

The Auditor-General
Audit Report No.57 2004–05
Business Support Process Audit

Purchasing Procedures and Practices

Australian National Audit Office

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of Australia 2005

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Canberra ACT
28 June 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a business support process audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Purchasing Procedures and Practices*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations

AH	Australian Hearing
ANAO	Australian National Audit Office
ANU	Australian National University
ARC	Australian Research Council
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CPGs	Commonwealth Procurement Guidelines
CRS	CRS Australia
EOI	Expression of interest
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Administration Act 1997</i>
FMIS	Financial Management Information System
GA	Geoscience Australia
GaPS	Gazette Publishing System
RFQ	Request for quotation
RFT	Request for tender
SME	small and medium enterprises

Glossary¹

Covered procurement	A procurement, other than one that is specifically exempt, where the value of the property or services being procured exceeds the relevant procurement threshold. Covered procurements must comply with the mandatory procurement procedures.
Direct sourcing	A procurement process, available only under certain defined circumstances, in which an agency may contact a single potential supplier or suppliers of its choice and for which only a limited set of mandatory procurement procedures apply.
Evaluation criteria	The criteria which are used to evaluate the compliance and/or relative ranking of submissions.
Expression of Interest (EOI)	A response to an open approach to the market requesting submissions from businesses interested in participating in a procurement. The list of potential suppliers who have submitted expressions of interest may be used as the basis for conducting a select tender process.
Mandatory procurement procedures	A set of rules and procedures, outlined in Division 2 of the CPGs, which must be followed when conducting a covered procurement.
Open tender	A procurement procedure in which a request for tender is published inviting all businesses that satisfy the conditions for participation to submit tenders.
Panel	An arrangement under which a number of suppliers, usually selected through a single procurement process, may each supply property or services to an agency as specified in the panel arrangements.

¹ Source: Department of Finance and Administration, *Commonwealth Procurement Guidelines*, January 2005, Appendix E.

Request documentation	Documentation provided to businesses to enable them to understand and assess the requirements of the procuring agency and to prepare appropriate and responsive submissions.
Request for Tender (RFT)	A published notice inviting businesses who satisfy the conditions for participation to submit a tender in accordance with requirements of the request for tender and other request documentation.
Select tender	A procurement procedure in which the procuring agency selects which potential suppliers are invited to submit tenders.
Tender	A submission from a potential supplier making an offer to perform a procurement in response to an approach to the market.

Summary and Recommendations

Summary

Introduction

1. Australian Government entities purchase in excess of \$15 billion worth of goods and services annually.²
2. Government policy on the purchase of goods and services is outlined in the Commonwealth Procurement Guidelines (CPGs). The core principle of the CPGs is value for money, which requires a comparative analysis of all relevant costs and benefits of each purchasing proposal over the life of the purchase. The CPGs apply to a wide range of Government entities including all agencies operating under the *Financial Management and Accountability Act 1997* (FMA Act), and from 1 January 2005, to certain procurements of particular entities operating under the *Commonwealth Authorities and Companies Act 1997* (CAC Act).³ The CPGs applying from January 2005 represent good practice and provide relevant guidance for all Australian Government entities. They also include new mandatory procurement procedures.⁴

Audit scope and objectives

3. The audit was conducted at the Australian Research Council, CRS Australia, Geoscience Australia, Australian Hearing and the Australian National University. The latter two entities are not covered by the CPGs. In aggregate, the five entities purchase goods and services with a value of more than \$400 million annually.
4. The objective of the audit was to assess whether purchases of goods and services are conducted in accordance with relevant legislation, Government policies and guidelines, and sound purchasing principles and practices. The audit at each entity covered the internal control framework for purchasing and purchase transactions during 2002–03 and 2003–04 and, where applicable, was based on the CPGs current at that time. The audit examined all

² Operating expenditure paid to suppliers; in addition, payments to suppliers for property, plant and equipment, and intangibles are in excess of \$4 billion annually (Commonwealth of Australia Consolidated Financial Statements for the years ending 30 June 2002, 2003 and 2004, Consolidated Statement of Cash Flows by Sector: General Government).

³ At the date of preparation of this report, there were 33 CAC Act entities listed under Regulation 9 of the *Commonwealth Authorities and Companies Regulations 1997* for which aspects of the CPGs apply. All of these entities have been listed since the implementation of the Australia - United States Free Trade Agreement (AUSFTA) from 1 January 2005. The CPGs are mandatory for these entities where the procurement of property or services other than construction services exceeds \$400 000 or construction services exceeds \$6 million.

⁴ For example, in the absence of mitigating conditions, FMA Act agencies must now use open tendering for purchases over \$80 000. Under the previous CPGs, agencies could choose their own tendering thresholds.

aspects of the purchasing process from the initial requirement for purchase through to the delivery of the supply and payment. It included an examination of a selection of individual purchases at each audited entity.

Audit conclusion, findings and recommendations

5. The ANAO concluded that the five entities were generally making purchases in accordance with relevant Government requirements and sound purchasing principles and practices. However, there were various aspects of each entity's purchasing framework that could be improved. The Government's revised and enhanced procurement policy framework effective from 1 January 2005 has broader application and should provide a stronger procurement environment, as an additional 33 entities are now covered by particular aspects of the CPGs.

6. The ANAO considered that all entities audited had addressed the main risks of purchasing through the development of their purchasing policies. However, while some entities had considered purchasing risks in their fraud control plans, most had not included purchasing activity and functions in their organisational risk management plan or associated supporting planning material, where these existed. Also, although purchasing thresholds and requirements had been established, they were not always clearly linked to the nature, risks and financial profile of each entity's purchases. Entities also needed to review the purchasing threshold levels and the associated procedures to apply to each level.

7. All entities had generally established appropriate responsibility and policies for purchasing. There were opportunities, however, for most of the entities to provide more guidance on purchasing processes and/or increase the level of training for officers involved in purchasing.

8. Entities had, in the main, followed appropriate control processes and their own policies and procedures in conducting purchases of goods and services. The audit did identify instances of breakdowns in purchasing processes, and in the maintenance of documentation for a range of purchases, although these were not systemic or widespread. For example, tender evaluations were not always conducted in accordance with best practice, and quotations obtained were not always recorded on file. As a result, there was a need for improvement in particular purchasing processes and procedures, and overall recordkeeping practices.

9. The ANAO found several cases where tender evaluation plans were not used. An evaluation plan is considered to be a necessary accountability document that outlines the overall evaluation approach, including providing guidance for the evaluation panel members to assess each evaluation criterion and overall value for money, and should be approved by the delegate prior to

tenders closing and the evaluation commencing. There was also a wide variance in the methodology used for assessing tenders. Better practice was exhibited by entities that used a scoring system, weighted the criteria and evaluated price using a costing index. Many of the evaluations examined did not weight or index price, or assess it separately from the other criteria. The ANAO also found that, to varying degrees, all of the entities required relevant staff to sign conflict of interest declarations. However, only some of the entities had this requirement as a part of their purchasing policies.

10. The ANAO also found some cases where formal contracts had not been entered into for the supply of services. The ANAO considers that a contract should be in place where the nature of the relationship with the supplier involves the need to specify requirements in relation to such matters as confidentiality, intellectual property, insurance, price, performance measures, duration and termination. The ANAO therefore considers that there are only limited circumstances in which a contract would not be required, such as for 'off the shelf' goods and the provision of services of short duration. There was little information on this aspect in any of the purchasing guidance available. However, most of the entities did enter into contracts for purchases by tender, and most other relevant purchases.

11. Public reporting of purchasing information was generally completed in accordance with relevant requirements, although a few entities had occasionally overlooked some aspects of the requirements. Review of purchasing activity was mainly through internal audit and to varying degrees, by central purchasing units. The ANAO considers that entities should also monitor purchasing activity through the evaluation of financial purchasing data against the various purchasing threshold levels and the use of performance information, such as lead times and variances from standard policy. Such monitoring would assist entities in assessing the effectiveness of existing policies and procedures. Entities should incorporate periodic reporting of the purchasing performance information into their overall management reporting arrangements.

12. The ANAO has made eight recommendations designed to strengthen Australian Government entities' purchasing activities.

Entities' comments

13. All of the audited entities and the Department of Finance and Administration, as the policy department for the CPGs, responded positively to the audit report.⁵ The audited entities agreed, or agreed with qualification, to each of the recommendations relevant to them.

⁵ Entities' general or specific comments are provided in the relevant section of the report to which they refer and/or in Appendix 1.

Recommendations

The recommendations are based on the findings from the entities reviewed. The ANAO considers that, except for Recommendation 2, they are likely to be relevant to all Australian Government entities. Recommendation 2 is aimed at CAC Act entities only.

Recommendation No.1
Para 2.33

The ANAO recommends that, where entities rely on the provision of goods and services for a significant element of their activities, they assess and address purchasing risks within their risk management frameworks to help ensure that the risks are identified and mitigated effectively.

