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Performance Audit

## **Direct Source Procurement**

Australian National Audit Office

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Canberra ACT  
30 September 2010

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure. The report is titled *Direct Source Procurement*.

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 below the 'Yours sincerely' text.

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 (ANAO). 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 Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

For further information contact:

**The Publications Manager**  
**Australian National Audit Office**  
**GPO Box 707**  
**Canberra ACT 2601**

**Telephone:** (02) 6203 7505  
**Fax:** (02) 6203 7519  
**Email:** [webmaster@anao.gov.au](mailto:webmaster@anao.gov.au)

ANAO audit reports and information about the ANAO are available at our internet address:

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### Audit Team

Tracey Martin  
Alison Wardrop  
Grace Guilfoyle  
Gede Adnyana  
Stuart Turnbull

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# Abbreviations

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CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CEIs	Chief Executive Instructions
CPGs	<i>Commonwealth Procurement Guidelines, December 2008</i>
CPU	Central Procurement Unit
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMA Regulations	<i>Financial Management and Accountability Regulations 2007</i>
FMG No.13	<i>Financial Management Guidance (FMG) No.13, Guidance on the Mandatory Procurement Procedures, January 2005</i>
FMG No.14	<i>Financial Management Guidance (FMG) No.14, Guidance on Ethics and Probity in Government Procurement, January 2005</i>
FMG No.15	<i>Financial Management Guidance (FMG) No.15, Guidance on Procurement Publishing Obligations, July 2007</i>
GPP No.1	Good Procurement Practice No.1, Chief Executive's Instructions and Operational Guidelines for Procurement
MAC Report No.7	Management Advisory Committee (MAC), Report No.7, <i>Reducing Red Tape in the Australian Public Service</i> , 2007
MPPs	Mandatory Procurement Procedures (Division 2 of the CPGs)

# Glossary

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AusTender	The Australian Government's web-based procurement information system. AusTender provides centralised publication of Australian Government business opportunities, annual procurement plans, multi-use lists and contracts awarded.
Commonwealth Procurement Guidelines (CPGs)	Establishes the core procurement policy framework and articulates Government expectations for all departments and agencies subject to the <i>Financial Management and Accountability Act 1997</i> (FMA Act). Also known as Financial Management Guidance No.1. The CPGs also apply to <i>Commonwealth Authorities and Companies Act 1997</i> (CAC Act) bodies in certain circumstances.
Contract reporting criteria	<p>The AusTender contract reporting criteria for <i>Financial Management and Accountability Act 1997</i> (FMA Act) agencies are:</p> <ul style="list-style-type: none"><li>• the instrument to be reported is a Commonwealth contract, agency agreement or standing offer arrangement or amendment thereto; and</li><li>• the value of the instrument (including GST where applicable) is \$10,000 or above.</li></ul>



Covered procurement	<p>Under the Commonwealth Procurement Guidelines (CPGs) a procurement is a covered procurement if:</p> <ul style="list-style-type: none"> <li>• its total estimated value exceeds the procurement thresholds; and</li> <li>• it is not exempt under Appendix A of the CPGs.</li> </ul> <p>Generally for FMA Act agencies, procurements that have a maximum anticipated value of more than \$80 000 are covered procurements. The exception to this rule is procurement of construction services, where a value of more than \$9 million applies. Division 2 of the CPGs establishes Mandatory Procurement Procedures for covered procurements.</p>
Direct Sourcing	<p>A procurement process, in which an agency may invite a potential supplier or suppliers of its choice to make submissions. Direct Sourcing may include a competitive process, for example obtaining quotes. For covered procurements, Direct Sourcing can only be used to procure property and services in limited circumstances as stipulated in the CPGs.</p>
Mandatory Procurement Procedures	<p>The Mandatory Procurement Procedures are a set of rules and procedures, outlined in Division 2 of the CPGs, which must be followed when conducting a covered procurement.</p>
Multi-use list	<p>A multi-use list is a list, intended for use in more than one procurement process, of pre-qualified suppliers who have satisfied the conditions for inclusion on the list.</p>
Open approach to market	<p>Open approaches to the market include requests for tender, requests for expressions of interest and requests for application for inclusion on a multi-use list, all of which are published on AusTender.</p>
Open Tender	<p>A procurement procedure in which a request for tender is published inviting all suppliers that satisfy the conditions for participation to submit tenders.</p>

Procurement	Procurement encompasses the whole process of acquiring property or services. It begins when an agency has identified a need and decided on its procurement requirement. Procurement continues through the processes of risk assessment, seeking and evaluating alternative solutions, contract award, delivery of and payment for the property and services and, where relevant, the ongoing management of a contract and consideration of options related to the contract.
Property	Property refers to every type of right, interest or thing which is legally capable of being owned. This includes, but is not restricted to, physical goods and real property as well as intangibles such as intellectual property and goodwill.
Request for an Expression of Interest	An open approach to the market requesting submissions from potential suppliers interested in participating in a procurement. The list of potential suppliers who have submitted expressions of interest who satisfy the conditions for participation may be used as the basis for conducting a select tender process.
Request for Tender	A published notice inviting suppliers 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. For covered procurements, a select tender process may only be conducted in accordance with certain procedures and circumstances set out in Division 2 of the CPGs.

Value for  
money

The CPGs explain that value for money in procurement requires a comparative analysis of all relevant costs and benefits of each proposal throughout the whole procurement cycle (whole-of-life costing). Value for money is enhanced in government procurement by: encouraging competition; promoting the efficient, effective and ethical use of resources; and making decisions in an accountable and transparent manner.



## **Summary and Recommendations**



# Summary

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## Introduction

### Legislative and policy framework

1. Effective procurement of property and services underpins the delivery of programs by Australian Government agencies. In 2009, the Australian Government purchased over \$23.5 billion in property and services using relatively straightforward or short-term procurement, through to more complex and longer term procurement.<sup>1</sup> Agencies purchased a wide variety of goods and services, including enabling assets such as buildings, printers and information and communications technology; and services such as consultancy advice on program management, and provision of government services to the public by external suppliers.
2. Chief Executives of departments and agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act) must promote the proper use of Commonwealth resources.<sup>2</sup> To help achieve this, under the *Financial Management and Accountability Regulations 1997* (FMA Regulations), the Finance Minister issues Commonwealth Procurement Guidelines (CPGs) for officials to follow when performing duties in relation to procurement (Regulation 7).<sup>3</sup> FMA Regulation 9 also requires that approvers of spending proposals be satisfied, after undertaking reasonable inquiries, that the spending proposal provides for the proper use of Commonwealth resources.

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<sup>1</sup> The value of purchased property and services was sourced from AusTender data for the 2009 calendar year. This data includes contracts valued at \$10 000 and over, based on a contract start date in 2009. Data was supplied by the Department of Finance and Deregulation on 7 January 2010, and includes agencies subject to the *Financial Management and Accountability Act* (FMA Act) 1997 and bodies subject to the *Commonwealth Companies and Authorities Act* (CAC Act) 1997.

<sup>2</sup> Proper use of Commonwealth resources means efficient, effective and ethical use that is not inconsistent with the policies of the Commonwealth. FMA Act, section 44(3).

<sup>3</sup> The CPGs are known as Department of Finance and Deregulation (Finance), Financial Management Guidance (FMG) No.1 *Commonwealth Procurement Guidelines*, December 2008. The CPGs may also apply, following a direction by the Minister for Finance, to Commonwealth entities subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act) listed in Schedule 1 of the *Commonwealth Authorities and Companies Regulations 1997* as being subject to Section 47A of the CAC Act. This audit did not include an examination of entities subject to the CAC Act.

3. The CPGs establish the core policy framework and articulate the Government's expectations for procurement.<sup>4</sup> The last substantial revision of the CPGs occurred in January 2005, and gave effect to the Australian Government's procurement obligations under the Australia-United States Free Trade Agreement.<sup>5</sup> Among the changes was a general presumption of open tendering for higher value procurements, which meant that selective and limited tendering was only available in specific and appropriately justified circumstances. It was anticipated that the dominant impact of the revised CPGs would be to increase the number and scope of procurement opportunities offered to the full market by Australian Government agencies.<sup>6</sup>

4. The current CPGs establish procurement principles that apply to all procurement processes, and promote value for money as the core principle of the Government's procurement policy framework.<sup>7</sup> Value for money is enhanced and complemented by other key principles—encouraging competition; efficient, effective and ethical use of resources; and accountability and transparency in decision-making. Applying these procurement principles is a requirement of the CPGs, and necessitates that agencies take a considered approach when establishing arrangements for individual procurements.

5. For higher value procurements (known as covered procurements, and generally valued at more than \$80 000), the CPGs also establish Mandatory Procurement Procedures.<sup>8</sup> The Mandatory Procurement Procedures establish a range of prescriptive obligations that must be complied with when selecting a procurement method and managing the resultant procurement process.

6. Under the CPGs, agencies are obliged to maintain appropriate documentation for each procurement. The appropriate mix and level of documentation depends on the nature and risk profile of procurement being undertaken. Agencies need to ensure there is sufficient documentation to provide an understanding of the reasons for the procurement, the process that

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<sup>4</sup> Finance, CPGs, 2008, p. 2.

<sup>5</sup> As outlined in footnote 3, the current version of the CPGs was issued in December 2008.

<sup>6</sup> The Hon Dr Sharman Stone MP (the then Parliamentary Secretary to the Minister for Finance and Administration, Federal Member for Murray), Media Release 04/2004, *\$200 billion US procurement market open to Australian suppliers from January 1, 2005*, 31 December 2004.

<sup>7</sup> Finance, CPGs, 2008, p. 9.

<sup>8</sup> Covered procurements are generally procurements in excess of the procurement thresholds of \$80 000, or \$9 million for construction services, except where the property or services are exempted by Appendix A of the CPGs.



was followed and all relevant decisions, including approvals and authorisations, and the basis of those decisions.<sup>9</sup>

7. The CPGs guide agencies to establish Chief Executive Instructions (CEIs) and operational guidelines outlining their own approach to procurement, while at the same time encouraging agencies to adopt processes that are commensurate with the scale and risk profile of the procurement. This sentiment was also supported by Management Advisory Committee (MAC) Report No.7,<sup>10</sup> which outlined the minimum requirements to meet the Government's legislative and policy framework applicable to procurement. The MAC suggested that agencies only adopt processes in addition to the CPGs in specific circumstances, where the benefits of doing so outweigh the associated costs.<sup>11</sup> More recently, the Advisory Group on Reform of Australian Government Administration reiterated that agencies need to reduce internal red tape to promote efficiency, including streamlining administrative and legislative compliance in areas such as financial management.<sup>12</sup>

## Direct Source procurement

8. The CPGs and related Department of Finance and Deregulation (Finance) guidance define three procurement methods: Open Tender, Select Tender and Direct Source procurement. Direct Source procurement is a process in which an agency may invite a potential supplier or suppliers of its choice to make submissions such as quotes or tenders. By its nature, Direct Sourcing is less competitive than Open and Select Tendering as it does not provide the opportunity for all or, in many instances, a number of potential suppliers to compete for the provision of property and services.

9. For covered procurement, the CPGs require that Direct Sourcing only be undertaken in a limited number of specified circumstances, such as when an approach to the market has failed.<sup>13</sup> For non-covered procurement, agencies should conduct an appropriately competitive procurement process

<sup>9</sup> Finance, CPGs, 2008, p. 18, paragraph 7.9. Refer also to Appendix 6: Documentation obligations, requirements and sound practices.

<sup>10</sup> MAC, Report No.7, *Reducing Red Tape in the Australian Public Service*, 2007, pp. 25–26 and 30.

<sup>11</sup> MAC, Report No.7, *Reducing Red Tape in the Australian Public Service*, 2007, p. 26.

<sup>12</sup> Advisory Group on Reform of Australian Government Administration, *Ahead of the Game—Blueprint for Reform of the Australian Government Administration*, March 2010, p. 66.

<sup>13</sup> The circumstances are outlined in paragraph 8.33 of the CPGs. A full list of the circumstances is provided in Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing.

commensurate with the scale, scope and relative risk of the procurement.<sup>14</sup> In all cases, agencies need to be mindful that it is generally more difficult to adhere to the procurement principles such as value for money, encouraging competition and ethical use of resources when Direct Sourcing, but under the CPGs the onus is on them to do so.<sup>15</sup>

## Audit approach

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

**11.** The audit examined whether selected agencies had developed a sound procurement framework; appropriately classified procurement methods when meeting external reporting requirements; implemented the CPGs and relevant legislation when Direct Sourcing; and established effective procurement monitoring and review arrangements.

