract between the Commonwealth and the supplier.

The six areas of risk contained in the risk assessment matrix, (Figure 2), are discussed in more detail in Part 2, Chapters 2.1 to 2.6, of the guide. Each chapter includes an explanation of the objective of assessing the area of risk, points to consider in undertaking the risk assessment and a list of sources of publicly available information that can be used to assist in making such an assessment. These latter sources of publicly available information are described in detail at Appendix B. Chapter 2.7 discusses the treatment of identified risks. Throughout the guide, a case study is used to illustrate the specific concepts discussed.

The case study is an example of a medium level complexity procurement project. It is not intended to be an all encompassing, definitive case study, for example, it does not canvass the policy dimensions in relation to the project. Rather, it is intended to focus specifically on assessing the risk associated with a particular supplier and highlights the key points made in each chapter.

While, in this case study, the nature of the program is such that individual suppliers can submit proposals to the Department at any time, the principles remain the same for competitive tender situations where multiple suppliers are being evaluated.

Assessing the risk of using a non-government supplier: A case study

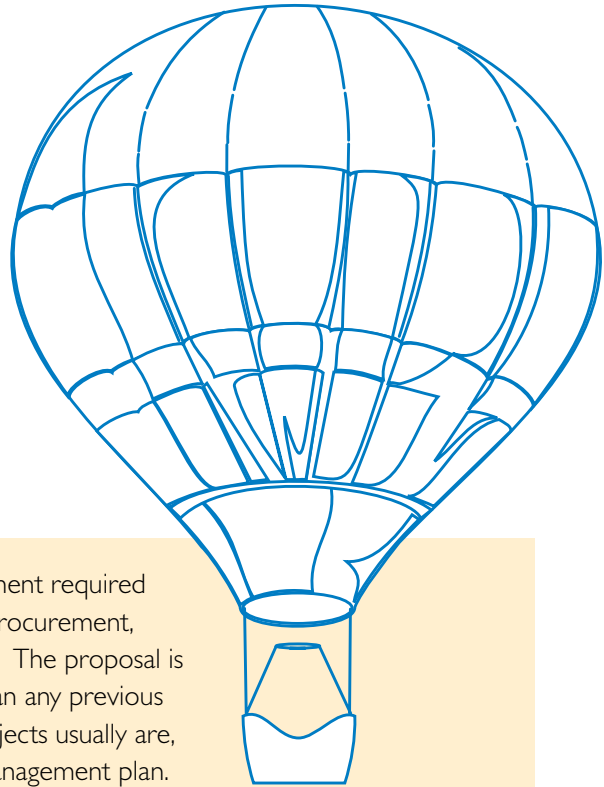
The following case study is used throughout the better practice guide as an example of the risk assessment process for a proposed supplier of any goods or services.

A small unit in a large Commonwealth department administers a Program for Improvements to the Environment (PIE). The unit funds projects that result in improved environmental conditions for specified areas in need. The PIE unit processes many proposals, typically from environmental bodies who have previously dealt with the unit and are well-known non-profit environmental groups.

The PIE unit is approached by Live Earth, an environmental group that has had numerous contracts with the department in the past. The group proposes to clean up and replant native flora in a national park that is a specified area in need according to the PIE guidelines. Completion of the project has been assessed by the PIE unit as a high priority in terms of meeting overall program objectives. The execution of a contract for the project is therefore considered a priority for the PIE unit.

Previously tourists were allowed to drive through the national park resulting in degradation of the environment from tyre tracks and littering. Live Earth introduces to the PIE unit a new company, Up-In-The-Air, that is intending to set up a hot-air ballooning operation. Up-In-The-Air will be a new entrant to the tourism industry and will compete with established tour operators.

Live Earth's proposal is for the department to close the national park to motor vehicles. Using funds from the department's PIE program, Live Earth will clean up the park and plant native flora to redress the soil degradation resulting from the tourist traffic; alternative tourist access to the park is a key contractual condition. The new company, Up-In-The-Air, will then start a hot-air ballooning operation that will provide sightseeing of the park for tourists, which will boost the local economy and provide employment opportunities. Involvement of Up-In-The-Air is essential for the project to proceed - they will provide the labour and materials for the clean-up work (concurrent with the development of the ballooning operation), while Live Earth will provide the environmental expertise.



The PIE unit determined the extent of risk management required for this project and established the context of the procurement, in line with appropriate risk management processes. The proposal is for a contract involving significantly more money than any previous PIE projects, and is also more complex than PIE projects usually are, so it is decided to implement a documented risk management plan.

In identifying the risks to this proposed project, the risk of Live Earth not being able to meet its contractual obligations emerges. In assessing this risk the unit is aware that Live Earth has a long and successful history of dealing with the department on environmental projects. However, the group's experience with a tourism operation is questionable. As well, this is a significantly larger and more complex project than Live Earth has previously dealt with. It is determined that this risk required an assessment by the PIE unit.

As the PIE unit begins to assess Live Earth's ability to fulfil its contractual obligations, Up-In-The-Air approaches the PIE unit and asks that the contract be between the department and Up-In-The-Air, rather than with the environmental group. The reason cited by Up-In-The-Air is that it is about to be floated on the stock exchange and that a major departmental contract would enhance its prospectus. The PIE unit realises that even though the contract would be essentially the same, simply with a different party contracting with the department, the assumptions behind the risk management process have now changed and that the risks need to be reconsidered. The PIE unit decides that the risk of Up-In-The-Air not meeting its contractual obligations merits a risk assessment of Up-In-The-Air.

The overarching objective is to assess the ability of the intended supplier to deliver successfully the services/products contemplated under the intended contract.

Part 2

RISK ASSESSMENT AND TREATMENT

- 2.1 History and Development of the Supplier's Business
- 2.2 Legal Background and Capital Structure
- 2.3 Critical Performance Elements of the Contract
- 2.4 Management and Employees
- 2.5 Commitment, Contingencies and Litigation
- 2.6 Financial Viability
- 2.7 Risk Treatments



2.1 History and Development of the Supplier's Business

Objective:

To assess whether the business is well established in the industry and whether it has appropriate credentials for, and relevant successful experience in, delivering the type of services/products contemplated under the proposed contract.