Recommendation No.2
Para 2.35

The ANAO recommends that CAC Act entities evaluate the benefits and costs of implementing procurement plans and consider the benefits of making such plans available to potential suppliers.

Recommendation No.3
Para 2.38

The ANAO recommends that entities provide staff involved in purchasing decisions and processes with appropriate guidance material and training on procurement. The training provided should be commensurate with the nature and significance of purchasing activity undertaken.

Recommendation No.4
Para 3.67

The ANAO recommends that entities periodically review their purchasing thresholds and associated purchasing procedures applying to each threshold level, taking into account the nature, risk and financial profiles of their purchases.

Recommendation No.5
Para 3.69

The ANAO recommends that entities only exercise options to extend contracts where they are satisfied that the extension represents value for money.

Recommendation No.6
Para 3.71

The ANAO recommends that entities strengthen tender evaluation processes through the use of evaluation plans, the mandatory use of conflict of interest declarations, and methodology that includes a documented assessment of price and its relationship with non-price criteria to arrive at an overall value for money assessment.

Recommendation No.7
Para 3.73

The ANAO recommends that entities incorporate into their purchasing policies the circumstances in which a contract should be entered into having regard, where applicable, to the requirements of the Commonwealth Procurement Guidelines.

Recommendation No.8
Para 4.24

The ANAO recommends that entities establish performance measures for reporting on their purchasing activities, and incorporate periodic management reporting against these measures as an integral element of their management reporting arrangements.

Entities' responses to the recommendations

14. The audited entities agreed, or in two instances, agreed with qualification, to the recommendations. Where provided, entities' additional responses to each recommendation are provided in the body of the report.

Audit Findings and Conclusions

1. Introduction

Background

1.1 Australian Government entities⁶ are significant purchasers of goods and services. The costs associated with these purchases across the General Government Sector⁷ are in excess of \$15 billion annually.⁸ These purchases comprise thousands of transactions, including many in excess of \$2000.⁹

1.2 Government policy on the purchase of goods and services is outlined in the Commonwealth Procurement Guidelines (CPGs), which are issued by the Minister for Finance and Administration under Regulation 7 of the *Financial Management and Accountability Regulations 1997*.¹⁰ The CPGs apply to all agencies operating under the *Financial Management and Accountability Act 1997* (FMA Act), and from 1 January 2005, to certain procurements of particular entities operating under the *Commonwealth Authorities and Companies Act 1997* (CAC Act).¹¹

1.3 The CPGs provide a policy framework to assist the chief executive of each FMA Act agency and governing body of each applicable CAC Act entity in managing their purchasing activities. The core principle of the CPGs is 'value for money', which requires a comparative analysis of all relevant costs and benefits of each purchasing proposal over the life of the purchase. This core principle is supported within the CPGs by the principles of encouraging competition; promoting efficient, effective, and ethical use of resources; and accountability and transparency. From 1 January 2005 the CPGs include mandatory procurement procedures that were not included in the previous versions of the CPGs.

⁶ Except where otherwise specified, the term 'entities' is used generically throughout this report for all Government organisations, including departments and agencies operating under the *Financial Management and Accountability Act 1997* and statutory authorities and companies operating under the *Commonwealth Authorities and Companies Act 1997*. Departments and agencies operate through the Official Public Account and do not constitute separate legal entities.

⁷ The General Government Sector comprises services that are mainly non-market in nature, and for the collective consumption of the community, or involve the transfer or redistribution of income.

⁸ Refer footnote 2.

⁹ More than 180 000 purchases greater than \$2000 were reported annually in the years ending 30 June 2002, 2003 and 2004 by agencies operating under the *Financial Management and Accountability Act 1997* (Department of Finance and Administration, 2005, *Statistics on Commonwealth Contract Notifications 1999-2004*, viewed 21 May 2005, <<http://www.finance.gov.au/ctc/statistics%5Fon%5Fcommonwealth%5Fcon.html>>).

¹⁰ The current version of the CPGs was issued by the Minister for Finance and Administration on 7 December 2004. The CPGs are available on the Department of Finance and Administration website at <<http://www.finance.gov.au>>.

¹¹ Refer footnote 3.

1.4 Australian Government entities may also be subject to particular legislation or specific policies that may have an impact on purchasing arrangements. These include the *Freedom of Information Act 1982*, *Public Service Act 1999*, *Privacy Act 1988* and the *Crimes Act 1914*, and various policies, such as those relating to legal services, telecommunications, construction procurement and government advertising.

Audit approach

Audit objectives

1.5 The objectives of the audit were to:

- assess whether purchases of goods and services are conducted in accordance with sound purchasing principles and practices, relevant legislation and Government policies and guidelines; and
- where appropriate, identify better practices and recommend improvements in the controls and practices associated with purchasing arrangements.

Audit scope

1.6 The audit was conducted at a selection of Australian Government entities, and included both FMA Act agencies and CAC Act entities.

1.7 The selected entities were assessed on compliance with legislation and Government policies, where such requirements were applicable, and sound purchasing principles and practices. Accordingly, the FMA agencies were specifically assessed against relevant aspects of the CPGs that existed at the time the audit commenced.¹²

1.8 The audit at each entity covered the internal control framework for purchasing and purchase transactions during 2002–03 and 2003–04. It examined key aspects of the purchasing process from the initial requirement for purchase through to the delivery of the supply and payment. The audit did not cover the payment process in detail or management of contracts beyond formation.¹³

1.9 The audit primarily focused on purchasing in general, rather than on specific categories of goods and services. There was a limited emphasis on categories governed by special policies, such as major capital equipment acquisitions, information technology outsourcing services, legal services and

¹² That is, prior to the January 2005 version of the CPGs.

¹³ Audit Report No.37, 2004–05, *Management of Business Support Service Contracts*, tabled on 10 March 2005, examined the contract management process at a selection of entities.

travel services. These categories of purchases are generally covered by other performance audits.

1.10 In addition, for the purposes of the second objective, the ANAO liaised with the Department of Finance and Administration (Finance), which has responsibility for Government procurement policy.

Audit criteria

1.11 The management of purchasing in each of the selected entities was assessed against audit criteria based on the four main elements of the internal control framework, as outlined in the ANAO's Better Practice Guide, *Controlling Performance and Outcomes*.¹⁴

1.12 In summary, the audit criteria were:

- *Risk management*—The risks associated with the administration of the purchasing function have been identified, assessed and treated accordingly.
- *Control environment*—Appropriate policies and procedures, and suitably qualified staff, are in place to enable effective management of the purchasing function.
- *Control activities*—Systems and processes have been established to ensure that requests for purchases are handled in accordance with better practice principles and relevant legislation, policies and guidelines.
- *Monitoring and review processes*—The performance of purchasing activities is measured and assessed on an ongoing basis to ensure continuous improvement.

Selected entities

1.13 The entities selected for the audit were:

- Australian Hearing (AH);
- Australian National University (ANU);
- Australian Research Council (ARC);
- CRS Australia (CRS), a business operation of the Department of Human Services; and
- Geoscience Australia (GA).

¹⁴ ANAO, Better Practice Guide to Effective Control: *Controlling Performance and Outcomes*, 1997.

1.14 The first two entities operate under the CAC Act, but are not subject to the current CPGs, while the latter three operate under the FMA Act. The entities comprise one large purchaser, three medium purchasers and one small purchaser. Purchasing activity by dollar values during 2002–03 and 2003–04 for each of the entities is shown in Table 1.1. Total purchases by the five entities amounted to approximately \$413 million in each of the two years.

Table 1.1

Selected entities purchasing activity – 2002–03 and 2003–04

Entity	2002–03 purchases		2003–04 purchases		Average annual purchases
	Expenses \$ million	Assets \$ million	Expenses \$ million	Assets \$ million	Expenses and assets \$ million
AH	61.408	6.342	59.760	2.230	64.870
ANU*	169.189	49.487	175.664	37.435	215.887
ARC	6.586	0.292	5.840	0.124	6.421
CRS	55.484	2.272	56.633	3.675	59.032
GA	55.658	6.148	64.510	7.632	66.974
Total	348.325	64.541	362.407	51.096	82.637
	\$412.866		\$413.503		

* ANU figures are for the years ending 31 December 2002 and 2003.

Source: Statement of Cash Flows, entities' financial statements for the years ending 30 June 2003 and 30 June 2004 (ANU: 31 December 2002 and 2003).

Audit methodology

1.15 The audit involved examination and analysis of files and records supporting purchasing activity, interviews with relevant officers and general observation. The examination covered a total of 136 individual purchases involving a range of purchase values from approximately \$250 to approximately \$6 million (with total purchase value of approximately \$25 million), together with tendering processes for major contracts, where those contracts represented a significant proportion of an entity's purchases. These purchases were selected from payments made between 1 July 2002 and 30 June 2004.

1.16 The audit was undertaken in accordance with ANAO Auditing Standards during the period July 2004 to March 2005 at a cost of approximately \$323 000.

Audit findings

1.17 The ANAO provided each of the five entities with an individual detailed report of the findings related to each entity prior to the preparation of the proposed audit report on all of the entities.