**12.** The ANAO selected four FMA Act agencies to provide a cross-section of the 104 agencies that reported procurement activity in AusTender in 2008–09. The agencies selected for audit were:

- the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA);
- the Department of Innovation, Industry, Science and Research (Innovation);
- the Department of Veterans' Affairs (DVA); and
- the Australian Crime Commission (ACC).

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<sup>14</sup> Finance, CPGs, 2008, p. 12, paragraph 5.7.

<sup>15</sup> Finance, CPGs, 2008, p. 18. The CPGs require that agencies must maintain appropriate documentation for each procurement based on the nature and risk profile of the procurement being undertaken. Transparency provides assurance that the procurement processes undertaken by agencies are appropriate and that policy and legislative obligations are being met. Transparency involves agencies taking steps to support appropriate scrutiny of their procurement activity.

13. The ANAO examined a stratified random sample of 645 procurements valued at \$10 000 and over, across the four agencies.<sup>16</sup> More detailed testing was undertaken for the 285 Direct Source procurements in the sample.<sup>17</sup>

## Overall conclusion

14. Procuring appropriate property and services, and being able to demonstrate value for money in such activities, is a prime consideration in the administration of Australian Government programs. Within the legislative and policy framework for government procurement, officials must be satisfied that decisions to procure property and services are proper and defensible. In this context, the Commonwealth Procurement Guidelines (CPGs) facilitate sound decisions by establishing procurement policy, including the principles that apply to all procurement processes. The CPGs promote value for money as the core principle in all procurements. The other key principles—encouraging competition, efficient, effective and ethical use of resources, and accountability and transparency in decision-making—underpin the achievement of value for money. Agencies are required to have regard to all such considerations in their procurement activities. As the scale and risk profile of the procurement increases, the transparency and defensibility of procurement activities becomes increasingly important.

15. For covered procurements (generally those above \$80 000), the CPGs establish Mandatory Procurement Procedures that agencies are obliged to comply with when procuring property and services. The prescriptive nature of these procedures means that agencies do not have discretion in their application. The Mandatory Procurement Procedures limit the use of non-open approaches to the market (including Direct Source procurement) to a small number of specified circumstances, thereby encouraging competition.<sup>18</sup> In addition, for covered procurements, the rigour required in documenting the

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<sup>16</sup> For the purposes of the audit an extract was taken from the AusTender database on 29 September 2009. The audit sample is based on contract notices reported by the audited agencies in AusTender with a contract start date between 1 July 2008 and 13 August 2009. The audit scope and approach are outlined in Chapter 1.

<sup>17</sup> Value for money, and efficiency, effectiveness and ethical tests were performed on 248 of these Direct Source procurements. For the other 37 Direct Source procurements, these principles were established through agency arrangements (rather than for each procurement) and it was not within the scope of the audit to test these arrangements.

<sup>18</sup> Finance, CPGs, 2008, p. 12, paragraph 5.8 refers to these mandatory procedures further encouraging competition.

key processes, decisions, and the basis for those decisions, becomes more important given the increased scale and risk profile of procurement.

16. Where procurements are non-covered (generally less than \$80 000), there will be situations where the cost of participating in an open approach to the market is not commensurate with the scale or risk of the task. In such situations it is the responsibility of agencies to determine an appropriate process that will provide value for money without causing undue costs to the industry or the agency, or reducing program effectiveness.<sup>19</sup> These processes may include establishing panels for the provision of common property and services, accessing another agency's panel where possible, or seeking quotes from one or more potential suppliers.

17. Covered and non-covered procurements can be undertaken through either an Open Tender, Select Tender or Direct Source procurement process. Direct Source procurement involves an agency selecting one or more suppliers of its choice to make submissions, such as quotes or tenders, to provide property or services. While Direct Source procurement is, in practice, undertaken for procurements of all scales and risk profiles, it should not be the default procurement approach as it is not conducive to open and effective competition and it is generally more difficult to demonstrate value for money.<sup>20</sup> The procurement principles reflected in the CPGs are expected to guide all Australian Government procurement activities. Where Direct Source procurement is overused, or perceived as the default method, agencies need to consider the implications this can have for reputational risks, not only for their agency but also for the wider public sector.<sup>21</sup>

18. In the 2009 calendar year, 48 per cent of all contracts entered into by the Government and reported on AusTender were Direct Sourced.<sup>22</sup> In addition,

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<sup>19</sup> Finance, CPGs, 2008, p. 12. In determining a procurement process, the CPGs refer to the selection of Direct Source, Select Tender or Open Tender procurement methods, as well as designing an appropriately competitive process when Direct Sourcing or Select Tendering.

<sup>20</sup> The CPGs explain that effective competition requires non-discrimination in procurement and the use of competitive procurement processes. Finance, CPGs, 2008, p. 11.

<sup>21</sup> Finance, FMG No.14, *Guidance on Ethics and Probity in Government Procurement*, 2005, p. 12. Ethical behaviour and good probity practices enhance an agency's reputation in the marketplace, thereby increasing business confidence in procurement processes, and in turn are likely to maximise the number of suitable responses for future agency work.

<sup>22</sup> For the ANAO audit sample, the level of Direct Sourcing reported by the audited agencies in AusTender was generally consistent with the actual level of Direct Sourcing. Misclassifications of Direct Source procurements (as Select Tenders) and panel procurements (as Direct Sourcing) had a net offsetting effect.

Direct Source procurement accounted for 43 per cent (or \$10.2 billion) of the total reported value of all of these contracts. These results are comparable to those of prior periods and, when considered in conjunction with other audit findings, suggest greater emphasis should be given to encouraging more open competition and access in Australian Government procurement, in balancing the range of requirements agencies are required to meet under the CPGs.

19. Overall, agencies were reasonably familiar with the Government's procurement framework and the CPGs. However, in practice, key elements of the CPGs were not consistently followed across the four audited agencies when choosing and conducting Direct Source procurements. For the majority of Direct Source procurements examined, from the circumstances of the procurement and/or procurement documentation, it was not evident that one or more CPG obligations, requirements or specified sound practices had been met, including for higher valued procurements.<sup>23</sup>

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

### *Agency guidance material*

21. All four audited agencies had Chief Executive Instructions (CEIs) and operational guidance for procurement that covered the requirements of the requisite legal and policy framework. Nevertheless, these need to more clearly address Direct Sourcing arrangements and achieving competitive procurement processes. The agencies' procedures and delegates' decision-making tended to favour Direct Source procurement, limiting opportunities for competitive procurement processes. Agencies also experienced difficulties in distinguishing Direct Sourcing from Select Tendering. In part, this reflected a lack of clarity in Finance's definitions of methods for non-covered

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<sup>23</sup> The CPGs specify obligations, requirements and sound practices, and variously use terms including 'must', 'need to' and 'should' to denote them, respectively.

procurements; an issue which Finance recognises and had advised it intends to address. Strengthening of agency operational guidelines, together with additional clarity in Finance's procurement definitions, should improve the level of support provided to officials to aid them in selecting appropriate procurement methods.

### *Agency practices*

**22.** The ANAO examined procurements valued between \$10 000 and \$305 million, for property ranging from stationery to buildings, and services such as research and development, information and communications technology support and management consultancies. Irrespective of the value or type of Direct Source procurements, there was often limited evidence to demonstrate that agencies' practices for individual procurements provided value for money. This does not necessarily mean that value for money was not achieved; rather that, in many cases, procurement practices applied to the particular circumstances, including the supporting documentation, did not engender confidence that value for money requirements of the CPGs were satisfied. The audit also highlighted issues in agencies' application of the other principles set out in the CPGs such as accountability and transparency in procurement decision-making.

**23.** Examination of Direct Source procurements across all four agencies provided evidence that, in 85 per cent of instances, agencies approached only one supplier and either did not seek, or only sought one quote prior to procurement.<sup>24</sup> The practical application of the CPGs can justify Direct Sourcing in certain instances, for example, for simple low cost items where market forces readily determine product price.

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

**25.** For covered Direct Source procurements, agencies could not consistently assure that their procurements complied with the Mandatory

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<sup>24</sup> The ANAO examined a stratified random sample of 645 procurements valued at \$10 000 and over, across the four agencies. More detailed testing was undertaken for the 285 Direct Source procurements in the sample. Value for money (and the number of quotes sought), and efficiency, effectiveness and ethical tests were performed on 248 of these Direct Source procurements.

Procurement Procedures. That is, from the circumstances of the procurement and/or procurement documentation, it was not evident that a valid condition for Direct Sourcing had applied to their higher valued procurements (covered procurements), as required by the CPGs.<sup>25</sup> When CPUs were involved in decisions to Direct Source covered procurements, this generally had a positive impact on compliance.

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

### *Improving procurement approaches*

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

28. Having regard to the underpinning expectations of the CPGs and the scale of Australian Government procurement, agencies should strive to better balance the broader benefit of competitive tendering and streamlined procurement practices. Such a balance would see agencies giving greater consideration to the scope of the potential procurement need at the outset of a procurement; more often seeking opportunities to approach the market to enhance the potential to achieve value for money; and adopting more strategic approaches to procurement, such as greater use of panels and other standing offer arrangements. In general, a greater emphasis on earlier planning for

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<sup>25</sup> In the sample of 285 Direct Source procurements, the ANAO examined 105 covered Direct Sourced procurements. These procurements exceeded the threshold value of \$80 000, or \$9 million for construction services, and were not exempt procurements (see Appendix 5: Mandatory Procurement Procedures: exemptions for details of exempt procurements).

procurement activities would improve the procurement outcomes. The ANAO has made four recommendations to improve agency procurement practices in this regard, and to bring greater clarity to the requirements of the CPGs.

## Key findings by chapter

### Procurement Management and Support (Chapter 2)

29. All four agencies had in place CEIs and supporting operational guidance applying to procurement that reflected the suggestions outlined in Finance guidance. Importantly, the CEIs and guidance covered the requirements of the legal and policy framework applicable to procurement, and established the respective agency arrangements for both covered and non-covered procurement. These documents had been subject to recent review and were available on each agency's intranet.

30. Nevertheless, the agency guidance did not always lead to selection of an appropriate procurement method and sound Direct Source procurement practices. There was scope for agencies to provide simple templates to guide staff through the procurement process<sup>26</sup> and improve guidance in relation to:

- early consideration of the procurement need and approach, including estimating the value of a procurement and selecting the appropriate procurement method; and
- the procedures that must be followed when Direct Sourcing, including establishing practices that better support the achievement of value for money, adequately assess risks and manage conflicts of interest.

31. All four agencies had a Central Procurement Unit (CPU), in which most staff had an appropriate qualification and/or extensive experience in procurement. The involvement of CPU staff in individual procurements varied, depending on factors such as the procurement value and method. The timely involvement of CPU staff in decisions to Direct Source, generally had a positive impact on compliance with the Mandatory Procurement Procedures. In this regard, a good practice implemented by FaHCSIA required clearance by

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<sup>26</sup> In this respect, Innovation provided staff with a two page guide (and simple templates) summarising key procurement steps.



the CPU Branch Head of decisions to Direct Source procurements in excess of \$80 000.<sup>27</sup>

## Classifying and Reporting Procurement (Chapter 3)

32. To facilitate the accountability and transparency of procurement activities, agencies are required to publish a range of procurement information on AusTender. This includes timely publication of contracts awarded and reporting the procurement method for each contract. Accurate reporting of the procurement methods employed provides transparency on the form of the procurement processes used by agencies, and guides potential suppliers on available procurement opportunities.