Points to consider:

Longevity/stability of the business

A business that has been operating for, say, less than two years could be considered high risk while a business that has been operating for more than two years but has undergone a change in its line of business may be considered medium risk (or may be high risk if it has undergone major changes in business activity). Numerous changes to directors and/or management could be considered a high risk.

Principal activities and past successes

Consider whether the principal activity and past successes of the business are relevant to the proposed contract and, therefore, whether the business has relevant experience in delivering the contracted services. If the business has contracted to Commonwealth or State Governments previously, contact the relevant agency to find out about their dealings with the proposed business or its directors - an adverse report may increase the level of risk assigned to the organisation.

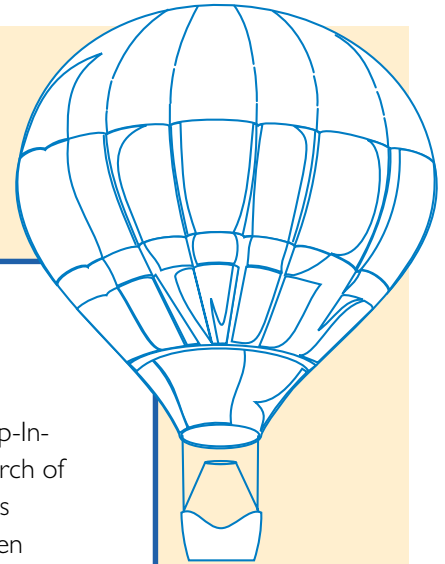
Market experience

Consideration should be given as to how well the business is placed within the relevant market, for example is the business a leader in the market or a relatively new entrant to a market with numerous competitors.

Sources of information:

- Australian Securities Commission (ASC) searches
- Australian Stock Exchange (for listed companies)
- proposed supplier/contractor

NB. For more detail on the above aspects see Appendices A, B and C



Case study:

The PIE unit sought to establish whether Up-In-The-Air was an established business. A search of Up-In-The-Air with the Australian Securities Commission (ASC) revealed that it had been registered only four months earlier as an unlisted private company and that there had been a number of changes to the directors of the company. The ASC search named the current company directors, and reported that the principal activity of the company was described as "shelf company". Given that Up-In-The-Air had been operating for a very short period of time and had experienced numerous changes to its company directors, the company was assessed as being high risk.

The information obtained from the ASC as well as from discussions with Up-In-The-Air did not provide evidence of any particular expertise in tourism-related business. The PIE unit considered that this also represented a high level of risk in relation to the project.

Risk Assessment Matrix

Summary of Risk Escalation	Low	Med	High
I. History and development of the supplier's business			●

2.2 Legal Background and Capital Structure

Objective:

To assess whether the business's legal arrangements are transparent in terms of ownership and share holdings, and whether there are any legal agreements or loan arrangements that may adversely affect the business's ability to fulfil the proposed contract.

Points to consider:

Ownership

Examine any entities related to the business as well as its shareholding. If the corporate structure of the business is complex and ultimate ownership is unclear, the business should be considered high risk.

Control of the business

Examine authorised and issued share capital and rights attached to shares. Investigate the integrity of shareholders with significant influence over the business. If shareholders are not identifiable, or different types of shares create uncertainty about ownership and control, the business should be considered high risk.

Loan arrangements

Review all loans and borrowings and examine security, restrictions imposed and interest rates. Consider changes in borrowing requirements over the intended period of the contract. If loan arrangements require considerable repayments during the contract period, the business should be considered high risk.

Legal agreements

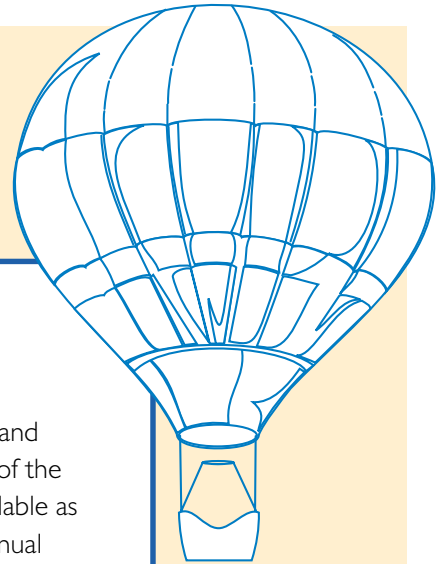
If there are legal agreements in place that appear to significantly constrain and influence the business, the business should be considered high risk.

A risk assessment of the legal background and capital structure of a potential supplier may involve a complicated financial assessment of a business's operations. Therefore, it is important that officers have the relevant skills and expertise necessary to gather and evaluate appropriate information in order to assess the level and nature of risk associated with a particular supplier. Where officers do not have the necessary skills, the agency should seek expert advice in relation to this assessment.

Sources of information:

- ASC searches
- Australian Stock Exchange (for listed companies)
- proposed supplier/contractor

NB. For more detail on the above aspects see Appendices A, B and C.



Case study:

The PIE unit assessed the legal background and capital structure of Up-In-The-Air. Details of the shareholders of Up-In-The-Air were unavailable as the company had not yet lodged its first annual return with the ASC. As a result of being unable to obtain information about the shareholders, corporate structure and loans and borrowings of Up-In-The-Air, the PIE unit assessed the company as being high risk against this criterion. The PIE unit could also not find any evidence of a prospectus being prepared so that Up-In-The-Air could be floated on the stock exchange. Under the circumstances, this also warrants assessment as a high risk.

Risk Assessment Matrix

Summary of Risk Escalation	Low	Med	High
1. History and development of the supplier's business			●
2. Legal background and capital structure			●

2.3 Critical Performance Elements of the Contract

Objective:

To assess what elements are critical for the performance of the contract and whether the business owns, or is legally entitled to, those critical elements.