1.18 The results of the audit, including entities' specific responses to each of the recommendations, are set out in Chapters 2 to 4.

1.19 The audit findings are not attributed to particular entities.

2. Entities' Purchasing Frameworks

This chapter covers the first two elements of an entity's internal control framework, being the conduct of a risk assessment and the establishment of a suitable purchasing control environment.

Introduction

Risk assessment and planning

2.1 Risk assessment is the starting point for evaluating the internal control framework of an entity, function or activity, because it provides, through a formal, systematic process, the necessary information to design controls that are appropriate and cost-effective. Risk assessment involves the identification, analysis, assessment and prioritisation of risks that need to be treated by specific control measures (control activities).

2.2 Entities may develop a number of plans for treating risks, for example: a risk management strategy or plan, an asset management plan and fraud control plan.

Control environment

2.3 The control environment reflects management's commitment and attitude to the implementation and maintenance of an effective internal control structure to align policies, procedures and day-to-day work practices with overall corporate strategy and objectives.

2.4 An entity should establish a control environment that clearly sets out management responsibilities and promotes sound principles of active management, including continuous improvement. Appropriate, up-to-date, policies and procedures and ongoing training programs are important elements in establishing an effective purchasing environment.

Audit criteria

2.5 Entities would be expected to have:

- undertaken risk assessments relating to their operations including aspects relevant to their purchasing activities;
- implemented plans for mitigating any identified risks associated with purchasing;
- developed purchasing policies that are in line with better practice principles, relevant legislation, Government policies and the organisation's objectives;

- allocated suitably qualified staff to manage and resource their purchasing activities, and issued instruments of delegation to appropriate personnel; and
- issued instructions and procedures on purchasing, established systems for recording purchasing data, and implemented appropriate training and staff awareness programs.

Risk assessment and planning

Organisational risk management

2.6 Risk management in Australia is guided by Australian Standard AS/NZS 4360:2004 *Risk Management*. Many Australian Government entities have adopted this standard to develop organisation-wide approaches for managing risks.

2.7 All of the entities had developed, or were in the process of developing, an organisational risk management framework and plan. In general, these plans addressed the main risks faced by each entity. Some plans focussed on the high level strategic risks of an organisation, while others also covered operational risks and/or were supported by risk assessments and plans for each of the entity's major functions or business lines.

2.8 All FMA Act agencies are required, under section 45 of the Act, to have an operational fraud control plan. In addition, several CAC Act entities are required to, or choose to, maintain a fraud control plan under the Government's fraud control policy arrangements.¹⁵

2.9 All of the entities had developed a fraud control plan. While the two CAC Act entities' plans were out of date, they were under review at the time of the audit.

Purchasing risk management

2.10 There are several risks in procuring goods and services. The ANAO has identified the main purchasing risks to be addressed by an entity as:

- unavailability of supplies at the time of need;
- supplies not meeting user requirements;
- over-reliance on key suppliers;

¹⁵ Attorney-General's Department, *Commonwealth Fraud Control Guidelines 2002*. The policy applies to CAC Act entities that receive at least 50 per cent of funding for their operating costs from the Commonwealth or a Commonwealth agency. The policy strongly encourages other CAC Act entities to comply with the best practice standards set out in the Guidelines. Entities are responsible for determining their funding status to ascertain whether the Guidelines apply to them.

- supplies not representing value for money;
- incurring costs above budget estimates; and
- fraudulent activity.

There has been a number of instances of public sector purchasing fraud identified in the media in recent years suggesting that the likelihood of fraud in purchasing is an issue of which public sector managers need to be mindful.

2.11 The abovementioned risks have the potential to impact adversely on the timing, quality and cost of an entity's performance in delivering outcomes. The ANAO considers that the risks should be addressed at an organisational level through operational risk plans and the fraud control plan, and at the individual purchase level through purchasing policies and practices. The extent of identifying and treating such risks would vary according to the nature and complexity of the entity and of the goods and services that it purchases. For example, where an entity operates within a market with a small number of specialist suppliers, there may be an increased risk of over-reliance on key suppliers and the unavailability of supplies.

2.12 Two of the entities' risk management plans referred to purchasing while all but one of the fraud control plans included risks associated with purchasing activities. Those plans that included purchasing varied from a brief general reference in a risk management plan to a thorough analysis in a fraud control plan. Risks identified included non-compliance with the CPGs, loss of skilled staff, purchases by staff for their own use, staff collusion with suppliers, and the manipulation of purchase orders. The ANAO noted that one of the entities had identified fraudulent activity in relation to certain purchasing activities in recent years.

2.13 The ANAO found that all the entities had addressed purchasing risks indirectly through the establishment of purchasing thresholds for which particular purchasing procedures were to apply. Purchasing thresholds are discussed further in Chapter 3.

2.14 The ANAO also found that two of the entities' policies had identified potential risks for individual purchases. These included:

- delays arising from unrealistic estimates of lead times for planning and conducting the tendering process, production slippages, unavailability of key service personnel, unavailability of parts or inadequate distribution arrangements; and
- unacceptability of the delivered goods or services to the end user because of inadequacies in the development of the statement of requirements and the ability of the supplier to meet the requirements.

2.15 One of these entities' policies indicated that such risk exposures had the potential to result in substantial cost overruns or even litigation, as well as to cause harm to the entity's reputation.

Procurement plans

2.16 Procurement plans are a new initiative of the revised CPGs. From the 2005–06 financial year, FMA Act agencies will be required to produce annual procurement plans.¹⁶ Those CAC Act entities subject to the CPGs will need a plan covering any procurements over \$400 000. These plans are to contain a short strategic outlook for the entity, as well as details of planned procurements.

2.17 The advantages of procurement plans include:

- suppliers are alerted to potential purchases in advance of any tendering or quotation process, thereby providing suppliers with greater opportunity (time) for preparing bids and therefore potentially increasing the number and quality of bids received; and
- improved internal planning processes, for example, by publishing an annual plan, early attention can be given to required purchases, which should, in turn, result in better analysis of requirements and improved planning and timing of purchasing activity.

2.18 While none of the entities had a procurement plan now required by the CPGs, some entities had capital expenditure plans, one of which covered a rolling ten-year period, for management and budget planning purposes.

2.19 The ANAO considers that all CAC Act entities should consider implementing a procurement plan, particularly where the entity has extensive and diverse purchasing needs. Such a plan could be annual, or for a longer term. CAC entities should also consider the benefits of making their plans available to potential suppliers.

Control environment

Policies and guidance

2.20 All of the entities had issued policies on purchasing. Each of the FMA Act agencies had issued a Chief Executive's Instruction(s). All entities' policies had addressed the generally accepted principles of purchasing, and in particular, the principle of 'value for money'. All of the documents were available on entities' intranets.

¹⁶ An annual procurement plan is required by paragraphs 7.16 and 7.17 of the CPGs.

2.21 The nature and extent of the detailed procedures available to staff varied among entities. Two entities had comprehensive guidance and instructions. One of these entities also had separate guidelines for its Information Technology unit that supplemented and complemented the main guidance. The ANAO considered that the other three entities needed to develop more detailed guidance to assist staff in the conduct of purchasing activities. The main area requiring development related to tendering, and in particular tendering evaluation procedures and processes.

2.22 The two CAC Act entities had established a relationship with the NSW Department of Commerce (NSW DC), which undertakes purchasing on behalf of the NSW Government and other bodies. Both entities had gained access to NSW Government period contracts (SmartBuy) for the purchase of many common use items, for example, furniture, office machines and stationery, while one of them used the NSW DC tendering services for many of its larger purchases. The ANAO considered these arrangements enhanced the effectiveness of each entity's purchasing activities.

2.23 Some entities had entered into panel supplier agreements for a number of frequently used supplies. This had streamlined the purchasing processes for these supplies and represented an effective strategy for each of the relevant purchases.

Responsibility for purchasing

2.24 All entities had delegated purchasing powers to relevant operational staff. They had also allocated responsibility for purchasing policy and coordination to corporate section staff reporting to either the Head of Corporate Services or the Chief Financial Officer. The role and number of these staff varied. One of the larger entities had devoted several staff to its purchasing unit, which played a significant role in purchasing and contract management control. For example, this unit frequently provided a member on tender evaluation committees. Most of the other entities' purchasing units acted in an advisory capacity to operational staff. The corporate units normally were responsible for common use purchases, such as stationery, travel and mail services.

Recording of purchases

2.25 As most entities' purchasing activities involve high numbers of transactions, entities need robust recording processes and systems. This is most commonly catered for by the entity's financial management information system (FMIS) and/or the maintenance of a contract register.

Use of purchase orders

2.26 All entities had implemented purchase request forms for the initiation of purchases and processed purchase orders through their FMIS. Some entities required purchase orders to be completed for all purchases above a certain threshold.