33. There is a need for agencies to improve the accuracy and timeliness of contract notice reporting, as:

- around five per cent of the procurement audit sample was made up of grants, sponsorships and other agency contracts, which do not fit the definition of a contract notice for AusTender reporting purposes. FaHCSIA was responsible for almost all of these reporting errors;
- there was a range of instances of agencies reporting purchase orders, invoices and amendments under a contract as separate contract notices, in part reflecting difficulties in the automatic transfer of contract variations or extensions to AusTender;<sup>28</sup> and
- the proportion of agency procurements reported as required on AusTender within six weeks of entering into the arrangement ranged between 85 per cent (at FaHCSIA) and 15 per cent (at ACC, due to

<sup>27</sup> A procurement pre-approval mechanism is one of the measures the Department of Environment, Water, the Heritage and the Arts (DEWHA) and the Department of Climate Change and Energy Efficiency (DCCEE) are using to address findings of non-compliance with the CPGs and agency requirements in relation to the Green Loans program. DEWHA has outlined these arrangements in *Doing our Business Better, Response to the Review of the Administration of the Home Insulation Program (the Hawke review)* and the *Independent Inquiry into the Green Loans Program (the Faulkner review)*, July 2010, pp. 2 and 3. DCCEE has outlined these arrangements in the *Department of Climate Change and Energy Efficiency's Response to the Hawke Report on the Home Insulation Program and the Faulkner Inquiry in the Green Loans Program*, 8 July 2010, p. 6.

<sup>28</sup> Similar findings were made in ANAO Audit Report No.6, 2009–10, *Confidentiality in Government Contracts—Senate Order for Departmental and Agency Contracts (Calendar Year 2008 Compliance)*. Most of the agencies had taken steps to address the current practice of reporting contract amendments as separate contract notices by manually entering contract variations in AusTender so that they appear as amended records of the original contract notice. Finance is progressing solutions to linking contract variations that are automatically transferred.

problems encountered with its new financial management information system).

34. For non-covered procurements, the inaccuracy of reporting may, in part, be due to the subtle differences in definitions of the procurement methods contained in the CPGs. For non-covered procurement, the definitions of Select Tender and Direct Source procurement contained in the CPGs and related guidance imply that there is little or no difference between the two methods of procurement. Agencies may approach more than one supplier of their choice and could classify the procurement as Select Tender or Direct Source.

35. However, for covered procurement, the CPGs provide definitions that clearly differentiate between the two methods of procurement. Specifically, the Mandatory Procurement Procedures permit three methods for a Select Tender—the first two require an initial open approach to market, and the third involves restricted supplier markets. The Mandatory Procurement Procedures also limit the circumstances when Direct Sourcing may be undertaken for covered procurement. When the procurement process is not an Open Tender or Select Tender process in accordance with the Mandatory Procurement Procedures, it is considered to be Direct Sourcing.

36. Partly reflecting this situation, agency definitions of the various procurement methods were not always clear or consistent with those contained in the CPGs and related guidance. For the sample of procurements, all four agencies had instances of incorrect or inconsistent reporting of their procurement methods in AusTender, ranging from 6 per cent (at Innovation) to around 28 per cent (at FaHCSIA). The main areas of misclassification related to reporting procurements from a panel as Direct Source rather than Open Tender,<sup>29</sup> and reporting procurements as Select Tender when they are more appropriately considered Direct Source procurement.<sup>30</sup>

37. Finance has recognised that the policy intention relating to procurement methods may not be clear from the current guidance documents.

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<sup>29</sup> Where a panel is established using an Open Tender process, procurements from the panel should be reported as Open Tender procurements. There were 41 misclassified panel procurements in the audit. These procurements had a total reported value of almost \$19 million. Thirty of these procurements were covered procurements.

<sup>30</sup> Thirty-nine procurements were misclassified as Select Tender when they were Direct Sourced. These procurements had a total reported value in excess of \$4 million. Thirteen of these procurements were covered procurements.

Finance advised that only procurements that follow one of the three Select Tender procedures outlined in the Mandatory Procurement Procedures should be regarded as Select Tenders, regardless of whether or not the procurement is covered. Finance intends to review the relevant guidance to clarify and simplify the procurement method classifications, which will support the accuracy of AusTender reporting and the transparency of Government procurement.

## **Compliance of Direct Source Procurement Decisions and Processes (Chapter 4)**

### *Value for money and encouraging competition when undertaking Direct Source procurement*

38. When procuring property and services, the Australian Government has an objective of achieving value for money. This requires a comparative analysis of all the relevant costs and benefits of each supplier's proposal throughout the procurement cycle. Determining value for money involves a range of considerations, including: fitness for purpose; the performance history of each prospective supplier; the relative risk of each proposal; the flexibility to adapt to possible change over the lifecycle of the property or service; financial considerations; and the evaluation of contract options.<sup>31</sup>

39. For 74 per cent of the Direct Source procurements in the ANAO sample, agencies were unable to demonstrate whether the procurement gave them value for money.<sup>32</sup> In the majority of cases there was a lack of evidence of any comparative analysis of the relevant costs and benefits of different procurement options to support the procurement decision.

40. Obtaining multiple quotes assists with achieving value for money and introduces competition into a Direct Source procurement process. However, from available evidence multiple quotes were sought in only 15 per cent of the Direct Source procurements examined.<sup>33</sup> Where agency procedures required more than one quote, ANAO sampling identified that this was not generally

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<sup>31</sup> Finance, CPGs, 2008, p. 10, paragraph 4.4.

<sup>32</sup> The ANAO examined value for money assessments for 248 Direct Source procurements across the four agencies.

<sup>33</sup> For Direct Source procurements valued at more than \$80 000, more than one quote was sought for only 14 procurements (10 per cent). This means that 121 Direct Source procurements (that were each valued in excess of \$80 000), with a total reported value of almost \$183 million sought one or no quotes prior to procuring their property or services.

occurring. Where procedures did not specify a minimum number of quotes it was commonplace for officials to obtain only one quote. Overall, agencies' quotation practices did not support competitive procurement.

### *Efficiency and effectiveness when undertaking Direct Source procurement*

41. Efficiency and effectiveness are established as requirements of the CPGs. Efficiency in procurement includes the selection of a procurement process that is consistent with government policy and is the most appropriate to the procurement objective under the prevailing circumstances. Effectiveness in procurement can be achieved by ensuring that the property or service being sought will make the maximum possible contribution to the relevant outcome.<sup>34</sup> To achieve efficiency and effectiveness in procurement, it is important that prior to commencing the procurement the agency gives due consideration to the procurement need and process, including the value of the procurement, the level of risk and prevailing market circumstances. This assists the selection of an appropriate procurement method.<sup>35</sup> The consideration may take the form of a business case, procurement planning or equivalent, or can be built into established working arrangements.<sup>36</sup>

42. In all cases, the approach taken to efficiency and effectiveness considerations should be fit for purpose, that is, commensurate with the scale and risk profile of the procurement. For low value, basic purchases, these considerations would normally be built into established working arrangements, and therefore would not need to be specifically documented. As the scale and risk profile of the procurement increases, appropriate documentation of efficiency and effectiveness considerations would generally need to be maintained to demonstrate adherence to the CPGs.

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<sup>34</sup> Finance, CPGs, 2008, p. 14, paragraph 6.6.

<sup>35</sup> The value of a procurement determines whether it should be treated as covered. Accurate estimation of value is particularly important for procurements approaching or likely to exceed the covered procurement thresholds.

<sup>36</sup> Finance, CPGs, 2008, p. 19. The CPGs identify, as part of the phase of identifying the procurement need, the preparation of documentation that outlines the business case, risk assessment and procurement method decision. Similar requirements are outlined in Finance, FMG No.13, *Guidance on the Mandatory Procurement Procedures*, January 2005, pp. 8 and 19. FMG No.13 is primarily directed at covered procurements. The practices outlined in this guidance are considered better practice. In this regard, it is considered that it could be to an agency's advantage to apply these practices to non-covered procurement as these practices would assist the agency to comply with the procurement policy framework. FMG No.13, 2005, p. 4. Procurement planning is addressed in FMG. No.13 (Finance, FMG No.13, pp. 8–19).

43. Agency guidance for FaHCSIA, Innovation and DVA generally required documentation of the aforementioned efficiency and effectiveness considerations for all Direct Source procurements, whereas ACC generally only required documentation of the reasons for Direct Sourcing.

44. For 60 per cent of the Direct Source procurements examined, there was limited evidence of the aforementioned efficiency and effectiveness considerations prior to commencing the procurement.<sup>37</sup> Innovation was able to demonstrate some consideration of the procurement need and process, for 84 per cent of the Direct Source procurements examined.

45. FaHCSIA, DVA and the ACC were only able to demonstrate adequate consideration of the procurement need and process for 33 per cent, 15 per cent and 7 per cent, respectively, of their Direct Source procurements in the audit sample. For the 100 instances where there was evidence of the considerations:

- only 43 included an estimate (rather than quotes) of the value of the procurement, and in nine of these instances the estimates were significantly over or undervalued. As indicated above, estimating the value of a procurement is necessary to determine whether or not it should be treated as covered, and is particularly important as procurements approach the procurement thresholds in value. At present, there is a risk that many procurements are being inappropriately treated as non-covered—with the ANAO finding evidence of behaviour that sought to avoid the procurement thresholds in some instances. This behaviour included treating procurements as non-covered procurements when their value could not be reliably estimated and splitting the cost of services between more than one contract; and
- the rationale provided for Direct Sourcing non-covered procurements tended to be limited, often only suggesting that it was an appropriate method, rather than having regard to established working arrangements of the agency, and the scale and risk profile of the procurement. Similarly, the rationales for Direct Sourcing covered procurements generally only referenced the relevant circumstance that was considered to apply, rather than outlining why it applied.

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<sup>37</sup> For procurement valued in excess of \$80 000, 85 (63 per cent) procurements did not demonstrate these considerations had taken place. In comparison 56 per cent of procurements valued at \$80 000 or less did not demonstrate that these considerations had taken place.

### *Risk management when undertaking Direct Source procurement*

46. Risk management is a sound practice to be applied to all elements of public administration. The CPGs state that risk management should be built into an agency's procurement processes, and agencies should ensure that appropriate procedures are in place to identify and consider all risks throughout the procurement cycle.<sup>38</sup> In practice, agencies may adopt different approaches to risk management when undertaking individual procurements. For low risk procurements this may simply involve following routine procurement processes; whereas for procurements of medium and high risk, agencies should, at a minimum, acknowledge the level of risk, and mitigation strategies, in procurement documentation. The benefit of such an approach is that it signals to those with formal roles in procurement approval that there is a heightened risk to the procurement, and prompts officials to both understand and manage any significant procurement risks.

47. For the sample of Direct Source procurements, it was not evident from procurement documentation that risk had been specifically considered by FaHCSIA, DVA and ACC in relation to individual procurements. Meanwhile, Innovation was able to demonstrate specific consideration of risk in a limited number of cases. While for many low risk procurements these findings reflect the application of routine procurement processes, the scale and nature of procurements examined by the ANAO suggested some of these procurements were likely to be of medium to high risk. Sound practice in such instances would be to more explicitly consider risk.

### *Ethical considerations when undertaking Direct Source procurement*

48. Adopting ethical practices, behaviour and approvals when undertaking procurement is a requirement of the CPGs. Ethical behaviour identifies and avoids conflicts of interest, and does not make improper use of an individual's position. A specific aspect of ethical behaviour relevant to procurement is an overarching obligation to treat potential suppliers as equitably as possible.<sup>39</sup> Agencies reduce the risk of unethical dealings, and the associated consequences for an agency's reputation, by setting expectations for staff behaviour, such as through values and a code of conduct. As the scale and/or risk profile of particular procurements increase, more formal requirements

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<sup>38</sup> Finance, CPGs, 2008, p. 14.

<sup>39</sup> Finance, CPGs, 2008, p. 16, paragraphs 6.17 and 6.18.

should be applied to protect the integrity of the procurement processes. Recent reviews have highlighted particular risks in relation to Direct Source procurements.<sup>40</sup>

49. For the sample of Direct Source procurements, it was only evident from procurement documentation for two procurements that conflicts of interest had been considered,<sup>41</sup> and for all agencies documentation of probity matters such as dealings with suppliers, was limited. The agencies' arrangements for dealing with ethical matters tended to be more formalised for Select and Open Tender procurements, instead of relating the degree of formality to the scale and risk profile of the procurement. Under such an approach, ethical matters would have been given more formal consideration for some of the Direct Source procurements examined.

### *Delegate approval of procurement*

50. It is commonplace for agency Chief Executives to delegate their authority to approve spending proposals to individuals within their agency. Delegates are responsible for being satisfied, after reasonable inquiries, that the spending of public money is efficient, effective and ethical, and is not inconsistent with the policies of the Commonwealth. Agencies must document the key elements of a delegate's approval, such as the items, cost, parties and timeframes. However, there is no requirement to document delegates' inquiries.