Points to consider:

Availability of critical elements ▶

Consider whether the business has available to it the elements critical to the performance of the contract (for example, a particular technology, capital equipment, infrastructure or intellectual property rights). If the critical elements are not in existence; are not readily available; or if the business does not own or is not legally entitled to the critical elements; the business should be considered high risk.

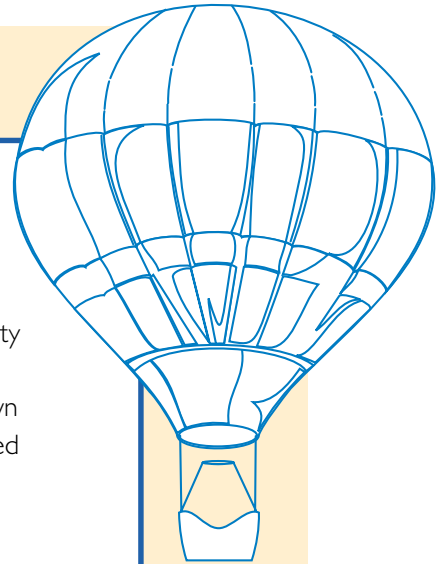
Reliance on another party ▶

If another party is responsible for the availability of elements critical to the performance of the contract (for example, if the delivery of technology, capital equipment or training is to be sub-contracted) the business should be considered medium risk. Consideration could also be given to undertaking a risk assessment of any proposed sub-contractors, and their ability to deliver the services being sub-contracted, prior to the agency agreeing to any sub-contract arrangement.

Sources of information:

- proposed supplier/contractor
- industry experts

NB. For more detail on the above aspects see Appendices A, B and C.



Case study:

The PIE unit identified that an element that was critical to Up-In-The-Air's performance of the contract was the availability of hot-air balloons to the company. Through inquiries with Up-In-The-Air, it was established that the company did not own or presently lease any balloons. However, the company assured the PIE unit that it would obtain them. The company did not currently have any balloons available to it so it was assessed as high risk in terms of the availability of critical elements.

A few days later Up-In-The-Air provided a lease document for a number of hot-air balloons to the PIE unit. The PIE unit considered that Up-In-The-Air's level of risk against this criterion should be reassessed on the basis of the existence of the lease document. The unit was concerned, however, to ensure that it did not expose the Commonwealth to an unnecessary level of risk. In particular, the unit identified a risk of the balloons not being operational by the proposed commencement date for the project due to lead-times involved in training balloon operators. The PIE unit asked the department's legal group for advice.

The legal group advised the PIE unit that, in order to mitigate the risk of balloons not being operational by the required commencement date for the project, a clause should be inserted into the contract specifying that balloons must be operational, including the completion of all necessary training for the balloon operators, by a particular date. The achievement of this contract milestone could then be effectively monitored by the PIE unit. However, Up-In-The-Air would have to agree to the addition of a clause to this effect in the contract. Providing that an appropriate contractual clause was agreed between the parties (including legal group), the PIE unit was prepared to reassess Up-In-The-Air as medium risk with respect to critical elements.

Risk Assessment Matrix

Summary of Risk Escalation	Low	Med	High
1. History and development of the supplier's business			●
2. Legal background and capital structure			●
3. Critical performance elements of the contract		●	

2.4 Management and Employees

Objective:

To assess whether the business has a team of competent directors and/or managers with reasonable continuity of service and whether the interests or backgrounds of key executives are likely to have an impact on the delivery of the contracted services.

Points to consider:

Experience of management team

If a review of the organisation chart of management structure indicates a lack of experience of the management team, the business may be considered high risk.

Continuity of directors/management

Consider the reasons for directors or managers leaving within the past twelve months. Strong continuity of service suggests low risk; numerous changes to directors and/or management should be considered high risk; while changes in management that result in greater depth of management may reduce the level of risk assigned.

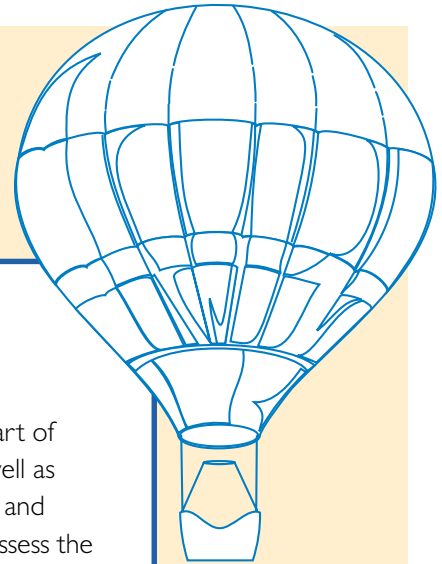
Directors' backgrounds

Assess the directors and senior executives' qualifications, experience, years of service, position prior to joining the business, other directorships, loan accounts and interests in any contracts. If directors do not appear to have sufficient qualifications or experience, have not previously held a directorship or have held numerous short-term directorships, the business may be considered high risk. Also consider whether directors, significant stakeholders or senior directors are subject to criminal investigation, for example in relation to fraud or misrepresentation.

Sources of information:

- ASC searches
- proposed supplier/contractor

NB. For more detail on the above aspects see Appendices A, B and C.



Case study:

Up-In-The-Air provided its organisation chart of management structure to the PIE unit, as well as particulars of current and former directors and senior managers. The PIE unit needed to assess the experience of the management team and how the experience and backgrounds of, and changes to, directors and senior management may impact on the proposed contract. As the ASC search had established, there were numerous changes to the company directors in the short time that the company had been in existence. The organisation chart provided by Up-In-The-Air was rudimentary and did not clearly indicate lines of responsibility in the company. The PIE unit could therefore not adequately assess whether the management team was appropriately skilled and experienced. Although Up-In-The-Air provided reasons for the changes in directors, the number of changes in a short period of time indicated a high risk. The current management team's experience and background did not provide assurance that Up-In-The-Air had appropriately experienced and committed personnel to meet its contractual obligations. Up-In-The-Air was assessed as high risk against this area of risk.