2.27 One entity had an electronic system incorporated within its FMIS that allowed for approvals to be made electronically and orders to be automatically emailed or faxed to the suppliers. Other entities used purchase orders to varying degrees. While the ANAO accepts that purchase orders may not be warranted for low value and/or routine purchases, it considers that some entities could make greater use of purchase orders. Purchase orders can be useful to an entity for both supplier ordering and for financial management purposes. For example, purchase orders can assist in the control of purchases and enable details of financial commitments to be collected and reported.

Contract registers

2.28 The three FMA Act agencies maintained contract registers to facilitate monitoring of contracts by relevant staff and to report on contract activity. These registers contained details of current contracts, such as contract prices, contract start and end dates, payments made to date, entity and supplier contact officers, tender details and budgeted funds. Among other things, contract registers were used for highlighting impending contract extension dates, so that new tenders could be considered with sufficient lead time, insurance renewal arrangements and the identification and reporting of contract liabilities and commitments. Such a facility can also aid in the monitoring of individual contracts and provide organisation-wide information on all contracts.

2.29 The two CAC Act entities agreed to consider the benefits of introducing a contract register to enhance their procurement functions.

Relevant skills and experience

2.30 Staff with purchasing responsibilities should be aware of the entity's purchasing policies and procedures, and the broader responsibilities and risks associated with holding delegations to spend entity monies. Staff undertaking purchases also need to have the appropriate levels of skills and experience commensurate with the extent, nature and risk profile of their purchasing responsibilities.

2.31 All entities conducted training on the operation of their FMIS. However, generally there had been limited training offered by most of the entities on purchasing policies and procedures. In addition, few entities included training requirements or guidance in their procedural documentation.

2.32 The level of training required will vary depending on the skills and experience of individual purchasing officers and the nature of the supplies being procured. Nevertheless, training in purchasing policies and procedures, particularly tendering, is considered to be warranted so that staff are aware of the entity's requirements and are able to assess value for money. Training is considered particularly necessary for staff involved in tender selection processes for the first time or on an infrequent basis. The ANAO considers that each entity should include any relevant training information for staff with purchasing responsibilities in its purchasing guidance documentation, and arrange the conduct of such training, where appropriate.

Recommendation No.1

2.33 The ANAO recommends that, where entities rely on the provision of goods and services for a significant element of their activities, they assess and address purchasing risks within their risk management frameworks to help ensure that the risks are identified and mitigated effectively.

Entities' responses

2.34 All entities agreed with the recommendation. Specific comments provided were:

Australian Hearing

Agreed. This recommendation already forms part of the organisation risk analysis in particular for each purchasing tender undertaken and any other material purchasing arrangements.

CRS Australia

Agree—The recommendation is already incorporated in the organisation's risk management framework and purchasing policy and practices.

Recommendation No.2

2.35 The ANAO recommends that CAC Act entities evaluate the benefits and costs of implementing procurement plans and consider the benefits of making such plans available to potential suppliers.

Entities' responses

2.36 The two CAC entities agreed with the recommendation, one of which, the Australian National University, 'agreed with qualification.' Specific comments provided were:

Australian Hearing

Agreed. Costs and benefits are being reviewed.

Australian National University

The University agrees with qualification. The nature of the University's income stream (grant funds) makes the development of a procurement plan a complicated and costly exercise. This recommendation will need to be evaluated in this context.

The University's preferred supplier/panel contracts, including contract timelines, are published on the ANU intranet.

2.37 The three FMA Act agencies subject to audit noted the recommendation.

Recommendation No.3

2.38 The ANAO recommends that entities provide staff involved in purchasing decisions and processes with appropriate guidance material and training on procurement. The training provided should be commensurate with the nature and significance of purchasing activity undertaken.

Entities' responses

2.39 All entities agreed with the recommendation. Specific comments provided were:

Australian Hearing

Agreed. The Finance policies and procedures manual incorporating purchasing has been updated and issued to staff in March 2005 to provide guidance. Training requirements are being reviewed and implemented across the organisation.

CRS Australia

Agree—CRS Australia provides an environment for staff to be aware of the purchasing policy and procedures through numerous formal mechanisms but acknowledges there is an opportunity to increase staff awareness at regional offices, thereby reducing reliance on the Corporate Purchasing Unit.

3. Specific Controls Applied to Individual Purchases

This chapter examines the operation of the specific controls that the entity has in place for managing purchasing.

Introduction

Background

3.1 Entities require a set of specific controls for the processing of individual purchases to mitigate any assessed risks and contribute to the efficient and effective delivery of quality outputs and outcomes. Successful implementation and operation of such controls also promotes compliance with the policies and procedures of the entity and assists in ensuring the integrity, accuracy and completeness of administrative processes.

Audit criteria

3.2 Entities would be expected to have specific controls for each stage of the purchasing process, namely:

- defining the requirements for each purchase and selecting an appropriate procurement strategy;
- establishing the sources of supply and inviting bids from suppliers;
- evaluating bids, including the assessment of value for money, and selection and approval of the successful bidder(s);
- documenting individual purchasing agreements and specifications including terms of payment (for example, purchase orders, contracts, as applicable) and advising unsuccessful bidders of the reasons for non-selection; and
- checking that goods and services have been received in accordance with the purchase documentation.

Defining requirements and selecting a strategy

Statement of requirements

3.3 The first stage of a procurement process is to define the requirements. Defining the requirements is a key element of any purchase, as it assists the delegate when approving purchasing requests and purchasing staff in providing specifications to potential suppliers. While the detail of the

requirements varies according to the nature and significance of the proposed purchase, it normally involves:

- a description of the goods or services to be procured;
- reason(s) for the procurement;
- estimated costs and proposed timing;
- consideration of other issues affecting the procurement, for example, existing contracts for the goods or services; and
- the delegate's authorisation.

3.4 Where a complex, high risk or high value purchase is required, a more detailed statement of requirements, or a 'business case', should be prepared. Among other things, a business case should outline:

- how the purchase will contribute to the entity's business outcomes or objectives;
- whether the purchase is replacing existing resources, or is a new requirement;
- costs and benefits on a whole-of-life basis, including financial and sensitivity analyses, and an analysis of alternative options (for example, lease versus buy); and
- details of the resources required for the procurement, including consultants, legal and probity advisors, and the estimated costs of managing the project.

3.5 Most entities' policies provided for a purchase request form to be completed covering specifications, estimated cost and reason for a purchase. For high value purchases, some entities' policies required a more detailed document fully justifying the purchase.

3.6 The ANAO found that in most instances, entities had developed sufficient statements of requirements prior to undertaking purchases. Higher value purchases generally included a business case or equivalent. Lower value purchases were not always supported by a formal statement of requirements, but were usually defined and justified to the satisfaction of the delegate.

Procurement strategy

3.7 Having defined the requirements, a procurement strategy or approach should be selected. This will vary according to each purchase, and the key factors to consider should include:

- the nature of the goods or services required (general or specialist);

- the cost of the goods or services;
- the cost of the preferred selection method, for example, request for quotations (RFQ),¹⁷ open tender,¹⁸ select tender,¹⁹ or request for expressions of interest (EOI);²⁰
- knowledge of the market and the number of potential suppliers;
- time available for the procurement; and
- other risks associated with the procurement, for example, political sensitivity.

Purchasing thresholds

3.8 A well-structured purchasing threshold framework, based on the entity's purchasing profile, can directly assist entities in achieving value for money, encourage competition, promote the efficient, effective and ethical use of resources; and enhance accountability and transparency.²¹ The purchasing policies of each entity established a purchasing threshold framework that set the dollar amount or range for which certain quotation and tendering procedures must be applied. While the structure of the frameworks varied, an example of a purchasing threshold framework is as follows:

- Less than \$2000—oral quotations should be obtained to ensure value for money;
- \$2000 to \$20 000—written quotations should be obtained to ensure value for money;
- \$20 000 to \$80 000—a business case should be prepared with written responses being sought on a statement of requirement or to an expression of interest;
- \$80 000 or more—an open tender should be issued, unless otherwise approved by the delegate.

¹⁷ A procurement procedure in which requests are made to a select number of suppliers, identified by the entity, to supply quotations for the required good or service.

¹⁸ A procurement procedure in which a request for tender is published inviting all businesses that satisfy the conditions for participation to submit tenders. Refer footnote 1.

¹⁹ A procurement procedure in which the procuring agency selects which potential suppliers are invited to submit tenders. Refer footnote 1.

²⁰ An open approach to the market requesting submissions from businesses interested in participating in a procurement. The list of potential suppliers who have submitted expressions of interest may be used as the basis for conducting a select tender process. Refer footnote 1.

²¹ These are the key principles and elements underpinning Australian Government procurement, as outlined in the CPGs, Division 1.

3.9 For the period covered by the audit, the minimum purchasing thresholds set by entities varied from \$500 (two entities) to \$2000 (two entities) to \$10 000 (one entity). At the maximum purchasing threshold, four entities had a tender threshold of \$50 000 while the fifth entity had one of \$30 000. The latter entity, an FMA Act agency, revised its tender threshold to \$80 000 early in the 2004–05 financial year, in anticipation of the revised CPGs that took effect on 1 January 2005.²²

3.10 Other variations in the purchasing thresholds included:

- two entities had three purchasing threshold levels, one entity had four, and two entities had five; and
- two entities specified the number of quotations required while the other three left the decision to the delegate.