51. FaHCSIA was able to demonstrate approval for all of its Direct Source procurements in the audit sample because it employed a suitable workflow system in its financial management information system. Innovation, ACC and DVA were able to provide evidence of delegate approval for 81 per cent, 90 per cent and 57 per cent, respectively, of Direct Source procurements in the

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<sup>40</sup> For example, lower value procurements may be the result of splitting large procurements into smaller components to avoid CPG and/or agency thresholds so that agency officials can use Direct Source procurement. Recent reviews of the Green Loans program have highlighted a range of practices that do not meet CPG and/or agency requirements and reflect risks attached to lower value Direct Source procurements. In response to these risks the Department of Environment, Water, Heritage and the Arts has tightened control measures for Direct Source procurements. The following reviews were released on 8 July 2010, by the then Minister for Climate Change and Energy Efficiency and Water, Senator Penny Wong, on the Department of Climate Change and Energy Efficiency's website: *Independent Inquiry into the Green Loans Program—Review of procurement processes and contractual arrangements* by Ms Patricia Faulkner AO (pp. 15–23); and *Review of the Green Loans Program* produced by Resolution Consulting Services (pp. 4, 11–12).

<sup>41</sup> While there were 285 Direct Source procurements in the audit, as outlined in footnote 17 it was only within scope to test conflict of interest for 248 of these procurements.

sample.<sup>42</sup> These agencies had scope for improvement in their documentation of the spending proposal approvals.

52. For the sample of Direct Source procurements, documentation forming procurement approvals was of varying standards, and often did not clearly set out the basis for delegates' decisions. This does not mean that delegates did not undertake reasonable inquiries prior to approving spending, as there is no specific requirement to document delegates' inquiries under in the FMA Regulations. Nevertheless, under the CPGs agencies need to ensure there is sufficient documentation to provide an understanding of approvals and authorisations, and the basis of these decisions.

### *Exempt Direct Source procurement*

53. Procurements that are in excess of the covered procurement thresholds of \$80 000, or \$9 million for construction services, may be exempt from the Mandatory Procurement Procedures if an exemption listed in the CPGs applies. This includes the procurement of research and development services, and procurement from another government entity in accordance with legislative requirements.<sup>43</sup> There were 164 Direct Source procurements that exceeded the relevant covered procurement threshold. Of these 164, the ANAO considered that 59 procurements (36 per cent) were exempt from the Mandatory Procurement Procedures and, therefore, did not need to be treated as covered procurements.

54. To satisfy obligations and requirements in relation to accountability and transparency in procurement decision-making, agencies need to maintain sufficient documentation on such matters as the procurement process that was followed and all relevant decisions, and the basis of those decisions.<sup>44</sup> Notwithstanding these requirements, 47 (80 per cent) of the exempt procurements, with a total reported value in excess of \$44.6 million, did not document the basis of the procurement decision and the specific exemption that supported the exemption decision.

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<sup>42</sup> There was no documentation of Regulation 9 approval for 47 of the 285 Direct Source procurements examined across the agencies. The total reported value of these procurements was almost \$16 million. Thirty-five of these procurements individually exceeded \$80 000.

<sup>43</sup> See Appendix 5: Mandatory Procurement Procedures: exemptions, Table A 2 for a full list of exemptions.

<sup>44</sup> Finance, CPGs, 2008, p. 18, paragraph 7.9.



### *Covered Direct Source procurement*

55. For covered procurement, Direct Sourcing may only be undertaken in specified circumstances as outlined in paragraph 8.33 of the CPGs, such as when an approach to market has failed.<sup>45</sup> For the audit sample, the most commonly claimed circumstances (whether appropriate or otherwise) were the provision of additional services or property by the original supplier for compatibility reasons; there was no reasonable alternative supplier due to an absence of competition for technical reasons; and for reasons of extreme urgency brought about by events unforeseen by the agency. When an agency uses a circumstance under paragraph 8.33, it must also, under paragraph 8.34 of the CPGs, prepare a written report including a statement indicating the circumstances or conditions that justify the use of a procedure other than an Open or Select Tender process. However:

- from the circumstances of the procurement and/or procurement documentation it was not evident that 54 (51 per cent) of the covered Direct Source procurements in the audit sample complied with paragraph 8.33;<sup>46</sup> and
- where relevant circumstances applied, they were only documented in accordance with paragraph 8.34 on 63 per cent of occasions. Further, documentation supporting decisions to Direct Source often lacked adequate reference to the range of factors relevant to making the decision. In this regard, Finance advised the ANAO that agencies cannot claim compatibility or an absence of competition as the reason for Direct Sourcing, without factual evidence of these situations.<sup>47</sup>

56. The extent to which compliance with paragraph 8.33 of the CPGs was not evident (based on the circumstances of the procurement and/or the procurement documentation) for covered Direct Source procurements ranged between 24 per cent at FaHCSIA, 42 per cent at DVA, and 67 and 70 per cent

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<sup>45</sup> A full list of the circumstances outlined in paragraph 8.33 of the CPGs is provided in Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing.

<sup>46</sup> Fifty-four procurements were found to be non-compliant. The total reported value of these procurements was approximately of \$10.2 million.

<sup>47</sup> Similar expectations regarding the need to substantiate the circumstances that demonstrate how a condition for Direct Sourcing applies to the procurement were established in the Faulkner Inquiry of the Green Loans program. *Independent Inquiry into the Green Loans Program – Review of procurement processes and contractual arrangements* by Ms Patricia Faulkner AO, 8 July 2010, p. 22.

respectively at Innovation<sup>48</sup> and ACC. The decisions taken by the agencies to Direct Source covered procurements in circumstances other than those allowed by the CPGs, in large part occurred when they were seeking to continue supplier relationships, including where the existing contract and any extension options had been exhausted. The regularity of such instances suggests the presumption of Open Tendering has not been well embedded at an agency level.

## **Procurement Monitoring and Review (Chapter 5)**

57. Effective monitoring and review of procurement activity helps agencies to comply with the CPGs, and to increase the efficiency and effectiveness of their procurement processes.

58. The agencies generally did not use their contract registers and/or financial management information system to prepare reports on procurement information. This constrained their ability to undertake systematic analysis or a review of procurement activities, including as a means to help assess compliance with the CPGs. Aside from ACC's CPU, the review role of CPUs tended to be limited to their involvement in individual procurements.

59. Each of the agencies had completed audits of procurement in recent years, and where similar ground was covered, the findings of these audits were generally consistent with the ANAO findings. However, the agencies' Certificates of Compliance, through which they report compliance with the FMA Act and regulations, reported lower levels of non-compliance (than identified by this audit) for 2008–09. The differences may be attributed to delegates' level of awareness of the relevant FMA requirements and, in some cases, a lack of understanding of the procurement method undertaken (highlighting the need for Finance to clarify the CPGs in relation to procurement methods). Agencies need to improve the identification of

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<sup>48</sup> Innovation's result was influenced by eight procurements (representing 27 per cent of Innovation's covered Direct Source procurement in the audit sample) resulting from a single procurement decision, for which compliance with paragraph 8.33 was not evident. This procurement decision is discussed in Table 4.11 on page 114.

non-compliance, and to take action to reduce its occurrence for future procurement activities. As mentioned earlier, strengthening of agency procurement guidelines would assist by raising awareness of the government's procurement requirements under the CPGs.

60. The agencies all used panel arrangements as a means to increase the efficiency of their procurement processes, and the ANAO noted examples of use of whole-of-government panels and intra-agency cooperative procurement arrangements. Nevertheless, there was an opportunity for the agencies to better appreciate their overall procurement requirements, as a basis for adopting more strategic approaches to procurement and assisting with the preparation of annual procurement plans. Doing so would help to achieve more efficient procurement processes, for example, by identifying situations where a standing offer arrangement may be more appropriate than separate procurement arrangements.

## Summary of agencies' responses

61. The agencies' comments on the recommendations are contained in the body of the report following the relevant recommendation. A summary of the agencies' responses is provided below and at Appendix 9: Agencies' responses.

### Department of Families, Housing, Community Services and Indigenous Affairs

62. Overall, FaHCSIA considers that this report is well targeted and has made sound recommendations which the Department supports. In addition, FaHCSIA looks forward to the Department of Finance and Deregulation reviewing the clarity of the Commonwealth Procurement Guidelines relating to classification of procurement methods. It is pleasing to note that FaHCSIA was recognised as having good practices in several areas covered by the audit. FaHCSIA continuously reviews its procurement policies and practices to ensure they reflect better practice.

### Department of Innovation, Industry, Science and Research

63. The Department of Innovation, Industry, Science and Research acknowledges the findings of the ANAO Audit of Direct Source Procurement and supports the recommendations proposed in the report. The department found the audit process to be a valuable exercise and is continuing to implement measures to further improve its performance in this area.

## **Department of Veterans' Affairs**

64. The Department of Veterans' Affairs (DVA) agrees with the overall findings and recommendations of the ANAO report. In regard to the observation that DVA has a lower than average percentage of direct sourcing procurements it should be pointed out that DVA has health services contracts with a value in excess of \$4 billion annually which include a large volume of small value procurements being delivered by way of standing offers with individual health providers. The lower than average percentage of direct sourcing procurements within these large procurement processes undertaken by DVA highlights DVA's commitment to increasing the number and scope of procurement opportunities offered to the open market.

## **Australian Crime Commission**

65. The Australian Crime Commission (ACC) agrees with the findings of the audit and will undertake the appropriate action to implement the relevant recommendations.

66. In response to the findings of the audit the ACC has already implemented changes to its processes to ensure the accuracy and timeliness of reporting contract information on AusTender. In addition to this the ACC is currently undertaking a full review of its procurement framework and guidance material to ensure that it is current and addresses these findings. This review will be followed by a training and awareness program advising staff and delegates of their responsibilities in relation to direct sourcing. It is planned that this training will focus on the findings of the audit, in particular the requirement for adequate documentation to support the justification for direct sourcing and the documented evidence of the approvals.

## **Department of Finance and Deregulation**

67. This Audit Report highlights practices that are of concern because they indicate a lack of understanding of key rules and procedures in Commonwealth procurement, underpinned by legislation, and an appreciation that these are intended to promote value for money and accountability. These practices included either not estimating the value, or significantly underestimating the value, of a proposed procurement to avoid an open approach to the market, required by Mandatory Procurement Procedures of the CPGs.

**68.** As outlined in Appendix 3 of the Report, Finance continues to provide a broad range of support to agencies to assist them to manage their procurement obligations. In addition, Finance is in the process of reviewing its procurement policy guidance to both simplify and better target it towards the specific needs of new procurers, experienced procurers and financial delegates.

**69.** Improved understanding and procurement practice within agencies is necessary to support enhanced value for money outcomes. In this regard, Chief Executives could be encouraged to consider providing the central procurement areas of their agencies with clear authority to advise line areas on effective and compliant procurement processes. These central procurement areas have a direct link to procurement advice from Finance and are encouraged to participate in proposed developments to the procurement framework and activities.

# Recommendations

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*The recommendations are based on findings from fieldwork at the audited agencies and are likely to be relevant to other Australian Government agencies. Therefore, all Australian Government agencies are encouraged to assess the benefits of implementing these recommendations in light of their own circumstances, including the extent to which each recommendation, or part thereof, is addressed by practices already in place.*

## **Recommendation No.1**

### **Paragraph 3.50**

To improve the transparency of Commonwealth procurement, the ANAO recommends that:

- (a) Finance review the clarity of the CPGs, including classification of procurement methods, specifically Direct Source and Select Tender procurements; and
- (b) agencies review their policy and guidance on classifying procurement methods to ensure consistency with the CPGs and related guidance.

**Agencies' responses: Agreed**

## **Recommendation No.2**

### **Paragraph 4.100**

Having regard to the scale and risk profile of different procurements, the ANAO recommends that agencies develop concise guidance and templates, covering:

- (a) methodology for estimating the value of procurements to inform decisions about whether the procurement should be treated as covered;
- (b) the expected level of documentation to support decisions to undertake Direct Source procurement (covered and non-covered); and
- (c) consideration of the level of risk and the existence of conflicts of interest for the Direct Source procurement, consistent with the CPGs and Management Advisory Committee Report No.7.