Risk Assessment Matrix

Summary of Risk Escalation	Low	Med	High
1. History and development of the supplier's business			●
2. Legal background and capital structure			●
3. Critical performance elements of the contract		●	
4. Management and employees			●

2.5 Commitment, Contingencies and Litigation

Objective:

To assess how a business's capital commitments, contingent liabilities or outstanding litigation might affect the business's ability to fulfil the contract and whether relevant insurance or other cover is adequate.

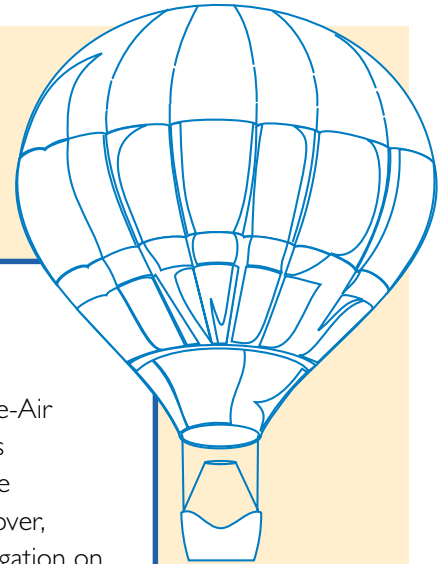
Points to consider:

Capital commitment	Consider whether adequate financing is in place to satisfy commitments over the period of the proposed contract. Consider the effect of significant or onerous non-cancellable commitments on the business's ability to deliver the contracted services. If the level of capital commitment appears excessive, the business should be considered high risk.
Insurance cover	Consider whether the level and type of insurance or other cover are adequate and what exclusions and deductibles apply to the cover. In particular, consider whether the business has adequate insurance to specifically cover professional indemnity, public liability and other potentially catastrophic events. If insurance cover is not current or does not cover the value of the contract, the business should be considered high risk.
Litigation	Consider the nature, value and impact on future operations of any significant litigation that the business has been involved in, including investigation of possible fraud. If the business is still involved in litigation, carefully consider the effect of this on the business's ability to fulfil the contract. Unresolved litigation should usually be considered high risk.
Contingent liabilities	Consider liabilities of a contingent nature and the commercial implications for the business and its ability to deliver the contracted services.

Assessing this area of risk may involve a complicated financial and legal assessment of a business's operations. Where officers do not have the necessary skills and expertise to assess the level and nature of risk associated with a particular supplier, the agency should seek outside expert advice in relation to this assessment.

Sources of information:

- Australian Stock Exchange (for listed companies)
 - proposed supplier/contractor
- NB. For more detail on the above aspects see Appendices A, B and C.



Case study:

The PIE unit considered whether Up-In-The-Air had adequate financing in place to satisfy its commitments. The unit also considered the implications of Up-In-The-Air's insurance cover, contingent liabilities and any outstanding litigation on the potential contract. Up-In-The-Air provided information that revealed that the company had no current commitments and that it had no outstanding, threatened or prior litigation. Up-In-The-Air did not provide a schedule of contingent liabilities because it had not considered this before. Up-In-The-Air's lawyers provided a statement that concurred with the company's representations.

Given that Up-In-The-Air was a new company that had not previously operated a ballooning business, the PIE unit considered that it was unlikely to have contingent liabilities. Up-In-The-Air provided a copy of its insurance cover for its intended hot-air ballooning business. A further check with the insurance firm satisfied the PIE unit that the insurance was adequate for the intended business. The PIE unit discussed these findings with the departmental legal group and concluded that Up-In-The-Air was low risk against this area of risk.

Risk Assessment Matrix

Summary of Risk Escalation	Low	Med	High
1. History and development of the supplier's business			●
2. Legal background and capital structure			●
3. Critical performance elements of the contract		●	●
4. Management and employees			●
5. Commitment, contingencies and litigation	●		

2.6 Financial Viability

Objective:

To assess financial aspects of the business to determine whether it is an ongoing concern, solvent and profitable enough to supply services or goods for at least the period of the proposed contract.

Points to consider:

Financial strength and viability

Assess ratios and trends involving net worth, working capital, reserves and revenue to determine the ability of the business to supply the services/products contemplated for at least the contract period. This assessment will require the collection of more than one year's financial statements from the business. Qualitative information such as that covered in chapters 2.1 and 2.3 is also important in assessing financial strength and viability.

Gearing level and credit rating

Assess gearing, borrowing requirements and capital requirements. If gearing levels are high this indicates a high level of risk. Also consider the business's credit rating. A poor credit rating may indicate a high level of risk.

Contingency funding and current level of operations

Other sources of funding and current and future operations should be considered. It is in the interests of suppliers seeking government funding to also have funding from other sources. However, at the very least, the effects of an over reliance on funds from government sources needs to be examined.

Reasonableness of information

Audited, general purpose financial statements have strong credibility and special purpose and unaudited accounts have lesser credibility. If only unaudited or special purpose accounts can be provided, the business may be considered high risk.

Compliance with the Australian Corporations Law (if relevant)

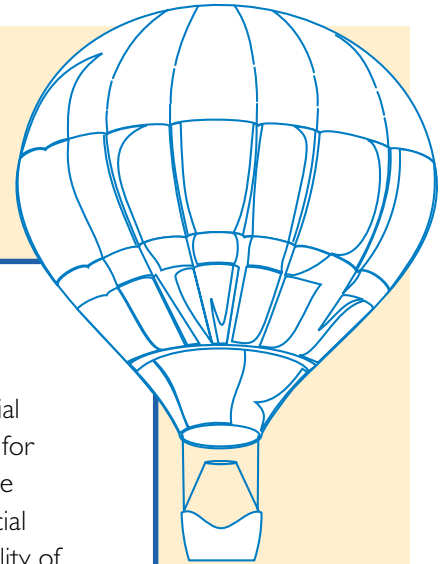
Consider, for example, whether there has been timely lodgement of financial statements and changes to directors and whether the business's accounts are audited. If financial statements have not been lodged or are not audited, the business may be considered high risk.