3.11 Two of the entities' policies provided information on determining the appropriate purchasing method. Factors covered by the policies included strategic importance of the purchase, size and complexity of the market, planning and risk management.

3.12 The two entities with only three purchasing threshold levels had a relatively large range of values for purchases immediately below the tender threshold. That is, under the entities' policies, the same procedures may have been applied for a \$5000 purchase as for a \$75 000 purchase. The ANAO considers that purchasing threshold frameworks should allow for some flexibility in the procurement approach, taking into account such factors as the cost and nature of the purchase, market conditions and an assessment of the risks involved.

Exemptions from policies

3.13 The ANAO found that some entities' policies provided for purchases to be exempted from the purchasing threshold requirements in certain instances.²³ These included cases where:

- there was only one supplier;

²² The mandatory requirements under the revised CPGs from 1 January 2005 apply to 'covered procurements'. Covered procurements are defined by the CPGs as: for other than construction services, purchases over \$80 000 (FMA Act agency) and over \$400 000 (CAC Act entity), and all construction services over \$6 million.

²³ Prior to 1 January 2005, an entity covered by the CPGs could choose, subject to the principle of value for money, to exempt certain procurements from its purchasing threshold requirements, and purchase directly from a supplier of its choice. After 1 January 2005, an entity subject to the CPGs that makes a covered procurement may only invite a potential supplier or suppliers of its choice to make submissions (that is, 'direct sourcing') under limited circumstances, outlined in the CPGs paragraph 8.65. The ANAO considers that all exemptions from particular threshold requirements should be approved by an authorised person.

- the supplier had pre-eminent expertise;
- uniformity of equipment was desired;
- there was a reliable supplier that had a proven record for value for money and quality of products;
- substantial artwork or other graphic material from previous work was retained by the supplier; and
- supplies were required urgently.

Purchasing methods applied

3.14 The ANAO found that all the entities employed a range of purchasing methods, including: open tenders, select tenders, expressions of interest, preferred supplier arrangements, panel contracts, requests for quotations and direct sourcing. The ANAO also found that requests for quotations were generally used for lower value purchases, in accordance with entities' policies.

3.15 Overall, the ANAO considered that the purchasing methods employed by entities were generally appropriate for the cases reviewed. However, there was little indication that any of the entities had analysed their purchases in determining and/or reviewing their purchasing thresholds, including the exemptions to apply. The ANAO considers that entities should examine the nature, risks and financial profile of their purchasing activity in developing or reviewing their purchasing thresholds, including any exemptions from threshold requirements. This would help to ensure they remain appropriate and relevant. Further comments on entities' purchasing profiles are provided at Chapter 4 of this report.

Establishing a source of supply and inviting bids

3.16 The second stage of the process is to establish a source of supply and to invite bids.

Source of supply

3.17 The ANAO found that sources of supply were generally reliant on the experience of purchasing staff and their interaction with suppliers, together with recorded supplier history and the identification of new suppliers. In general, entities were aware of, and engaged with, a range of national, regional and local suppliers where appropriate.

3.18 In addition, the ANAO found that most entities had negotiated 'standing offer' arrangements with suppliers. Under these arrangements, suppliers agree to offer goods or services at specified or discounted prices for finite periods of time. Most of the arrangements were for common use items, such as stationery or courier services, although one entity's arrangements

included the supply of specialised high value services. Such arrangements may be negotiated with more than one supplier for a particular type of good or service, in order to form a panel of suppliers from which purchases of that type of good or service can be made.²⁴ In some instances, the selection of suppliers was the result of a tender process.²⁵

3.19 The ANAO considers these arrangements can provide an effective mechanism that allows entities to minimise the time and resources expended on assessing the suitability of potential suppliers for recurring purchases.

Tenders

3.20 A Request for Tender (RFT)²⁶ is the normal means of inviting bids for large and/or high-risk purchases. Request documentation²⁷ for tenders should clearly set out the following information:

- a statement of requirements and evaluation criteria;
- a timetable, including when tender responses are due and an expected decision date;
- delivery instructions, for example, whether tender responses should be delivered to a tender box, faxed or emailed;
- contact officer details for questions relating to the tender; and
- a draft contract.

3.21 In almost all of the tenders examined by the ANAO, entities had produced sufficiently detailed request documentation, including outlining the evaluation criteria on which tender responses would be assessed. In some cases, evaluation criteria were ranked in order of importance. The ANAO considers that, as a minimum, it is good practice for evaluation criteria to be ranked in order of importance, so that potential tenderers are better informed about the relative importance of each evaluation criterion.

²⁴ A 'panel' of one supplier is also possible (Department of Finance and Administration, *Guidance on the Mandatory Procurement Procedures*, Financial Management Guidance No.13, January 2005, p. 60).

²⁵ From 1 January 2005, entities subject to the CPGs can only establish panel supplier arrangements for 'covered procurements' through tendering processes.

²⁶ A published notice inviting businesses who satisfy the conditions for participation to submit a tender in accordance with requirements of the request for tender and other request documentation. Refer footnote 1.

²⁷ 'Request documentation' is defined as: 'documentation provided to businesses to enable them to understand and assess the requirements of the procuring agency and to prepare appropriate and responsive submissions. This general term includes documentation for expressions of interest, multi-use lists, open and select tender processes, and direct sourcing'. Refer footnote 1.

3.22 One entity outsourced most of its tender requirements to an external service provider. Request documentation for each of these tenders included a statement of requirements, comprehensive instructions on delivery, a timetable for lodgement and contact details for further information. In addition, request documentation was clearly set out and provided potential suppliers with a draft version of the supply contract.

3.23 The ANAO found that most entities utilised pro-forma request documentation in their tenders, and that they effectively provided suppliers with the information required to complete tender responses. The ANAO considers that the use of pro-forma request documentation is a useful mechanism to help ensure that tender documentation is consistent and complete.

Request for expression of interest

3.24 Some entities requested Expressions of Interest (EOI) where they sought to obtain information from the market about a range of potential solutions. While an EOI should lead to a select tender, following the development of a detailed statement of requirements, entities had, in some instances, engaged suppliers on the basis of responses to the EOI. The ANAO considers that an EOI should be used to research the capabilities of suppliers to meet requirements, or to determine the feasibility of a procurement, rather than as the sole method to select suppliers.

3.25 For one EOI, an entity provided a budget to potential suppliers. The ANAO considers that providing a budget to tenderers can be seen as a barrier to competition between suppliers. This is because, indirectly, suppliers may be encouraged to structure their bids close to, but not exceeding, budget limits. As a result, the entity may not receive the lowest possible bids, potentially putting value for money at risk. However, the ANAO also recognises that there may be cases where potential suppliers are provided with budget information, to enable tenderers to better address the needs of the entity. The ANAO considers that, where budget information is provided to potential suppliers, written justification for doing so should be recorded and authorised by an appropriate level of management.

Tender documentation

3.26 Documentation of tender processes varied between the audited entities. One entity, in particular, demonstrated sound documentation practices. The ANAO found that this entity had completed a tender process for all purchases over the tender threshold, and each tender had a file recording the history of the purchase. Among other things, the documentation included copies of advertisements in the press and details of industry briefings.

Purchases below the tender threshold

3.27 For purchases below the tender threshold, entities should invite bids from a range of suppliers commensurate with the nature and value of the purchase, or use existing standing offer agreements.

3.28 The ANAO found that most entities had complied with their policies regarding the number of quotations to be obtained, although evidence of quotations received was not retained on file in some instances.

3.29 For some entities, quotations were not obtained where the supplier had been supplying the entity on a regular basis for a period of time. The ANAO considers that, where a supplier provides for an entity's recurring requirements, for example, courier services, periodic testing of the market should be undertaken. This market testing allows the entity to satisfy itself that value for money is still being obtained from its regular suppliers.

Contract extensions

3.30 Where a procurement contract contains an option to extend the duration of the agreement, the entity should assess the value of exercising that option against alternative sources of supply. In considering which course of action will provide the best value for money, the entity should identify and compare all relevant risks, costs and benefits on a common basis over the life of the procured good or service. As a necessary precursor to the analysis of procurement options, the entity must be aware of when its contracts will expire, and the lead-times involved in undertaking new purchases. To do this, the entity must have arrangements in place to monitor critical contract dates.

3.31 The ANAO found that, while the processes for reviewing existing contracts for renewal or extension varied from entity to entity, justification of most of the extensions granted was adequately documented.

3.32 One entity requested information from incumbent suppliers before assessing the option to extend on a value for money basis. Suppliers were required to detail how they would continue the agreement, should an option be offered, and to detail any new efficiencies available. The option was then assessed against other suppliers in the market. In one instance examined, this analysis led to the existing supplier agreement being discontinued, as the entity found it was more likely to obtain better value for money from a new supplier. The ANAO considers that this was an effective approach in assessing extensions of supplier agreements.