**Agencies' responses: Agreed**

**Recommendation  
No.3**

**Paragraph 4.107**

Having regard to the scale and risk profile of different procurements and to improve compliance with the CPGs, the ANAO recommends that agencies assist delegates to address reasonable inquiry requirements prior to procurement approval, by:

- (a) documenting the procurement need, the prevailing market circumstances and other matters that support the use of Direct Sourcing;
- (b) documenting value for money assessments when Direct Sourcing; and
- (c) reviewing, and where necessary strengthening, pre-approval compliance assurance mechanisms when Direct Sourcing.

**Agencies' responses: Agreed**

**Recommendation  
No.4**

**Paragraph 5.25**

To enhance the annual procurement planning process and provide a basis for adopting more strategic and efficient procurement processes, the ANAO recommends that agencies regularly analyse their procurement activities with a view to streamlining multiple approaches to the market for similar types of property or services.

**Agencies' responses: Agreed**





## **Audit Findings and Conclusions**



# 1. Introduction

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*This chapter provides background information on the legislative and policy framework applicable to Commonwealth procurement, including the nature of Direct Sourcing and how it should be undertaken. The chapter also outlines the audit objective and approach.*

## Background

**1.1** Procurement of property and services is central to the delivery of programs by Australian Government agencies. In 2009, the Australian Government purchased over \$23.5 billion in property<sup>49</sup> and services using relatively straightforward or short-term procurement, through to more complex and longer term procurement.<sup>50</sup> Agencies purchased a wide variety of goods and services, including enabling assets such as buildings, printers and information and communications technology; and services such as consultancy advice on program management, and provision of government services to the public by external suppliers.

**1.2** When procuring property and services, the Australian Government seeks to achieve value for money. This requires a comparative analysis of all the relevant costs and benefits of each supplier's proposal throughout the whole procurement cycle. Determining value for money involves a range of considerations including: fitness for purpose; the performance history of each prospective supplier; the relative risk of each proposal; the flexibility to adapt to possible change over the lifecycle of the property or service; financial considerations; and the evaluation of contract options.

**1.3** The Australian Government's legislative and policy framework applicable to procurement provides a basis for the achievement of value for money. Legislation promotes the efficient, effective and ethical use of

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<sup>49</sup> For the purposes of this audit property is defined in accordance with the Commonwealth Procurement Guidelines (CPGs) to mean every type of right, interest or thing which is legally capable of being owned. This includes, but is not restricted to, physical goods and real property as well as intangibles such as intellectual property, contract options and goodwill.

<sup>50</sup> Source: AusTender data for the 2009 calendar year, which includes contracts valued at \$10 000 and over, based on contract start date in 2009. Data was supplied by the Department of Finance and Deregulation (Finance) on 7 January 2010, and includes agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act) and bodies subject to the *Commonwealth Companies and Authorities Act 1997* (CAC Act).

Commonwealth resources. Meanwhile, procurement policy establishes procurement principles, as well as specific procurement procedures for higher value procurements, that must be applied when procuring property and services for the Commonwealth.

## Legislative and policy framework applicable to procurement

**1.4** Sections 44 and 44A of the *Financial Management and Accountability Act 1997* (FMA Act) are of particular importance to Commonwealth procurement as they outline the responsibilities of Chief Executives to promote the efficient, effective and ethical use of Commonwealth resources, and to keep responsible Ministers<sup>51</sup> informed of their agencies' operations, including procurement.

**1.5** Relevant *Financial Management and Accountability Regulations 2007* (FMA Regulations)<sup>52</sup> address Australian Government agencies' compliance with the Commonwealth Procurement Guidelines (CPGs) (Regulation 7); approval of spending proposals in the current financial year as well as in future financial years (Regulations 9 and 10); and appropriate recording of approvals of spending proposals (Regulation 12).

**1.6** The CPGs<sup>53</sup> establish the Australian Government's procurement policy framework and articulate Government expectations for all departments and agencies that are subject to the FMA Act.<sup>54</sup>

**1.7** The CPGs are supported by guidance material prepared by the Department of Finance and Deregulation (Finance) to assist agencies to make procurement decisions.<sup>55</sup> FMA Act agencies determine their own procurement

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<sup>51</sup> This would include the Portfolio Minister and the Minister for Finance.

<sup>52</sup> The FMA Act and Regulations can be found at: <<http://finance.gov.au/financial-framework/fma-legislation/index.html>>.

<sup>53</sup> Also known as Finance, Financial Management Guidance (FMG) No.1 *Commonwealth Procurement Guidelines*, December 2008.

<sup>54</sup> The CPGs may also apply, following a direction by the Minister for Finance, to Commonwealth entities subject to the CAC Act listed in Schedule 1 of the *Commonwealth Authorities and Companies Regulations 1997* as being subject to Section 47A of the CAC Act. This audit did not include an examination of entities subject to the CAC Act.

<sup>55</sup> All guidance material can be found on the Finance website: <<http://www.finance.gov.au/procurement/procurement-policy-and-guidance/index.html>>. Appendix 2: Finance guidance material for procurement includes a list of relevant guidance material.

practices, consistent with the CPGs, through Chief Executive's Instructions (CEIs) and, if appropriate, supporting operational guidelines.

**1.8** Finance assists Australian Government agencies to manage their procurement obligations through the provision of:<sup>56</sup>

- (a) procurement information through bulletins, forums, seminars and their website; and
- (b) procurement support through the agency advice email address, informal visits to agencies, the Senior Procurement Officials Resource Group, and in the form of good procurement practice guides, finance circulars and training.

## Intent of the CPGs

**1.9** The CPGs have been periodically revised to reflect changing government expectations in relation to procurement. The last major revisions occurred in January 2005 to reflect the then Government's intent that higher value procurement opportunities be offered to the full market except in selective circumstances.<sup>57</sup> The new arrangements were expected to benefit Australian suppliers, including small and medium enterprises, through an opening up of Australian Government agencies' procurement, and by giving effect to the Australia–United States Free Trade Agreement,<sup>58</sup> which includes government procurement of both countries.<sup>59</sup>

**1.10** The 2005 changes were substantial, requiring agency officials to adopt a more rigorous and transparent approach to procurement. The major changes to procurement requirements included:<sup>60</sup>

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<sup>56</sup> Details of Finance's assistance are outlined in Appendix 3: Finance's procurement support.

<sup>57</sup> The January 2005 CPGs defined Direct Sourcing as a procurement process, available only under certain defined circumstances (Finance, CPGs, 2005, Appendix E, p. 59).

<sup>58</sup> The Agreement requires each government's procurement to afford the suppliers of goods and services of the other country the same treatment that applies to domestic suppliers of goods and services.

<sup>59</sup> The Hon Dr Sharman Stone MP (the then Parliamentary Secretary to the Minister for Finance and Administration, Federal Member for Murray), Media Release 04/2004, *\$200 billion US procurement market open to Australian suppliers from January 1, 2005*, 31 December 2004. This media release indicated that 'the dominant impact of the guidelines is that it will increase the number and scope of procurement opportunities offered to the full market.'

<sup>60</sup> ANAO, Audit Report No.21 2006–07, *Implementation of the Revised Commonwealth Procurement Guidelines*, January 2007, pp. 25–26, paragraph 1.4.

- the classification of procurements over a specified value<sup>61</sup> as covered procurements, to which mandatory procurement procedures apply;
- a general presumption of open tendering for covered procurement with selective and limited tendering available only in specific circumstances; and
- specifying procurement publication arrangements, including advertising tender opportunities, advertising pre-qualification processes and public notices on tender awards.

**1.11** For covered procurements, the 2005 CPGs specified the limited circumstances and exemptions under which non-open approaches to the market may be undertaken. For agencies to meet the more prescriptive conditions for the appropriate use of Direct Source procurement, greater attention needs to be given to planning in advance for procurement. There is also a need to maintain a suitable level of awareness of the CPGs to avoid non-compliance.

**1.12** The 2005 CPGs also required that for non-covered procurements, agencies conduct an appropriately competitive procurement process of a scale commensurate with the scale and risk profile of the procurement.<sup>62</sup>

**1.13** Despite these substantial changes, a requirement of the CPGs that remained unchanged was that value for money continued to be the core principle underpinning all procurement (regardless of the value of the procurement).

**1.14** The intent of the 2005 CPGs remains embedded in the current CPGs, which took effect on 1 December 2008. The new CPGs also seek to achieve a more coordinated approach to procurement. This includes reducing the duplication of effort and using the combined purchasing power of the Australian Government to improve value for money. Notwithstanding this direction, agencies continue to be responsible for their own procurement at an agency level.

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<sup>61</sup> Generally \$80 000 for agencies governed by the FMA Act.

<sup>62</sup> Finance, CPGs, 2005, p. 20, paragraph 5.8.

## Commonwealth Procurement Principles

**1.15** The procurement principles established in Division 1 of the CPGs, apply to all Australian Government procurement.<sup>63</sup> These principles are:

- value for money (which is the core principle underpinning Australian Government procurement):
  - in a procurement process this principle requires a comparative analysis of all relevant costs and benefits of each proposal throughout the whole procurement cycle (whole-of-life costing);
- encouraging competition by ensuring non-discrimination in procurement and using competitive procurement processes;
- efficient, effective and ethical use of resources; and
- accountability and transparency in decision-making.

**1.16** Value for money is enhanced and complemented by the other procurement principles.

## Covered procurements and application of the Mandatory Procurement Procedures

**1.17** Division 2 of the CPGs establishes the Mandatory Procurement Procedures (MPPs) for covered procurements. A procurement is a covered procurement if:<sup>64</sup>

- its total estimated value exceeds the procurement thresholds; and
- it is not exempt under Appendix A of the CPGs.<sup>65</sup>

**1.18** The CPGs establish dollar thresholds<sup>66</sup> for agencies subject to the FMA Act that determine when the MPPs must be applied to procurement processes. Generally, for FMA Act agencies, when the total estimated value of

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<sup>63</sup> Finance, CPGs, 2008, pp. 10–24.

<sup>64</sup> Procurements that are exempt or are valued at less than or equal to the thresholds are not covered procurements and are not required to meet the requirements of the MPPs.

<sup>65</sup> Refer to Table A 2 in Appendix 5: Mandatory Procurement Procedures: exemptions for full details of procurements that are exempt. Commonly used exemptions include: leasing or purchasing property or accommodation; procurement from other Commonwealth, state or territory entities where no commercial market exists, or legislation or general Government policy requires the use of a government provider; procurement of motor vehicles; and procurement of government advertising.

<sup>66</sup> Finance, CPGs, 2008, p. 26, paragraph 8.4.

the property or services is more than \$80 000 the MPPs apply. However, if the procurement is for construction services the MPPs do not apply until the estimated value of the procurement exceeds \$9 million.

**1.19** A key focus of the MPPs is establishing the circumstances under which different procurement methods should be used for covered procurements, including the limited circumstances when Commonwealth agencies may conduct procurement through Direct Sourcing.

## **Application of the CPGs by agencies**

**1.20** The CPGs use a range of terms to set expectations in relation to agencies' procurement processes:

- the term 'must' denotes obligations which must be complied with in all circumstances;
- language such as 'need to' and 'applies to' is used to describe various requirements; and
- the term 'should' refers to matters of sound practice.

**1.21** Using these terms the CPGs establish that:

- applying the procurement principles is a requirement for all procurements;
- maintaining appropriate documentation is an obligation for all procurements; and
- complying with a range of prescriptive rules under the MPPs is an obligation for covered procurements.

**1.22** In relation to documentation the CPGs state that the appropriate mix and level of documentation depends on the nature and risk profile of procurement being undertaken. Agencies are required to ensure there is sufficient documentation to provide an understanding of the reasons for the procurement, the process that was followed and all relevant decisions, including approvals and authorisations, and the basis of those decisions.<sup>67</sup>

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<sup>67</sup> Refer to Appendix 6: Documentation obligations, requirements and sound practices.



## Direct Sourcing

**1.23** The MPPs identify three different procurement methods: Direct Sourcing, Open Tendering and Select Tendering. As defined by the MPPs, Open and Select Tendering normally involve an open approach<sup>68</sup> to the market where, for example, all potential suppliers have the opportunity to submit a tender or expression of interest. In comparison, Direct Sourcing does not involve an open approach to the market and, therefore, lacks the competitive rigour of Open and Select Tendering. This means that there is at best a less rigorous competitive procurement process when undertaking Direct Sourcing, or otherwise no competitive process.