When assessing the financial information obtained as part of the risk assessment process, it is important that, where officers do not have the appropriate skills, an expert is engaged to evaluate the information supplied.

Sources of information:

- ASC searches
- Australian Stock Exchange (for listed companies)
- organisations that provide background information on business' operations
- proposed supplier/contractor

NB. For more detail on the above aspects see Appendices A, B and C.



Case study:

The PIE unit sought general purpose financial statements including notes to the accounts for Up-In-The-Air. The unit intended to engage suitably qualified staff to undertake a financial analysis to assess the solvency and profitability of Up-In-The-Air as well as assess the reasonableness of the information provided. However, as Up-In-The-Air is a new company, financial statements were unavailable. A credit check was obtained and revealed no credit calls on the company. The funding proposal included 'high level' projections of Up-In-The-Air's expected revenue and expenses over a three year period. Although the projected figures appeared reasonable, the PIE unit considered that in the absence of detail and substantive support, the projections offered little assurance regarding the solvency of the company during the life of the project. Overall, the lack of information available to the unit meant that Up-In-The-Air was assessed as high risk in terms of its financial viability.

Risk Assessment Matrix

Summary of Risk Escalation	Low	Med	High
1. History and development of the supplier's business			●
2. Legal background and capital structure			●
3. Critical performance elements of the contract		●	
4. Management and employees			●
5. Commitment, contingencies and litigation	●		
6. Financial viability			●

2.7 Risk Treatments

Objective:

Having identified and assessed the level and nature of the financial and probity risk associated with a non-government supplier, consideration should be given to the treatment of individual risks. It is important to consider the overall effect of the treatment on all risks, as well as the cost involved in managing/treating identified risks.

Treatment options:

There are many options for treating risks. Treatments or strategies to reduce levels of risk typically involve additional contract clauses designed to protect the interests of the Commonwealth in the event that the supplier is unable to fulfil the terms and conditions of the contract. As discussed in chapter 1.1, risk management strategies may include some combination of the following:

- providing a guarantee by an entity related to the supplier;
- regular performance reporting and access to all the supplier's financial and other relevant records;
- inserting conditions in the contract relating to the timing/standard of service delivery;
- linking progress payments to the achievement of clearly identified contract milestones, that is, payment to the supplier only for work successfully completed; and
- making contingent events conditional within any contract entered into by the parties.

Risk treatment plan:

Agencies should develop a plan, or at least a clear approach, to put the chosen treatments into effect. The plan should identify:

- the responsibility for various tasks, for example responsibility for project management (including the coordination of the project and establishing lines of communication and authority), performance monitoring and making payments under the contract;
- the relevant schedules and target dates for the project;
- the outputs and outcomes sought at various stages of the project and overall; and
- methods for monitoring and reviewing risks, for example establishing clear performance reporting requirements.

As also mentioned in chapter 1.1, as supplier risk increases, treatments required to manage the risk to the Commonwealth are more complex. It is, therefore, important that adequate and timely legal advice is sought in relation to the construction and negotiation of contracts. In particular, legal advice should be sought where changes to, or additional, contract clauses/conditions are to be imposed in order to mitigate the risks identified with a procurement.

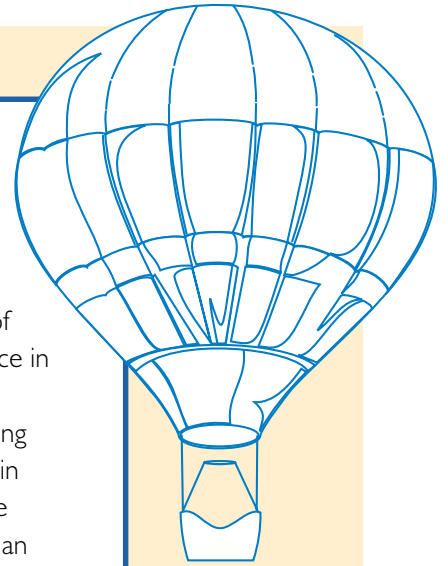
Case study:

Overall, the PIE unit assessed Up-In-The-Air as high risk on the basis of the company being newly established, having already undergone a number of changes in directors and having no prior experience in tourism operations. The risk assessment was also adversely affected as a result of Up-In-The-Air being unable to provide key information to the PIE unit in relation to the ownership and shareholdings of the company and its financial viability. However, such an assessment did not necessarily mean that a contract should not be entered into with Up-In-The-Air, rather that the contract would require effective management of the identified risks and action to ensure that the Commonwealth's interests were protected. The project remained a priority of the PIE unit in terms of achieving overall program objectives.

The unit subsequently sought the advice of the department's legal group regarding measures to take to mitigate the risk to the Commonwealth of entering into a contract with Up-In-The-Air. These included contractual conditions relating to:

- the timing and standard of delivery of services;
- regular performance reporting to enable the unit to monitor performance of the contract and take timely action to prevent slippage or address significant issues;
- withholding significant payments to Up-In-The-Air; and
- provision for the purchasing agency's right of access to all the supplier's financial and other relevant records.

The PIE unit and the department's legal group were confident that these measures would allow effective management of the contract whilst minimising the Commonwealth's exposure to risk. A contract was subsequently signed between the department and Up-In-The-Air.



Part 3

CONCLUSION

3.1 Managing Supplier Risk -
Key Concepts



3.1 Managing Supplier Risk - Key Concepts

Information must be evaluated and an informed risk assessment made.

Seek adequate and timely legal advice where changes to, or additional, contract clauses are to be imposed.