3.33 Another entity renewed a contract for property management services on two occasions, without any analysis of alternative options. Following the expiration of the second renewal agreement, the entity continued to use the supplier's services for a number of months, creating uncertainty around the

legal status of the agreement. Legal advice received by the entity indicated that the entity was exposed to the potential risk of non-performance. The entity advised that it had subsequently reviewed the property management services and discontinued the agreement with no impact on the entity.

Receipt and evaluation of suppliers' bids

Receipt of tenders

3.34 Tender responses should be delivered to a single location, then opened at the same time, after the deadline specified in the request documentation. For major tenders, the responses should be opened by two officers and a record of receipt maintained.

3.35 As a minimum standard, details of each tender response received should be documented. Such documentation is important to meet minimum probity obligations associated with tenders.

3.36 A review of documentation in relation to the opening of tender responses identified that all entities had followed sound practices, including the use of checklists and pro-forma documents.

3.37 For larger tenders, some entities engaged probity advisors and/or auditors. The ANAO considers that this approach enabled entities to effectively reduce the risk of probity issues having an adverse impact on the tender process.

3.38 Where a tender response was received after the deadline by an FMA Act agency, the ANAO found that acceptance of that tender response was properly explained and documented, in accordance with the CPGs applicable at the time.²⁸

3.39 The ANAO found that, in instances where tender boxes were not used, entities had appropriately documented the procedures followed in the receipt and opening of tender responses. For example, one entity held each of the tender responses in a locked area, and opened them all after the deadline had expired, with the opening witnessed by a probity auditor.

Evaluating tender responses

Evaluation plans

3.40 An evaluation plan is designed to support the consistent and transparent evaluation of tender responses and should be approved by an

²⁸ Prior to 1 January 2005, entities subject to the CPGs could accept late tender submissions. After this date, CPGs require that late submissions not be accepted, unless the submission is received after the procurement's closing time because of an error by the entity.

appropriate delegate prior to tenders closing and the evaluation commencing. It should set out:

- the objectives of the procurement;
- roles and responsibilities of each of the evaluation committee members and other parties that may be involved in the evaluation;
- timetable for the evaluation;
- the criteria by which tender responses will be evaluated that are consistent with the request documentation; and
- guidance for the evaluation committee on how to assess each criterion.

3.41 One of the audited entities had comprehensive evaluation policies that required a delegate to approve the evaluation plan prior to the evaluation commencing. Another entity did not have a formal policy on evaluation plans, but had developed pro-forma evaluation documents, which included practical guidance on how evaluations were to be performed.

3.42 The other entities had varying policies and related guidance for evaluations, but none had a formal requirement for tender evaluation plans to be used. Nevertheless, in practice, most entities used evaluation plans or assessed tender responses against the criteria in the request documentation.

3.43 The ANAO considers that formal evaluation plans enhance the probity and effectiveness of the evaluation process, and reduce the risk that value for money will not be obtained. The ANAO considers, therefore, that evaluation plans should be a standard requirement for all purchases by tender and represent good practice for all significant purchases.

Evaluation methodology

3.44 The evaluation of tender responses is the most important aspect of the value for money consideration.²⁹ The ANAO found that most entities did not have policies specifying the way in which tender responses were to be assessed, although all of the entities assessed tender responses against criteria contained within request documentation.

3.45 In most instances, entities assessed tender responses by weighting the assessment criteria outlined in the request documentation,³⁰ depending on their

²⁹ Department of Finance and Administration, *Guidance on the Mandatory Procurement Procedures*, Financial Management Guidance No.13, January 2005, p. 46.

³⁰ 'Evaluation of suppliers should be based on the relative importance of each criterion. There are a variety of methodologies that can be used to achieve this. The most commonly used is to weight criteria according to their relative significance using a rating scale. If a rating scale is used, agencies should consider providing the scale to potential suppliers if it will assist them to appropriately focus their responses'. (Department of Finance and Administration, *Guidance on the Mandatory Procurement Procedures*, January 2005, Financial Management Guidance No.13, p. 34).

importance to the objectives of the purchase, and generating numerical scores against these criteria. In this way, tender responses that effectively addressed the more important criteria had a greater chance of selection, as scores against these criteria generally had a larger impact on final scores. Similarly, performance against less important criteria had a smaller effect on final scores, and a lesser influence on selection.

3.46 In one instance, it was difficult to ascertain from the evaluation committee report how the entity had determined that the successful tender response represented best value for money. In this case, three tender responses that were rated similarly against the evaluation criteria had been short listed to make presentations to a steering committee. Following the presentations, the steering committee chose a tenderer whose price was substantially higher than the other two tenderers. While the ANAO acknowledges that a comparison of the three prices submitted may have required prices to be normalised, and that the presentations may have provided a different perspective from that provided in the tender responses, the evaluation report had not clearly documented the comparative reasons as to why the selected tenderer offered best value for money. In particular, there was no commentary on the importance of price in making the decision, nor a revised analysis following the completion of the presentations by tenderers.

3.47 Most entities did not weight price or have a set methodology for evaluating price. However, one method observed by the ANAO was for a value for money ratio to be calculated, by dividing each tender response's total score on all non-price criteria³¹ by total price. The resulting score was then used as a basis for ranking bids in order of value for money. Irrespective of the approach that is adopted, it is important for the delegated officer to confirm that the outcome represents the best value for money when all considerations are taken into account.

3.48 Some evaluations provided for the separate assessment of price. This treatment allows the qualities of each tender response to be assessed by an evaluation committee without that assessment being influenced by pricing considerations. The ANAO considers that such a process can enhance the objectivity of evaluations. However, to be fully effective, it requires pricing information to be processed separately from the remainder of the tender responses from the time of opening. Entities should consider the separate consideration of price on a case-by-case basis, and clearly outline the approach to be adopted in the request documentation and in the evaluation plan.

³¹ The assessment of non-price criteria is often referred to as an assessment of the 'technical worth' of a tender response.

Evaluation results and reporting

3.49 The results of the evaluation committee's deliberations should be reported to management in a signed evaluation report that should include:³²

- a summary of the evaluation process;
- a summary of each submission received;
- a summary of the assessment of each submission;
- reasons for any elimination of a submission from further consideration;
- recommendations concerning the preferred submission(s); and
- details of any issues which need resolution during subsequent contract negotiations.

The report should be approved by a delegate prior to the entity entering into a contract with the supplier.

3.50 The ANAO found that evaluation committees' findings and decisions were not always adequately documented. Where documentation was lacking, the ANAO was not able to examine or assess the reasons behind the entity's choice of supplier. The ANAO considers that all tender evaluations should be fully documented, to enable the selection process to withstand internal and external scrutiny.

Conflict of interest declarations

3.51 Real, perceived or potential conflicts of interest can have a major impact on the probity of a procurement process and therefore need to be identified and effectively managed. A potential conflict of interest may be an employee or contractor involved in the procurement process having:

- a personal relationship with one or more of the potential suppliers;
- a pecuniary interest, such as shareholdings, in one or more of the potential suppliers; or
- previous or potential employment relationship with a potential supplier.

3.52 The ANAO found that, to varying degrees, all of the entities required relevant staff to sign conflict of interest declarations. However, only some of the entities had this requirement as a part of their purchasing policies. In addition, in some instances conflict of interest declarations had not been retained on file.

³² For further guidance on evaluation reports, see Department of Finance and Administration, *Guidance on the Mandatory Procurement Procedures*, Financial Management Guidance No.13, January 2005, p. 47.

3.53 The ANAO considers that the need to complete conflict of interest declarations are an important and effective means of managing conflict of interest issues, and should be included in entities' policies. Such declarations should be completed for all tender evaluations and retained on file.

Purchases not made by tender

3.54 Purchases not made by tender should be assessed according to the same principles as those over the tender threshold, but at a level commensurate with the nature and value of the purchase.

3.55 The ANAO found that, in most instances, purchases had been assessed in accordance with sound purchasing principles and practices.

Engagement of suppliers

3.56 A decision to purchase from a particular supplier should involve reaching agreement on the terms and conditions of the purchase. This is most commonly done through the signing of a contract and/or the issue of a purchase order.

Letting the contract

3.57 The ANAO considers that, among other things, the following minimum information should be included in a contract:

- objectives of the contract;
- responsibilities of the purchaser and the provider, including the goods or services to be provided, the fees and charges to be paid, and arrangements for delivery and payment;
- performance measures and any reporting requirements, that is, when, what, and to whom, including information to be provided by the supplier;
- dates of commencement and expiry, and termination arrangements, including options to extend, where appropriate; and
- contact officers' names and contact details.