**1.24** Division 2 of the CPGs defines Direct Sourcing and establishes principles for its use:

[Direct Sourcing is] a procurement process, in which an agency may invite a potential supplier or suppliers of its choice to make submissions under the conditions in paragraph 8.33 [of the CPGs].

Direct Sourcing must not be used for the purposes of avoiding competition or to discriminate against any domestic or foreign supplier. In all such circumstances, the general procurement policy framework still applies, including the requirement to achieve value for money.<sup>69</sup>

**1.25** If an agency has chosen to Direct Source from the market, it is required to apply the procurement principles during the procurement process. To apply the procurement principles of value for money and encouraging competition, it is prudent for an agency to seek submissions from more than one supplier, where practicable.

**1.26** If the procurement is considered to be a covered procurement it must satisfy specific conditions which are outlined in the CPGs.<sup>70</sup> Examples of more commonly used conditions include: where additional services are provided by the original supplier for compatibility reasons; where there is no reasonable alternative supplier due to an absence of competition for technical reasons or

<sup>68</sup> The CPGs states that *open approaches* to the market include requests for tender, requests for expressions of interest and requests for application for inclusion on a multi-use list, all of which are published on AusTender. Finance, CPGs, 2008, p. 27, paragraph 8.12.

<sup>69</sup> Finance, CPGs, 2008, p. 30, paragraphs 8.30 and 8.31.

<sup>70</sup> Refer to Table A 1 in Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing.

because of exclusive rights; and situations of extreme urgency brought about by events unforeseen by the agency.

**1.27** For covered Direct Source procurements, agencies must prepare and appropriately file a written report that includes the value and kind of the property or services being procured and a statement indicating the circumstances and conditions that justify the use of a procedure other than an Open or Select Tender process. As mentioned in paragraph 1.22, documentation requirements in the CPGs extend to documenting the basis for decisions. For covered Direct Source procurements this means documenting how circumstances and conditions apply.<sup>71</sup>

## Commonwealth agencies' procurement activity

**1.28** Finance administers and maintains AusTender, a system that collates Australian Government contracting information. Agencies are required to report the results of individual procurement activities on AusTender if they are equal to or exceed \$10 000.<sup>72</sup>

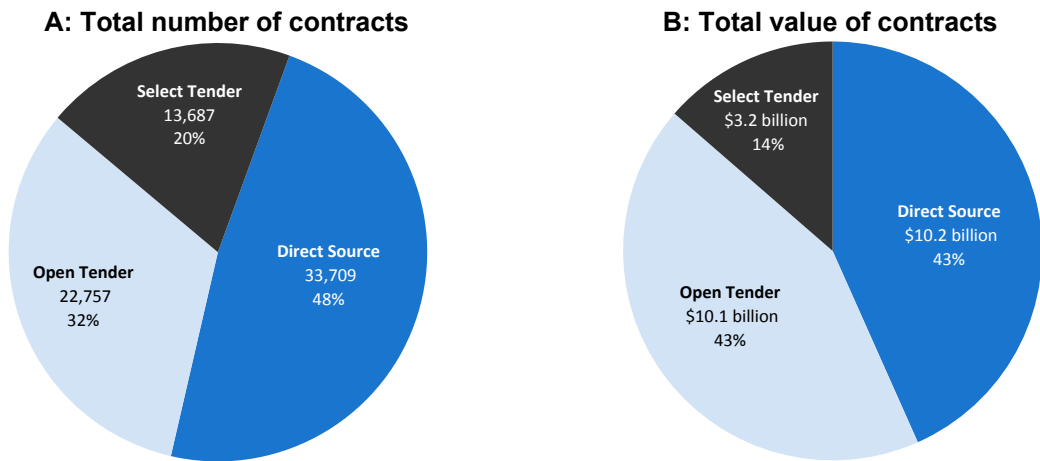
**1.29** AusTender data<sup>73</sup> shows that agencies reported that just under half (48 per cent) of all contracts (that meet AusTender reporting criteria) entered into by the Australian Government in the 2009 calendar year were formed following Direct Source procurement. Similarly, Direct Source procurement accounted for 43 per cent (or \$10.2 billion) of the total reported value of all contracts. These results are presented in Figure 1.1 below. Similar results, for both the number and value of Direct Source procurements, were produced when analysing AusTender data for the 2007–08 and the 2008–09 financial years.

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<sup>71</sup> Refer to Appendix 6: Documentation obligations, requirements and sound practices.

<sup>72</sup> Consequently, the total value and number of procurements undertaken by the Australian Government is larger than what is reported on AusTender.

<sup>73</sup> Data was extracted from AusTender on 7 January 2010 by Finance and was provided to the ANAO.

**Figure 1.1****Government procurement by procurement method, 2009**

Source: AusTender data for calendar year 2009, extracted on 7 January 2010.

**1.30** The large proportion of Direct Source procurement, relative to the total number and value of procurement undertaken by the Australian Government, when considered in conjunction with this audit's findings, suggests greater emphasis should be given to encouraging more open competition and access in Australian Government procurement, in balancing the range of requirements agencies are required to meet under the CPGs. This issue is explored further in the following chapters.

## Previous reviews and audits

**1.31** The ANAO has recently conducted several audits that have addressed aspects of procurement.<sup>74</sup> These audits identified a number of procurement processes that required improvement, including the need to improve procurement documentation and reporting.

**1.32** The ANAO has also conducted two audits in the last six years that specifically examined Commonwealth procurement across agencies.<sup>75</sup> The most recent of these audits identified a range of areas for improvement, including: the appropriate use of Direct Sourcing and contract variations;

<sup>74</sup> See Appendix 1: Recent ANAO audits that addressed aspects of procurement.

<sup>75</sup> ANAO, Audit Report No.21, 2006–07, *Implementation of the revised Commonwealth Procurement Guidelines*, January 2007 and ANAO, Audit Report No.57, 2004–05, *Purchasing Procedures and Practices*, June 2005.

decision-making processes where Open Tender was not used; procurement arrangements for low to medium value procurements; and the use of procurement information to inform strategy and procedures.

## About the audit

### Audit objective and criteria

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

**1.34** The audit examined whether selected agencies had:

- developed a sound procurement framework;
- appropriately classified procurements when meeting external reporting requirements;
- met the requirements of the CPGs when Direct Sourcing; and
- established effective procurement monitoring and review arrangements.

### Audit scope and approach

**1.35** The ANAO selected four FMA Act agencies to provide a cross-section of the 104 agencies that reported procurement activity in AusTender in 2008–09. The cross-section of agencies had regard to the total number of contracts the agencies reported and the percentage of contracts that were Direct Sourced. The agencies selected for audit were:

- the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA);
- the Department of Innovation, Industry, Science and Research (Innovation);
- the Department of Veterans' Affairs (DVA); and
- the Australian Crime Commission (ACC).

**1.36** Table 1.1 summarises the total number and value of procurements reported on AusTender as contract notices by the agencies between 1 July 2008 and 13 August 2009 (the audit sample period), and the proportion of Direct Sourcing to total procurement.<sup>76</sup> The table shows that the proportion of Direct Sourcing varied considerably between the audited agencies.

**Table 1.1**

**The total number and value of procurements and proportion of Direct Sourcing reported by FaHCSIA, Innovation, DVA and ACC on AusTender in the sample period**

Agency	Total number of procurements reported on AusTender	Number of Direct Source procurements as a percentage of total procurements reported on AusTender	Total value of procurements reported on AusTender \$ million	Value of Direct Source procurements as a percentage of total value of procurements reported on AusTender
FaHCSIA	2253	37%	\$475.4	54%
Innovation	997	68%	\$78.9	57%
DVA	490	27%	\$75.5	20%
ACC	246	76%	\$21.1	70%

Source: Contract notices reported by the audited agencies on AusTender with a contract start date between 1 July 2008 and 13 August 2009.

**1.37** The audit comprised two phases. The first involved: examining the agencies' procurement policy, procedures, systems and training material; and interviewing central procurement unit team members and a sample of agency delegates.

**1.38** The second phase of the audit involved analysing a selection of the agencies' procurement decisions and supporting records. The ANAO used each agency's AusTender data to select a stratified<sup>77</sup> random sample of

<sup>76</sup> The numbers and value of procurement reported in this table refer to both covered and non-covered procurements. The Mandatory Procurement Procedures do not apply to non-covered procurements.

<sup>77</sup> To test covered and non-covered procurements the three strata used to select a sample were: Direct Source procurements valued at \$80 000 or more (may need to apply MPPs); Open and Select Tender procurements valued at \$80 000 or more (may need to apply MPPs); and procurements valued at under \$80 000 (should not need to apply the MPPs). As procurements are not classified as covered or non-covered procurements on AusTender, the value of the reported procurements was used as the basis for whether they may need to apply the MPPs.

645 procurements (across the four agencies). For sample procurements the ANAO examined:

- whether the procurement method had been classified correctly in AusTender (for all sample procurements);
- if Direct Sourcing was conducted in accordance with the CPGs (for Direct Source sample procurements); and
- whether key procurement decisions and actions were appropriately recorded (for Direct Source sample procurements).

**1.39** The audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of approximately \$523 000.

## **Report structure**

**1.40** In addition to this introductory chapter this audit report has four other chapters:

- Chapter 2: *Procurement Management and Support* examines the agencies' management and support of procurement activities, including the provision of advice, guidance and training to staff;
- Chapter 3: *Classifying and Reporting Procurement* examines whether the agencies' met selected AusTender reporting requirements for procurement, and focuses on whether the procurement method is being consistently reported;
- Chapter 4: *Direct Source Procurement Processes* examines agencies' Direct Source procurement processes and decisions, and whether they met the requirements of the CPGs and relevant FMA legislation; and
- Chapter 5: *Procurement Monitoring and Review* examines whether the agencies effectively monitor and review procurement activity to support compliance with the CPGs and inform strategic planning and management.

## 2. Procurement Management and Support

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*This chapter assesses whether the agencies have managed and supported procurement activities effectively, by providing advice, guidance and training to relevant staff in accordance with legislative and policy requirements, and better practices.*

### Introduction

**2.1** In most procurement processes, a financial delegate from the business area is given overall responsibility for planning, managing and undertaking the procurement process. Delegates have responsibility for ensuring that their approval of spending proposals to procure property or services complies with legislative and policy requirements. This includes meeting the Commonwealth procurement principles for all procurements, and the MPPs for covered procurements.

**2.2** Chief Executives of agencies subject to the FMA Act may issue Chief Executive's Instructions (CEIs) to their officials on any matter necessary or convenient for carrying out or giving effect to the FMA Act or FMA Regulations. In relation to procurement, CEIs build on the legislative and policy framework applicable to procurement by articulating agency policy for delegates and staff involved in procurement that focuses on implementing Government procurement requirements, and meeting the agency's particular procurement needs.

**2.3** Agency central procurement units (CPUs) further assist delegates to conduct appropriate procurement processes and make sound decisions. This support includes: development and communication of agency procurement policy and guidance; provision of checklists and forms to guide staff through the procurement process and ensure they address procurement requirements; and provision of procurement advice and training to relevant staff.

**2.4** The ANAO examined for each of the agencies:

- the promulgation and contents of procurement policy, guidance and templates. This included whether they supported compliance with the CPGs, particularly in relation to Direct Sourcing, and the appropriateness of agency guidance on selecting procurement processes and methods;

- the role of CPUs, including their provision of expert procurement advice, and their involvement in procurement processes; and
- the provision of training to those involved in procurement processes, particularly delegates.

**2.5** To undertake this assessment the ANAO examined relevant documentation, and interviewed CPU staff and a selection of financial delegates in each agency.

## **Agencies' procurement policy, guidance and templates**

**2.6** Complete, informative and up to date policy and guidance is important to foster a good understanding of an agency's procurement responsibilities, and to facilitate the consistent application of sound practices throughout the agency.