Effectively managing the risks associated with contracting non-government suppliers is critical in order to protect the interests of the Commonwealth and to ensure that contract outputs and outcomes are achieved. By adopting a sound framework for managing risk, that includes the steps outlined in this guide for assessing the financial and probity risks associated with a potential supplier, agencies can significantly reduce the Commonwealth's exposure to risk and improve contract performance.

As mentioned at the beginning of this guide, it is critical that any risk assessment be undertaken by people who have the expertise to gather the necessary information upon which to base a realistic assessment, as well as the evaluation skills required to determine the level and nature of the risks associated with the procurement activity. The existence of information in relation to an individual element of risk does not of itself indicate a particular level of risk. Information must be evaluated and an informed risk assessment made. It is therefore critical that adequate consideration be given as to whether an outside expert is required to assist in gathering and evaluating information relating to potential suppliers. This decision will depend on a number of factors including:

- the context and nature of the procurement;
- the value of the procurement; and
- the risks to program outputs and outcomes.

Implicit in assessing the nature and level of risk associated with a potential supplier is a consideration of how, whether and at what cost, identified risks should be treated/managed in order to reduce the level of risk. The costs incurred in managing identified risks will affect the assessment of a potential supplier against the value for money criterion. External expert advice may be required in relation to the nature of the risk treatment/s required.

It is equally important that adequate, relevant and timely legal advice be sought where, for instance, officers do not have appropriate training or experience in the negotiation and construction of contracts. While most agencies make use of standard contract clauses, legal advice should be sought where changes to,



or additional, contract conditions are to be imposed in order to mitigate the risks identified with a procurement. These standard contracts should also make provision for access to the supplier's records by the purchasing agency and the ANAO. Model clauses which provide such access are available from the ANAO for use by any agency.

There are many sources of information regarding risk management available to agencies and individual officers that can be used to assist in procurement planning. The aim of this guide is to provide a useful framework which can be used by APS officers to assess the financial and probity risks associated with contracting non-government suppliers. The guide is not intended to provide an exhaustive risk management framework for procurement activities; rather the guide focuses on one aspect of the procurement process and should be read in conjunction with the publications listed in the Foreword on page three.

The ANAO encourages agencies to use these sources of information to assist their staff in making sound management decisions in relation to procurement activities. Further relevant information can also be obtained from the Department of Finance and Administration and the Australian National Audit Office.

Part 4

APPENDICES

- A Business Structure of the Supplier
- B Sources of Relevant Publicly Available Information
- C Information Available from the Supplier
- D Glossary of Terms




Appendix A - Business Structure of the Supplier

A prospective supplier may conduct a business through one or a combination of different business structures. Some of those structures are:

- a listed public company;
- an unlisted public company;
- small or large proprietary companies, often referred to as a private company;
- an incorporated association;
- a trust structure;
- a partnership structure; and
- a sole trader.

Irrespective of the structure of the supplier's business, the risk assessment matrix presented in Figure 2 (page 16) provides a framework that can be used to identify facts relating to the supplier and their business and make an assessment of the ability of the supplier to deliver the contracted services. Depending on the business structure adopted by the supplier, the sources of publicly available information may be narrowed or widened. For example, if the supplier is operating as a private company, partnership, sole trader or under a trust structure information to complete the risk assessment matrix will need to be obtained directly from the supplier.

In general, the Australian Securities Commission (ASC) is the only control body covering private, listed and unlisted companies in Australia. Some financial information is publicly available through the ASC. ASC searches can be undertaken to provide information on the company and on the company directors. An ASC search provides information on when the company was registered, what type of company it is (for example an unlisted public company), changes to directors and/or company secretary, current directors, the principal activity of the company, owners, issued shares and the existence of registered charges over the assets.



The financial information required to undertake an assessment of a supplier's financial viability is the full set of general purpose financial statements including the notes to the financial accounts. These may either be obtained from the supplier or, in the case of a listed company, the Australian Stock Exchange or the Australian Securities Commission.

Information about the management of the organisation should be provided by the supplier. In particular, information about the qualifications and experience of directors and senior executives is required to assess their ability to undertake the contract successfully. A more detailed list of the information that can be obtained from the supplier is at Appendix C.

Appendix B - Sources of Relevant Publicly Available Information

Each of the chapters in Part 2 of the guide have identified sources of publicly available information that can assist agencies to assess the ability of a supplier to deliver contracted services. Further details of the type of information available from each, and the purpose for which it can be used, is provided below.

Australian Securities Commission

The ASC can provide a full copy of the latest annual report submitted by the supplier. However, it is important to note that:

- if the company is a new company and has not lodged an annual return there will be no details of shareholders;
- the dates of relevant information should be checked as it can often be out of date; and
- if information is more than three months old, confirmation of its validity and/or updated information should be obtained directly from the potential supplier.

The information obtained from the ASC can be used to make an assessment of the financial viability of the supplier.

Australian Stock Exchange

The Australian Stock Exchange can provide the following information on listed companies: announcements; annual reports; latest financial reports; changes in directors; and recent acquisitions/disposals. This information can be used to assess the history and development of the business, the business's financial viability and prospects for future growth.

Other Organisations

There are a number of organisations that are able to provide background information on business' operations. For example:

- **Dun & Bradstreet:** Dun & Bradstreet is a global corporation that provides business information services and data reports on companies. Dun & Bradstreet should be able to provide a comprehensive credit check on the potential supplier and current

The named companies are representative of companies which provide these services. The ANAO does not endorse the named companies or suggest that other companies should not be used to provide these services.

and former directors. Bankruptcy charges and orders of discharge of bankruptcy obtained from court records should also be available.

When assessing the information obtained, however, it is important to note that the information supplied to Dun & Bradstreet is generally supplied directly by individuals (for example directors) or suppliers. Accordingly, it is unlikely that disadvantageous information will be supplied.