ANAO access clauses

3.58 As part of its audit responsibilities under the *Auditor-General Act 1997*, the ANAO sometimes needs to access contractors' premises and records. This is particularly so where the contractor is carrying out an activity or function on behalf of an Australian Government entity under an outsourcing arrangement. Consequently, ANAO access clauses should be included in certain contracts made between Australian Government entities and contractors. Paragraph 7.18

of the CPGs, applying to FMA Act agencies and certain procurements of certain CAC Act entities, states, among other things:

Steps need to be taken to plan for, and facilitate, appropriate disclosure of procurement information. In particular, officials should:

- where relevant, include a provision in contracts to enable the Australian National Audit Office to access contractors' records and premises to carry out appropriate audits (model access clauses have been developed for agencies to tailor and, where appropriate, incorporate into relevant contracts).³³

3.59 The ANAO found that most of the entities had developed and utilised standard form contracts. In addition, all three of the FMA Act agencies included ANAO access clauses in their contracts. The ANAO considers that ANAO access clauses should be included, where relevant, by all Australian Government entities, including those not covered by the CPGs.

Purchases made without a formal contract

3.60 The ANAO found that most entities entered into written contracts with suppliers appropriately, but found a number of cases where agreements had been entered into with suppliers without a written contract.

3.61 In one instance an entity had engaged a consultant to supply services to a group of its customers over an extended period of time. Consulting fees were approximately \$250 000 over an 18 month period. With no formal contract in place, there was uncertainty as to the terms of the consulting engagement, resulting in an increased risk of non-performance by the consultant. Adding to the uncertainty, the consultant was concurrently employed by the entity as a part-time staff member, with no clear differentiation between the role of employee and consultant. A written contract was subsequently drawn up, but was not signed by either party at the time of audit.

3.62 The ANAO also identified an entity that had purchased promotional services from a supplier without a contract, at a cost in excess of \$1 million. The services were required to be provided over a number of months. Rather than enter into a contract with the supplier to provide services over the duration of the project, the entity treated each component of work as a separate purchase. The ANAO considers that, while the arrangement may have afforded a degree of flexibility in the choice of services to be purchased, a contract should have been entered into that clearly identified the services to be provided, the timeframe involved, the estimated cost of services and how intellectual property considerations were to be dealt with. The entity advised

³³ Model Australian National Audit Office (ANAO) access clauses are available from <<http://www.finance.gov.au>>.

that it had subsequently implemented policies to ensure a contract was entered into in such circumstances.

3.63 While one entity had a policy of entering into contracts for all purchases over a certain threshold and two of the other entities entered into contracts for many of their purchases, most of the entities' policies did not address the circumstances under which a contract should be entered into. The ANAO considers that a contract is required where the nature of the relationship with the supplier involves the need to specify requirements in relation to such matters as confidentiality, intellectual property, insurance, price, performance measures, security, duration and termination. The ANAO also considers that, for high-value purchases, there are only limited circumstances in which a contract is not required, and generally these would be limited to the purchase of 'off the shelf' goods and the provision of services of short duration.

Unsuccessful tenderers

3.64 The ANAO found that most entities had policies in place specifying that unsuccessful tenderers were to be advised of the outcome of the tender process in writing. In practice, all of the entities advised unsuccessful tenderers following the engagement of a supplier(s).

Receipt of goods and services

3.65 The final control in the purchase process, as defined by the audit, is the satisfactory receipt of the goods and services in accordance with the purchase specifications. This control is also essential for payment purposes.

3.66 The ANAO found that each entity had adequate controls in place to determine whether goods and services had been received prior to making payment. For smaller purchases, this was generally achieved via certification of invoices. In some instances, larger purchases had additional controls. For example, one entity devoted resources to specific procurements, to ensure that the delivered good or service was of a satisfactory quality. Another entity effectively monitored supplier deliverables in a major software development project, and discontinued the project due to supplier deficiencies.

Recommendation No.4

3.67 The ANAO recommends that entities periodically review their purchasing thresholds and associated purchasing procedures applying to each threshold level, taking into account the nature, risk and financial profiles of their purchases.

Entities' responses

3.68 All entities agreed with the recommendation. Specific comments provided were:

Australian Hearing

Agreed. The organisation reviewed all threshold levels in March 2005 and as a result revised the tender threshold to \$80,000 in line with the new Commonwealth Procurement Guidelines.

CRS Australia

Agree—CRS Australia revised the tender threshold to \$80,000 from 1 January 2005, as a result of the new Commonwealth Procurement Guidelines. CRS Australia is currently undertaking a review of the appropriateness of the other threshold categories.

Recommendation No.5

3.69 The ANAO recommends that entities only exercise options to extend contracts where they are satisfied that the extension represents value for money.

Entities' responses

3.70 All entities agreed with the recommendation. Specific comments provided were:

Australian Hearing

Agreed. Options are only exercised to extend contracts based on business case procedures where the extension represents value for money taking into account upcoming cost and technology changes.

CRS Australia

Agree—CRS Australia only extends contracts where exceptional circumstances exist and only via a business case to the delegate on a value for money basis.

Recommendation No.6

3.71 The ANAO recommends that entities strengthen tender evaluation processes through the use of evaluation plans, the mandatory use of conflict of interest declarations, and methodology that includes an assessment of price and its relationship with non-price criteria to arrive at an overall value for money assessment.

Entities' responses

3.72 All entities agreed with the recommendation. Specific comments provided were:

Australian Hearing

Agreed. Tender evaluation processes in existence are extremely commercial with strong overall value for money assessment. Further refinement and strengthening should be undertaken on a regular basis.

Australian Research Council

The ARC will formalise processes and procedures for tender evaluation as part of the ARC's procurement manual, including mandatory conflict of interest declarations.

CRS Australia

Agree—CRS Australia will further refine its tender evaluation methodology noting that we assess quality and other procurement specifications and then compare relative price/value for those that meet the specifications.

Recommendation No.7

3.73 The ANAO recommends that entities incorporate into their purchasing policies the circumstances in which a contract should be entered into having regard, where applicable, to the requirements of the Commonwealth Procurement Guidelines.

Entities' responses

3.74 All entities agreed with the recommendation. Specific comments provided were:

Australian Hearing

Agreed. Procurement policies have been reviewed to ensure alignment with the CPGs.

CRS Australia

Agree—CRS Australia has recently updated its procurement policy and guidelines to ensure alignment with the CPG's.

4. Public Reporting and Management Review of Purchasing Activities

This chapter covers public reporting and the monitoring and review processes component of the internal control framework, that is, the processes and reporting mechanisms that are in place for measuring performance against objectives.

Introduction

Public reporting

4.1 Australian Government entities report publicly on their operations in various ways. The principal means of public accountability is through the entity's annual report, which is tabled in Parliament and made available on the entity's website.

Measuring performance

4.2 Entities should measure the performance of their processing activities on a regular basis and review the performance of overall programs against objectives from time to time. These processes include the establishment of appropriate performance indicators together with regular management review of performance reporting; and the use of periodic reviews, such as those undertaken by internal audit and external consultants. Such processes provide assurance and feedback on whether objectives are being achieved efficiently and effectively, and provide a check on the effectiveness of the internal control structure.

Audit criteria

4.3 Entities would be expected to meet any public reporting requirements for purchasing and to have regular monitoring and review processes to ensure that purchasing policies and procedures were being properly applied. Such processes would include:

- reporting against performance indicators, for example, lead times from request for purchase to receipt of supplies; and
- quality assurance reviews, for example, independent review of tender selections and long term supplier arrangements, and periodical internal audit coverage.

Public reporting

4.4 FMA Act agencies are required to report publicly on their purchasing activities. The requirements comprise:

- recording all purchases over \$10 000 in AusTender;³⁴
- listing all contracts over \$100 000 on their website (Senate Order for Departmental and Agency Contracts); and
- an assessment of performance against core purchasing policies and principles in the agency's annual report (annual report guidelines).

4.5 The ANAO found that most of the entities complied with the AusTender requirements. However, one entity did not publish approximately half of its 2002–03 transactions on AusTender. These purchases were incorrectly reported as standing offers, rather than contracts,³⁵ and only one purchase was correctly reported as a contract for that year. The entity rectified this matter from 2003–04.

4.6 The ANAO found that one of the FMA Act agencies had not complied with the Senate Order reporting requirements for the 2003–04 financial year, but noted it had complied with the earlier and subsequent reporting periods.

4.7 While each of the FMA Act agencies had reported on purchasing in their annual reports, the information reported varied from a single sentence in one agency stating 'the agency complied with the Commonwealth Procurement Guidelines' to more informative summaries in the other two agencies. The ANAO suggested that the first agency expand its commentary in future years by providing more specific information on its purchasing arrangements. Matters that have been, or could be, reported by agencies under this requirement of the annual reporting guidelines include commentary on: the agency's own purchasing policies; the total value of purchases; the numbers of public and select tenders issued; the extent of use of small and medium enterprises (SMEs)³⁶ and panel suppliers; compliance with the reporting of contracts (AusTender, Senate Order); and any special achievements during the year, such as the introduction of electronic

³⁴ Prior to 1 January 2005, the threshold for reporting in AusTender was \$2000. AusTender was previously known as the Gazette Publishing System (GaPS).