**2.7** Management Advisory Committee (MAC) Report No.7 reflected on the quality and contents of agency CEIs. The report cautioned agencies that lengthy CEIs on procurement may not be readily accessible or well focused, and may therefore be counterproductive. This can result in important requirements being overlooked or misunderstood, and in widespread inefficient procurement processes. The report noted that, as a minimum, CEIs on procurement need to address agencies' obligations under the FMA Act and Regulations, and the procurement policy framework set out in the CPGs; and that additional requirements must have regard to ensuring agency processes are commensurate with the scale, scope and relative risk of procurements, and thereby support the legislative obligation of Chief Executives to promote the efficient, effective and ethical use of public resources.<sup>78</sup>

**2.8** The audit assessed whether each of the agencies had promulgated appropriate policy and guidance material to assist staff with conducting procurement, making procurement decisions in accordance with the CPGs and adequately documenting procurement. The ANAO's criteria for assessing the adequacy of procurement policy and guidance material were drawn from the CPGs and Finance's Good Procurement Practice (GPP) No.1, *Chief Executive's Instructions and Operational Guidelines for Procurement*.

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<sup>78</sup> MAC, Report No.7, 2007, *Reducing Red Tape in the Australian Public Service*, p. 25.



## **Policy, guidance and templates addresses the legislative and policy framework applicable to procurement**

**2.9** All four agencies had CEIs and supporting operational guidance applying to procurement that generally reflected the suggestions outlined in GPP No.1.<sup>79</sup> Importantly, the policies and guidance covered the requirements of the legal and policy framework applicable to procurement, and established agency procedures for both covered and non-covered procurement. These documents had recently been reviewed and were available on each agency's intranet. There were some positive examples of the agencies' procurement documentation requirements for Direct Sourcing, which are outlined in Appendix 8: Positive examples of procurement documentation requirements for Direct Sourcing on page 149.

**2.10** Notwithstanding these findings, the ANAO noted there is scope for agencies to develop more succinct guidance material (including simple procurement templates), that focus attention on key procurement risks, including those associated with Direct Sourcing:

- There was a considerable volume of procurement information available on each agency's intranet and, reflecting concerns raised by the MAC, there is a risk that it may be difficult to locate specific material, or that staff may be discouraged from reading all the required information. In this respect, Innovation had established an informative two-page Quick Reference Guide for Procurement Contracts that provided a summary of key elements in the procurement process and important procurement requirements; and
- Agency procurement guidance did not always clearly address identified risk areas in relation to the application of the procurement principles. For example, previous ANAO procurement related audits have found weaknesses in defining the procurement need—which supports efficient and effective procurement; approaches to achieving value for money; and procurement recordkeeping—which underpins accountability and transparency. There remained scope for improved arrangements in each of these areas.<sup>80</sup>

<sup>79</sup> Finance, GPP No.1, *Chief Executive's Instructions and Operational Guidelines for Procurement*, November 2006, p. 2, provides a checklist for developing and updating associated CEIs.

<sup>80</sup> ANAO, Audit Report No.21, 2006–07, January 2007 and ANAO, Audit Report No.57, 2004–05, June 2005.

**2.11** There were opportunities to improve the guidance and to promulgate templates, covering:

- defining Direct Sourcing;
- supporting competitive procurement processes;
- early consideration of the procurement need and approach, including estimation of the maximum anticipated value of the procurement (which determines whether or not a procurement is treated as covered), selecting a procurement method and justifying its use in the circumstances;
- Direct Sourcing, including establishing approaches that better support the achievement of value for money, and to adequately assess risks and manage conflicts of interest; and
- general procurement documentation and recordkeeping.

**2.12** Chapter 4 discusses how these weaknesses in agency guidance, and/or variable practices, resulted in a lack of evidence that procurement processes appropriately addressed the requirements of the CPGs for a sample of Direct Source procurements. The following section considers agency guidance on selecting procurement processes and methods.

### **Agency guidance on selecting procurement processes and methods**

**2.13** The method used for procurement processes should suit the market circumstances as well as the scale, nature and relative risk of the procurement. It should also provide reasonable access for suppliers to government procurement—given that open competition is a key element of the procurement framework agencies should investigate relevant market conditions and consider whether an open procurement process is appropriate.<sup>81</sup> As previously discussed, procurements above a certain threshold (known as covered procurements) must follow the MPPs, which generally require an open procurement process.

**2.14** MAC Report No.7 commented that agencies may choose to provide additional guidance for non-covered procurement (for example, on

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<sup>81</sup> Finance, FMG No.14, *Guidance on Ethics and Probity in Government Procurement*, January 2005, p. 20, paragraph 6.3.

procurement methods and probity) to promote procurement processes that are commensurate with the scale and risk profile of the procurement. This may be achieved by informing agency officials about the options available and when each option might be appropriate. Agencies may also choose to use additional internal thresholds to specify the procurement processes to be undertaken. The risk to be managed in these circumstances is that such thresholds do not lead to unnecessary process. Accordingly, the number of thresholds should be limited to those required to promote efficient and effective processes.<sup>82</sup>

**2.15** Each of the agencies have developed tailored thresholds which help to determine the procurement processes they apply for both covered and non-covered procurement. Table 2.1 below summarises the approaches adopted.

**2.16** For covered procurements, agencies' guidance on the selection of a procurement method was consistent with the MPPs, indicating that the preferred approach was an Open Tender and that Direct Sourcing should only be undertaken in selective circumstances.

**2.17** For non-covered procurements, FaHCSIA and ACC had additional internal thresholds in place and required varying numbers or types of quotes for procurements valued within each threshold. While the number of additional thresholds adopted by these agencies was not excessive, the options available at each threshold could be strengthened to reflect the procurement principles. In particular, by adopting the minimum procedures at each threshold staff at FaHCSIA and ACC are likely to use Direct Sourcing, when for higher value and risk non-covered procurements, other procurement methods may be more appropriate to achieve value for money and encourage competition. Reflecting these findings, both FaHCSIA and ACC had a high proportion of Direct Sourcing to the total number and value of their procurement reported in AusTender (see Table 1.1).

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<sup>82</sup> MAC, Report No.7, 2007, p. 30.

**Table 2.1****Agency recommended procurement processes and methods**

Agency	Procurement value	Recommended procurement method/process based on estimated procurement value
FaHCSIA	Under \$30 000	Direct Source or by obtaining up to three quotes.
	\$30 000 to \$80 000	Minimum of three quotes.
	Over \$80 000	The provisions relating to covered procurement apply (excluding where a multi-use list, corporate contract or panel arrangement is in place).
Innovation	Non-covered procurements	The procurement process should reflect the size, risk and complexity of the procurement and must be in accordance with Division 1 of the CPGs. Many procurements of this scale use a Direct Sourcing method. If a relevant standing offer, existing contract or panel arrangement is in place then you may not need to approach the market. Although rare, a Select Tender approach can also be used for these procurements.
	Covered procurements	An open approach to the market must be undertaken for all covered procurements unless conditions for using other processes, as outlined in Division 2 of the CPGs, are met. A Direct Sourcing process for a covered procurement may only be conducted if one of the "conditions for Direct Sourcing" outlined in the MPPs applies.
DVA	Under \$80 000	Direct Source or Select Tender. For high risk procurements of this value an Open Tender is suggested.  DVA had also created a flowchart for selecting the procurement method. The flowchart suggests that staff look for the existence of a multi-use list or panel and if one does not exist they can then use an Open Tender, Select Tender or Direct Source process, or establish a panel.
	Over \$80 000	Open Tender (or Select Tender or Direct Source if compliant with the CPGs).
ACC	Under \$5 000	Oral quote/s.
	\$5 000 to \$10 000	Three oral quotes.
	\$10 000 to \$80 000	Minimum three written quotes.  The ACC guidance and intranet indicated that Direct Sourcing can only be used for procurement under \$80 000 in very selective cases. Select Tendering can be used for procurements of this value where the market for the good or service is well known. Open Tender can be used for procurements of this value if competitive market testing is required.
	Over \$80 000	Open Tender.

Source: Agencies' CEIs, procurement guidance and procurement intranet sites.

**2.18** In contrast, Innovation and DVA did not have additional internal thresholds in place for non-covered procurement. Instead, agency guidance on procurement processes referred to the level of risk (and for Innovation the size and complexity of the procurement) as a determinant of which procurement method should be used. Innovation's guidance indicated that many non-covered procurements would be Direct Sourced and, as shown by Table 1.1, Innovation had a high proportion of Direct Sourcing relative to the total number and value of their procurement reported in AusTender. Similarly, DVA's guidance suggested that unless non-covered procurements were high risk, Direct Source or Select Tender would be appropriate. To encourage competitive procurement processes, DVA suggested that staff first consider using multi-use lists or panels before considering other options. Of the four audited agencies, DVA recorded the lowest percentage of Direct Sourcing in terms of the number and value of procurement reported in AusTender.<sup>83</sup>

**2.19** The absence of additional thresholds and options for non-covered procurements at Innovation and DVA created a risk that when Direct Sourcing was undertaken minimal process or limited quotes would be followed or sought. This meant there was limited evidence that the procurement principles were being applied (also see Chapter 4).

**2.20** For the four agencies examined, guidance for the selection of a procurement method, including additional thresholds where established, did not give sufficient emphasis to the procurement principles, particularly value for money and encouraging competition. As a result, agencies' rationales for the Direct Sourcing option were limited, often giving little consideration to the market circumstances, scale, risks to performance and nature of the procurement. Expectations in relation to rationales for Direct Source procurement, and their documentation, are discussed in Chapter 4, paragraphs 4.41 and 4.42.

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<sup>83</sup> The percentage of procurements that have a reported value on AusTender of \$80 000 or less varies from 54 per cent for DVA to around 80 per cent for FaHCSIA, Innovation and ACC.

## The role of centralised procurement units

**2.21** All four audited agencies had a CPU. The role of the CPU generally covered the:

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

**2.22** Given the complexity of many procurement processes, it is important that CPU staff have relevant expertise to enable them to carry out their role efficiently and effectively, and in compliance with agency and government requirements. Most CPU staff in all of the agencies had a procurement qualification or extensive procurement experience.

**2.23** Interviews with a selection of delegates of the agencies indicated that the quality of CPU assistance was good, and that delegates were aware of the need to involve CPUs in some procurement activity. Delegates reported a variety of reasons or circumstances for when they would seek guidance from their CPU.

### CPU involvement in procurement processes

**2.24** It is important that staff undertaking procurement processes have access to CPU staff to obtain, where necessary, expert advice and support. For higher risk, greater value and/or more complex procurements an agency may consider it necessary for the CPU to be formally involved in the procurement process. This could involve CPU staff being involved in the procurement team or clearing key documents prior to delegate approval.

**2.25** The procurement guidelines for all four agencies established tailored thresholds for when their CPU must be advised of, or involved with, the procurement. With the exception of the ACC, the CPU must be advised, consulted or involved in all procurement regardless of the procurement method. The ACC CPU must clear all open approaches to market. The CPU at FaHCSIA is the only CPU that is involved in the decision to approve a Direct

Source procurement in excess of \$80 000. Table 2.2 below provides a summary of the varying thresholds and CPU involvement at the agencies.

**Table 2.2**

**Involvement of CPU in procurement processes**

Agency	Procurement value	Central procurement unit
FaHCSIA	Over \$5 000	Must be consulted.
	Over \$80 000 by Direct Source	Must be approved by CPU Branch Head.
Innovation	Over \$25 000	Must be involved.
DVA	\$10 000 to \$80 000	Should be consulted.
	High risk and/or a covered procurement	Must be consulted.
ACC	Not specified	Must clear market documentation for open approaches to market.

Source: Agencies' CEIs, procurement guidance and intranet sites.

**2.26** The ANAO's findings in Chapter 4 illustrate that in practice, for covered procurements, when the CPU had authority to approve Direct Source procurements (FaHCSIA) there was a positive impact on compliance with the MPPs.<sup>84</sup> At DVA, there was often consultation between the business area and the CPU on the appropriate procurement method, and this did have a positive impact on compliance for these procurements. There is no requirement for ACC's CPU to be involved in decisions concerning procurement method, and as indicated in Chapter 4, it was not evident that the majority of the ACC's decisions to Direct Source covered procurements complied with the MPPs. More broadly, the ANAO noted that advice from CPUs was sometimes sought after the procurement process had commenced, which limited their ability to influence the procurement method.