- **Standards & Poor:** Standards & Poor provides fundamental company financial and marketing information and is a global bond rating agency. Standards & Poor is able to confirm the credit rating of public companies.
- **Credit Reference Association of Australia:** Information available from the Credit Reference Association of Australia includes: directorship details; date of incorporation of companies; details of any credit applications within the last five years; records of default; and court records relating to bankruptcy and issue of writs.

On-line (Information Technology) Services

General information available through on-line services includes:


- **Ausinet:** This service will search "key words" in selected Australian and international press articles, for example all newspapers and journals. The period of the review can be stipulated. However, the weighting assigned to information obtained through press articles should be carefully considered, and verified through other sources wherever possible, as it may not necessarily be complete or correct.
- **Bloomberg:** This is an American on-line service which records publicly available information on American, Australian and some European listed companies. Financial information is not recorded in all cases. Access to this service is through subscription.
- **Internet:** Many businesses have home pages on the Internet that provide general background information on the supplier's business. However, the information provided by individuals or businesses may not necessarily be complete or correct.

Appendix C - Information Available from the Supplier

A great deal of information is available directly from the supplier. While the previous appendix identifies numerous sources of publicly available information which is critical to the assessment of risk, it should also be noted that much of the information needed to complete the assessment can only be obtained from the supplier. However there is no legal obligation for suppliers to provide this information to agencies.

Obviously, there are benefits to both the agency and the supplier in providing information about the background and capability of the business and its employees however, for commercial reasons, the supplier may choose not to provide some information. Agencies should try to develop working relationships with suppliers and potential suppliers that encourage the provision of information about the business. This may be achieved, in part, by assuring suppliers that information provided will be maintained on a strictly confidential basis. Information that is available from the supplier includes, but is not limited to, the following:

1. Organisation chart of management structure showing lines of responsibility.
2. List of current directors and senior executives:
 - length of time with entity;
 - age and qualifications;
 - date appointed to the Board/management;
 - relevant experience and job description; and
 - interest in entity, for example loans or shares.
3. List of former directors/executives who have left in the past 12 months and their reasons for leaving.
4. Details of those executives under service contracts.

- 
5. Details of the individual/s responsible for the contract, for example experience, years of service. For individuals who have been in their present position for less than 12 months, assess the relevance of their skills, experience and qualifications to those required to successfully deliver the contracted services.
 6. Details of management processes or plans to ensure continuing development of management takes place.
 7. References from customers to whom services/products similar to those contemplated by the contract have been provided. Confirm these dealings directly with the customers.
 8. Financial information. Such information includes, for example, the full set of general purpose financial statements, including notes to the financial accounts and revenue projections.
 9. The company prospectus (if relevant).
 10. Company Corporate Plan or Mission Statement.
 11. Company memorandum or articles of association.

Appendix D - Glossary of Terms

Authorised share capital	The maximum share capital which a company is authorised by its memorandum or articles of association to issue to subscribers.
Contingent liabilities	A potential liability that will arise out of a contingency, such as the possible obligation to pay damages at some future date if the judgement in a lawsuit is awarded against the business. Contingent liabilities are recorded in the notes to the financial statements of a business.
Debt capital	That part of the financing of a business which is derived from loans that are subject to repayment rather than from shares.
Debt-equity ratio	A ratio of total liabilities divided by owner's equity. A high ratio indicates risk because the business may be unable to pay principal and interest and obtain additional financing.
Gearing	The extent of debt capital compared to share capital, as expressed by the debt-equity ratio . Thus high gearing is a heavy reliance on long-term borrowing.
Issued share capital	The amount of authorised share capital represented by the nominal value of shares actually issued.
Net worth	See owner's equity.
Owner's equity	The portion of the finance of the business provided by its owners, comprising contributions of capital plus any retained profits. In accounting terms, owner's equity equals total assets minus total liabilities in the balance sheet.
Ratio analysis	An analysis involving the comparison of two individual items on the financial statements of a business, for example assets and liabilities, profit and sales or total liabilities and owner's equity. One item is divided by the other to form a relationship that is expressed as a ratio. Ratios can provide information about the financial viability of a business.
Reserves	Surplus after-tax profit not distributed to the owners or shareholders but set aside for particular or general purposes.
Risk	The chance of something happening that will have an impact upon objectives. It is measured in terms of consequences and likelihood.
Risk management	Managing risk involves systematically identifying, analysing, assessing, treating and monitoring risk.
Working capital	The excess of current assets over current liabilities.



For further information contact:

Malisa Golightly

Rod Nicholas

Australian National Audit Office

GPO Box 707

Canberra ACT 2601

Phone: (02) 6203 7300

ANAO Website:

<http://www.anao.gov.au>

Quick Reference Guide

Level of Risk
Low Med High

History and Development of the Supplier's Business

- Longevity/stability of the business
- Principal activities and past successes
- Market experience

Legal Background and Capital Structure

- Ownership
- Control of the business
- Loan arrangements
- Legal agreements

Critical Performance Elements of the Contract

- Availability of critical elements
- Reliance on another party (sub-contracting)

Management and Employees

- Experience of management team
- Continuity of directors/management
- Directors' backgrounds

Commitment, Contingencies and Litigation

- Capital commitment
- Insurance cover
- Litigation
- Contingent liabilities

Financial Viability

- Financial strength and viability
- Gearing level and credit rating
- Contingency funding and current level of operations
- Reasonableness of information
- Compliance with the Australian Corporations Law (if relevant)

Overall level of risk

--	--	--

Complete

Risk Treatments

- Develop a strategy/s to treat identified risks
- Develop a risk treatment plan that identifies:
 - responsibility for various tasks
 - relevant schedules and target dates for the project
 - outputs and outcomes sought at various stages of the project and overall
 - methods for monitoring and reviewing risks

4. Evaluate and prioritise risks

What are the most significant risks?