³⁵ In addition to contracts, 'standing offers' are required to be reported on AusTender. A standing offer is not a contract but a continuing offer by a supplier for a pre-determined length of time, usually at a pre-determined price. Standing offers are used to enable agencies to buy goods and services over a specific period on specified terms and conditions. However, each time agencies use a standing offer to order goods or services a discrete contract arises (Department of Finance and Administration, 2005, viewed 21 May 2005, <<http://www.contracts.gov.au/help/helpoutputsearchso.htm>>).

³⁶ An SME is defined in the CPGs as an Australian or New Zealand firm with fewer than 200 full time equivalent employees.

purchasing or enhanced procurement arrangements. In particular, the ANAO considers that agencies should report their usage of SMEs to ensure that they are meeting the Government's 10 per cent target by value³⁷ and compliance with the Senate Order and AusTender requirements.

Measuring performance

Performance information and management reporting

4.8 The purchasing policies of each entity generally did not encompass performance information and management reporting arrangements, although some of the entities had performance indicators and reporting for contract management purposes once a contract was in place. Management reporting at one entity included commentary on new contracts and a range of statistical information on existing contracts; it also showed the growth in the numbers of contracts over time and a breakdown by each work area within the entity.

4.9 The ANAO considers that performance information on purchasing is desirable for management purposes, and in the case of FMA Act agencies, for fulfilling the annual reporting requirements on purchasing performance. For example, agencies could measure their use of SMEs by coding supplier details in the financial management information system or using the data recorded in AusTender. Currently, Finance measures the overall performance of agencies in engaging small and medium enterprises through analysis of AusTender data. The results obtained by Finance for recent years are shown in Table 4.1.

Table 4.1

SME Participation In Gazetted Government Contracts*—1999–2000 to 2002–03

Year	SME% by value	SME% by number
2002–2003	27.0	55.7
2001–2002	25.1	61.3
2000–2001	22.4	58.3
1999–2000	27.6	58.2

* Small and medium enterprises (SME) were identified by matching supplier details in AusTender against other external data sources.

Source: Department of Finance and Administration Procurement Policy and Practice: Statistics on Commonwealth Contract Notifications 1999–2004.

³⁷ Paragraph 5.6 of the current CPGs states that 'the Government is committed to FMA agencies sourcing at least 10 per cent of their purchases by value from SMEs.' This commitment has been Government policy for several years.

4.10 Supplier information in an entity's FMIS may also be used for management purposes. For example, a report by supplier name could be used to identify frequently used suppliers for which contracts may be appropriate or the use of other suppliers for a supply already covered by a common use contract.

Financial data

4.11 Financial data can be a valuable source of information for assessing purchasing activity. The ANAO found that two of the entities made some use of their financial data.

Accounts payable 'health check'

4.12 One entity issued an accounts-payable 'health check' report to each business segment on a quarterly basis. While this report focused mainly on accounts payable data, such as comparison of due and actual dates of payment, it included a split between payments with and without purchase orders.

4.13 While this data was dependant on the nature, number and value of purchases by each segment, it illustrated a wide range in the use of purchase orders within the entity. As noted in Chapter 3 of this report, the ANAO considers that there is scope for some entities to increase their use of purchase orders. A report of this nature therefore represents a means of assessing improved performance in the extent of use of purchase orders.

Identifying suppliers

4.14 Another entity had made additional use of financial data for the purposes of improving purchasing performance. In particular, it had conducted reviews to determine common suppliers being used by different work areas for which there were no organisation-wide contracts. The purpose of this review was to arrange common user contracts, where appropriate, and to help ensure contracts were in place for amounts over a specified threshold, in compliance with the entity's policy that all purchases over this threshold should be covered by a contract.

Analysis of purchasing activity

4.15 The ANAO stratified payment and purchase order data for 2002–03 and 2003–04 for each of the entities from both the FMIS and AusTender (for the three FMA Act agencies). While it was difficult to make comparisons due to inconsistencies between the data and purchasing threshold levels, the ANAO found that more than approximately 80 per cent of most entities' purchases were for amounts less than \$2000, while less than three per cent of most entities' purchases were over the tender threshold.

4.16 The audit identified that none of the entities had conducted such an analysis. The ANAO considers that periodic analysis of such information would be beneficial in setting and reviewing relevant purchasing threshold levels. Entities could stratify both purchase order and payment data from their FMIS, as well as purchasing data on AusTender (for FMA Act agencies) to assist with this analysis. Such information could indicate that the current purchasing threshold levels are appropriate or that a revision of the purchasing thresholds is warranted. Any decisions on the purchasing thresholds should also recognise the nature and risks of their purchasing activity as outlined in Chapter 3 of this report.

Other performance measures

4.17 The ANAO considers that entities should consider developing other reporting measures for assessing purchasing performance in addition to those discussed above. Examples of measures that could be considered include:

- measuring the lead time from the date of the purchase request to signing of the contract and/or the receipt of supplies and comparing it with the estimated lead time; and
- requiring purchasing delegates to report the number of cases, where they have varied from standard policy, in instances where they have such authority, for purchases over a specified threshold.

4.18 Any performance measures developed should be easily measurable, without being administratively burdensome and be reported in conjunction with other management reporting requirements.

Quality assurance reviews

4.19 Quality assurance in most entities was generally carried out by a corporate purchasing cell and/or internal audit.

4.20 The corporate purchasing cells provided a source of advice to other staff, and where used effectively, added value to the purchasing process.

Internal audit

4.21 Internal audit coverage provided the principal means by which entity management obtained assurance about the entities' purchasing activities. Internal audits were completed in all of the entities in recent years and included:

- compliance with general business administration procedures such as use of purchase orders and purchasing decisions, use of credit cards and receipting of goods and services;
- contract management which included some purchasing issues;

- project management controls and monitoring of specific major purchases;
- credit cards, including approval of transactions; and
- accounts payable and procurement.

4.22 Overall, these audits revealed satisfactory results. Where issues had been noted the entities had taken or proposed appropriate remedial action. The ANAO considers that, although the range of audits provided reasonable coverage of purchasing activities, more attention could have been given to tendering selection processes in determining the scope of audit coverage.

4.23 The ANAO considers that entities should assess the need to establish arrangements for the periodic review of their purchasing activities. This can be achieved through the conduct of internal audit coverage or other review arrangements. The extent of these reviews should be commensurate with the nature and risk profile of the entity's purchases.

Recommendation No.8

4.24 The ANAO recommends that entities establish performance measures for reporting on their purchasing activities, and incorporate periodic management reporting against these measures as an integral element of their management reporting arrangements.

Entities' responses

4.25 All of the entities agreed with the recommendation, one of which, Geoscience Australia, 'agreed with qualification.' Specific comments provided were:

Australian Hearing

Agreed. Key performance indicators are in existence. There will be further focus on measurements of these for purchasing with regular reporting implemented.

Australian Research Council

The ARC will establish performance reporting measures on purchasing for inclusion in the monthly reporting processes.

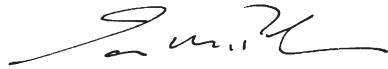
CRS Australia

CRS Australia will develop additional key performance indicators and measures for purchasing, noting that half yearly performance reports on purchasing are already provided to the CRS Australia Executive.

Geoscience Australia

Agree with qualification. GA will look to introduce reporting of performance measures where there is a definite cost benefit in doing so.

Canberra ACT
28 June 2005



Ian McPhee
Auditor-General

Appendices

Appendix 1: Entities' responses to the proposed audit report

This Appendix contains any general comments received on the audit report that are not shown in the body of the report.

Each of the entities selected for audit and Finance were provided with the opportunity to comment on the proposed audit report (or extracts of the proposed report, where applicable) in accordance with the provisions of section 19 of the *Auditor-General Act 1997*.

Entities' responses to the recommendations have been included in the main body of the report under the subheading "Entities' responses" directly following each recommendation.

General responses are reproduced below.

Australian National University

The University advised as follows:

The Australian National University welcomes the recommendations provided in this report. The University has already commenced action to review its procurement policies and practices in the light of the agency specific recommendations and the new Commonwealth Procurement Guidelines. Areas of particular focus will be:

- incorporating recent CPG changes (where applicable) into its procurement policy;
- training;
- management reporting; and
- documentation.

Australian Research Council

The Australian Research Council advised as follows:

The ARC was pleased to participate in this review and agrees with the recommendations proposed in the report. The ARC will work to implement these recommendations to further enhance the ARC's purchasing framework.

CRS Australia

CRS Australia advised as follows:

CRS Australia would like to thank the ANAO for the useful Purchasing Audit report, which will assist with the continuous improvement of procurement processes and practices within the agency.

Finance

Finance advised as follows:

The Department of Finance and Administration (Finance) supports the report's recommendations.

Finance notes that Annual Procurement Plans (APP) are mandatory for all *Financial Management and Accountability Act 1997* agencies and bodies subject to section 47A(2) of the *Commonwealth Authorities and Companies Act 1997* (CAC Act). Finance agrees that APPs are a useful tool and will endeavour to bring to the attention of CAC Act bodies not subject to section 47A(2) of the CAC Act, the second recommendation of the report.

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