- • **evaluate risks against the criteria established in step two (seek expert advice where necessary)**
- • **rank risks to determine management priorities**
- • **decide if risks are acceptable or unacceptable**

The aim of risk management is to reduce risks to a level that is acceptable to the agency. A potential supplier assessed as either high or medium risk, in terms of their ability to deliver the services proposed, may still be acceptable, provided that the risk is capable of being effectively managed or treated either by the agency or the supplier.

5. Treat risks

How can the risk of something going wrong be minimised?

- • **choose treatments for individual risks**

For example, a potential supplier that has been operating for a relatively short period of time may be assessed as high risk, however the risk may be treated by requiring, for example, a bank guarantee to protect the interests of the Commonwealth.

- • **consider the overall effect of the treatment on all risks**

Has one treatment reduced the necessity of another, or increased risks elsewhere?

- • **make a plan to put the chosen treatments into effect**

The treatment plan should, for example:

- allocate responsibilities for tasks;
- set schedules and target dates;
- identify and allocate resources;
- establish the outputs and outcomes sought; and
- determine the method for monitoring and reviewing risks.

It is important that the procurement is overseen by a project manager so that any risks to the success of the procurement are monitored and timely remedial action is taken to mitigate these risks.

6. Monitor and review

Have risks changed? Are risk treatments working?

- • **are the underlying assumptions of the risk assessment still valid?**

For example, has the financial viability of the potential supplier changed. Have any events or circumstances been identified that necessitate a review of the level of risk assigned?

- • **are the management and financial controls adequate?**

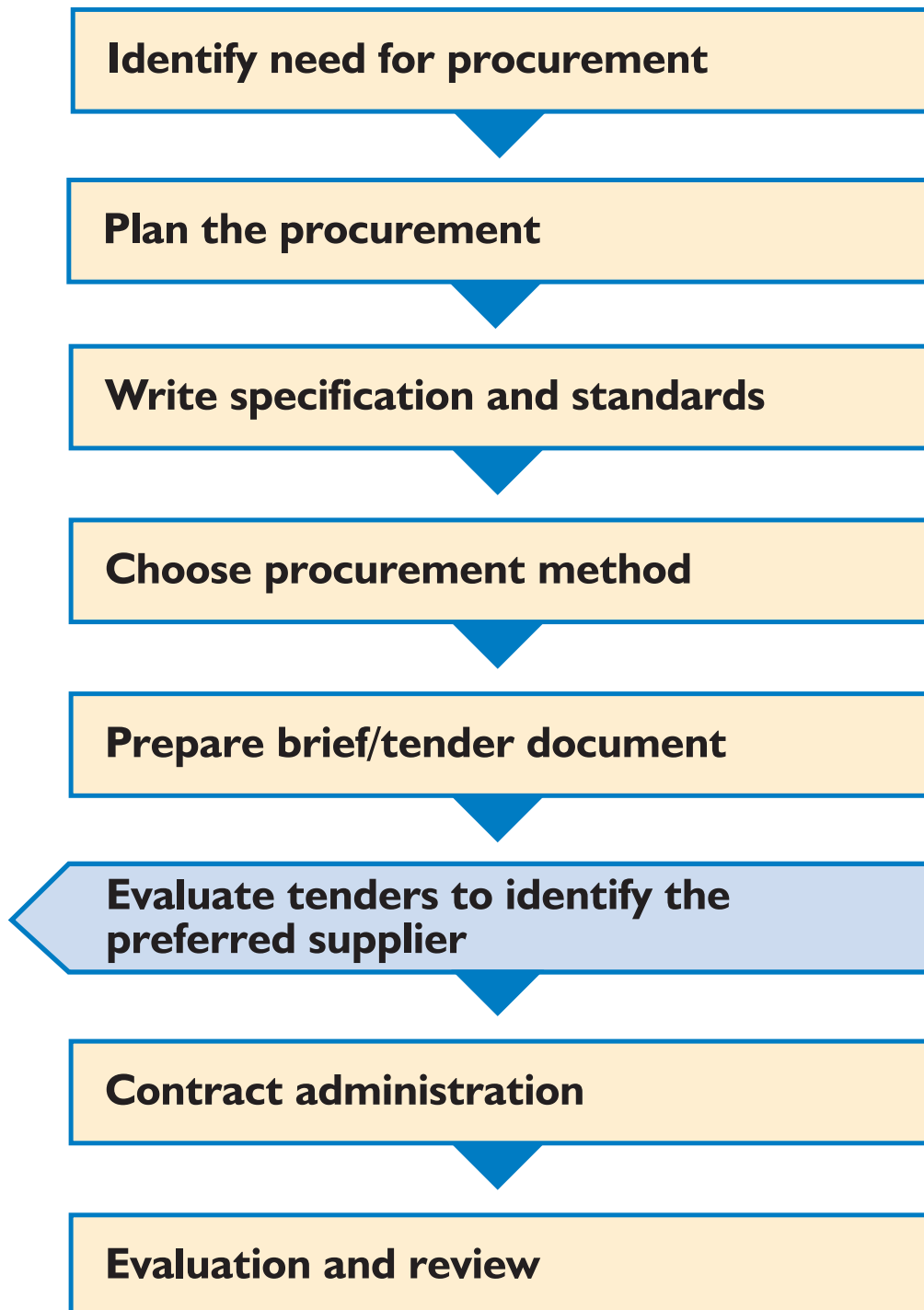
For example, has management of the project been facilitated by adequate access to the potential supplier's financial or other records? Is there evidence of problems in the working relationship with the potential supplier? Have risks been effectively managed or minimised through current internal controls?

- • **do the performance indicators established address the key success factors for the procurement?**

- • **are risk treatments effective in minimising risks?**

Risks, and the strategies to treat them, need to be subject to ongoing review. If a risk treatment is not effective in minimising the likelihood and/or consequence of a risk occurring, an alternative risk treatment may need to be considered or the priority assigned to the management of identified risks may have to be reviewed.

The Procurement Process ⁹



⁹ This is one model of the procurement process. For example, a more complex procurement process could also involve market testing and pre-solicitation. A less complex procurement process may not involve a full tender.