<sup>84</sup> In response to the findings of non-compliance with the CPGs and agency requirements in relation to the Green Loans program, the Department of Environment, Water, the Heritage and the Arts (DEWHA) has introduced a range of new procurement measures aimed at tightening controls over procurement, including a central gatekeeper (the Branch containing the CPU) to approve all new procurement plans. The Department of Climate Change and Energy Efficiency (DCCEE) has announced its intention to maintain a pre-approval requirement for all procurements with a value of \$70 000 and over. DEWHA has outlined these arrangements in *Doing our Business Better, Response to the Review of the Administration of the Home Insulation Program (the Hawke review) and the Independent Inquiry into the Green Loans Program (the Faulkner review)*, July 2010, pp. 2 and 3. DCCEE has outlined these arrangements in the *Department of Climate Change and Energy Efficiency's Response to the Hawke Report on the Home Insulation Program and the Faulkner Inquiry in the Green Loans Program*, 8 July 2010, p. 6.

## Procurement training

**2.27** Effectively planning and managing procurement processes requires a broad range of skills, including understanding legislative, policy and agency procurement requirements. Delegates and other agency staff involved in procurement also need to have an understanding of fraud control, risk management, and the Australian Public Service values and code of conduct. Individual training needs will depend on a range of factors, including past experience and training, and the extent to which staff are provided with expert advice and support.

**2.28** All agencies had developed and delivered procurement training that covered the legal and policy framework applying to procurement in the Australian Public Service, including procurement approaches and processes. The training was available to delegates and other agency staff. However, procurement training was not mandatory for staff involved in procurement, and the agencies did not have arrangements in place to actively identify staff that require procurement training. Such arrangements can involve procurement training being embedded in the agency's broader training programs.

### Delegate training and awareness of responsibilities

**2.29** Most agency delegates interviewed by the ANAO<sup>85</sup> were aware of, and had access to, the agency's CEIs and procurement procedural guidance. They were also satisfied with the level of support provided by the CPU. A number of delegates commented that procurement was a small component of their responsibilities, or that they conducted procurement infrequently. As a result, they considered that it was possible to be unfamiliar with the required procurement processes. This highlighted the importance of delegates having ready access to clear and concise agency policy and guidance, as well as agency procurement experts.

**2.30** Overall, there was a need to improve delegates' awareness of their responsibilities and understanding of procurement requirements:

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<sup>85</sup> The ANAO interviewed eight delegates in each of the agencies to assess if they understood their obligations and responsibilities under the FMA Act and Regulations, the CPGs, and agency procurement policy and guidance.



- a significant proportion of delegates had not been formally advised of their delegation and/or were unaware of their Regulation 9 delegation limit; and
- many of the delegates had not undertaken training in relation to their delegation, procurement or fraud control.

**2.31** Based on these findings, the ANAO considers there would be benefit in agencies undertaking additional analysis of their staff training needs (particularly for delegates) to help ensure that staff involved in procurement processes are sufficiently aware of requirements and expectations, and how to satisfy them when undertaking a procurement process. This may include maintaining records of attendance at procurement training and seeking course evaluations from participants, where they are not already being captured, and analysing this information (taking account of staff involvement in procurement). Records of attendance and course evaluations can be used to identify groups of staff that are not attending training and for considering whether course availability, duration or content may be limiting their attendance. It would also involve embedding procurement training in the broader training programs of the agency.

**2.32** To help achieve efficiencies in process, agencies may also choose to address some of their training needs by sending relevant staff to training sessions and programs, seminars and forums offered by Finance.<sup>86</sup>

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<sup>86</sup> Refer to Appendix 3: Finance's procurement support.

## 3. Classifying and Reporting Procurement

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*This chapter assesses the agencies' classification and reporting of procurements. It includes consideration of Commonwealth and agency definitions of procurement methods, and the associated implications for accountability and transparency of Australian Government procurement.*

### Introduction

**3.1** The Australian Government is committed to accountability<sup>87</sup> and transparency in its procurement activities. Transparency<sup>88</sup> enables scrutiny of procurement activity to provide assurance that procurement processes are consistent with the legislative and policy framework applicable to procurement. Transparency is facilitated through disclosure,<sup>89</sup> which involves publishing information relating to agencies' procurement activities, such as approaches to market and contracts awarded. Reporting accurately and fully on AusTender is one of the primary methods used by agencies to meet their procurement obligations of accountability and transparency.

**3.2** The CPGs and FMG No.15<sup>90</sup> establish AusTender procurement reporting requirements for agencies. These requirements include reporting contract notices equal to or greater than \$10 000 in a timely manner, and reporting the procurement method for each procurement.

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<sup>87</sup> The CPGs describe accountability in procurement as the responsibility of agency officials for the actions and decisions that they take in relation to procurement, and for the resulting outcomes. Officials are answerable for such activity through established lines of accountability including the agency's Chief Executive and senior management, the responsible Minister, and through the Minister, to the Parliament. Finance, CPGs, 2008, p. 17, paragraph 7.4.

<sup>88</sup> The CPGs describe transparency as providing assurance that procurement processes undertaken by agencies are appropriate and that policy and legislative obligations are being met. Transparency involves agencies taking steps to support appropriate scrutiny of their procurement activity. Finance, CPGs, 2008, p. 18, paragraph 7.5.

<sup>89</sup> The CPGs define disclosure as the mechanism by which agencies make their procurement activities visible and transparent. The broad aim of disclosure is to provide confidence in the processes that an agency intends to undertake, or has undertaken, and reassurance that the Chief Executive is promoting the efficient, effective and ethical use of resources. Finance, CPGs, 2008, p. 20, paragraph 7.14.

<sup>90</sup> Finance, FMG No.15, *Guidance on Procurement Publishing Obligations*, July 2007.

**3.3** For the audit sample of procurements, the following sections of this chapter consider:

- AusTender contract notice reporting anomalies, and the timeliness of AusTender reporting; and
- whether the agencies correctly and consistently classified procurement methods when reporting contract notices in AusTender.

## AusTender contract notice reporting anomalies

**3.4** Using AusTender data, the ANAO selected a stratified random sample of 645 procurements across the four agencies (for contracts with start dates ranging between 1 July 2008 and 13 August 2009). The sample included three strata:<sup>91</sup> procurements identified as Direct Source procurements with a value in excess of \$80 000;<sup>92</sup> procurements identified as Open and Select Tender procurements with a value in excess of \$80 000; and procurements with a value of less than or equal to \$80 000.

## Contract notice reporting errors and the adjusted audit sample

**3.5** FMG No.15 outlines a number of arrangements that must not be reported as a contract notice on AusTender such as grants and payments or the transfer of funds which are not in return for property or services.<sup>93</sup> Five per cent of the audit sample was made up such reporting errors. Almost all of the reporting errors were made by FaHCSIA, for whom 13 per cent of the sample procurements were incorrectly reported. The reporting errors included duplicates, reporting grants or sponsorships as contract notices, and reporting another agency's contract notices in AusTender. The ANAO removed these items from the sample, adopting an adjusted sample of 612 procurements for detailed testing.<sup>94</sup>

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<sup>91</sup> The sample size for these strata were designed to provide the ANAO with conclusive results for Direct Source, Select Tender and Open Tender procurements valued at \$80 000 or more, and, at a minimum, with indicative results for procurements valued at less than \$80 000.

<sup>92</sup> This value was used as a predictor for whether the procurement was covered or non-covered. It is acknowledged that not all procurements valued in excess of \$80 000 are covered procurements and not all procurements valued at less than or equal to \$80 000 are non-covered procurements.

<sup>93</sup> Finance, FMG No.15, 2007, p. 16, paragraph 5.7.

<sup>94</sup> The composition of the adjusted audit sample is reflected in Table 3.2 on page 76.

**3.6** Reporting activities that are not a procurement as a contract notice on AusTender reduces the transparency of Commonwealth procurement by distorting the number, nature and value of actual procurement undertaken by the agency. It also does not meet the CPGs or FMG No.15's reporting requirements, as such an approach does not satisfy the contract reporting criteria.

### **Reporting invoices, purchase orders and amendments as contract notices**

**3.7** FMG No.15 also requires that invoices, purchase orders or other payments under a contract which has previously been reported in AusTender must not be reported as a separate contract notice.<sup>95</sup> Despite this requirement, there were instances of agencies reporting: monthly invoices for property and services (ACC); each contract amendment as separate contract notices (ACC); more than 20 purchase orders for one contract amendment (Innovation); and the full value of the contract as well as individual purchase orders (Innovation).<sup>96</sup>

**3.8** The ANAO considers that reporting invoices and purchase orders as individual contract notices distorts the public's understanding of the real number and value of contracts let by an agency. It also distorts potential suppliers' views of the number of opportunities they may have to bid for Australian Government business.<sup>97</sup>

**3.9** The examples of reporting invoices, purchase orders and contract amendments as contract notices can be explained in part by difficulties experienced by the agencies with the input of procurement data into AusTender. A key issue is that AusTender is unable to link contract variations or extensions when information is automatically transferred via agencies'

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<sup>95</sup> Finance, FMG No.15, 2007, p. 16, paragraph 5.7.

<sup>96</sup> As indicated above, FMG No.15 states that invoices (including monthly accounts), purchase orders or other payments which are payable under a contract which has previously been reported are not to be reported in AusTender. In addition, where there is an amendment to the contract value FMG No.15 requires agencies to report variations to any contract on AusTender which meet the *contract reporting criteria*.

<sup>97</sup> In response to the proposed audit report Innovation commented that, '*Sections 3.7 and 3.8 of the report address the issue of reporting invoices and purchase orders as individual contracts on AusTender. The implementation in Innovation of the TechnologyOne Contracts Module in our Financial Management Information System has rectified this reporting issue for Innovation—contracts are now reported on AusTender directly from the Contracts Module resulting in more accurate and more timely reporting.*'

financial management information system (FMIS).<sup>98</sup> This results in additional contract notices which then overstate the number of opportunities there are to contract with the Australian Government. To address this issue most of the agencies were manually entering contract variations.

**3.10** Finance has advised the ANAO that it is progressing solutions to the automatic upload of contract amendments.<sup>99</sup> Finance has also cautioned agencies that when manually transferring contract notices to AusTender, there is a greater risk that duplicates will occur as the manual process bypasses AusTender controls that query notices that appear to be duplicates.

### **Timeliness of reporting on AusTender**

**3.11** Under paragraph 7.24 of the CPGs (and FMG No.15) agencies have an obligation to report procurements on AusTender that are equal to or exceed \$10 000, within six weeks of entering into the arrangement.<sup>100</sup> AusTender provides a contract start date and a gazettal publishing date for each procurement it lists. Based on this data, for the period covered by the audit sample, there were significant variations across the agencies in the timeliness of AusTender contract reporting, with all the agencies having scope for improvement. For example, FaHCSIA gazetted 85 per cent of their procurements within the required timeframes, whereas ACC only gazetted 15 per cent of procurements within the required timeframes due to the implementation of a new system.<sup>101</sup>

## **Classification and reporting of the procurement method**

**3.12** The selection of suppliers by Government agencies must be in accordance with the procurement principles of: value for money, encouraging competition; efficient, effective and ethical use of resources; and accountability and transparency. For covered procurements, agencies must follow the MPPs,

<sup>98</sup> See ANAO, Audit Report No.6, 2009–10, *Confidentiality in Government Contracts Senate Order for Departmental and Agency Contracts (Calendar Year 2008 Compliance)*, pp. 54–55.

<sup>99</sup> However, Finance has identified several issues that will need to be addressed, including: the need for agencies that have implemented a SAP FMIS to co-fund development of a reporting template that can automatically transfer contract amendments; and the need to pilot system changes to ensure that prior contract variations, whether transferred manually or automatically, are appropriately treated by AusTender.

<sup>100</sup> Where the procurements meet the contract reporting criteria outlined in paragraph 5.1 of FMG No.15.

<sup>101</sup> Innovation and DVA gazetted 76 per cent and 67 per cent, respectively, of their procurements within required timeframes.

which establish the limited conditions and circumstances under which non-open approaches to the market may be undertaken. To help satisfy these requirements, agencies should select an appropriate procurement method for the circumstances.

**3.13** The ANAO sought to establish whether agencies were classifying their procurement methods consistently, and in accordance with procurement policy and associated guidance.

### **Commonwealth definitions of procurement methods**

**3.14** FMG No.15 has been developed by Finance to assist agencies to meet their procurement publishing requirements, and it includes a requirement for agencies to report the procurement method when entering contract information into AusTender.<sup>102</sup> FMG No.15 lists three methods that agencies can select when reporting a contract on AusTender: Open Tender; Select Tender; or Direct Source.

#### ***Open Tender***

**3.15** A procurement can only be the result of an Open Tender process if there is an open approach to market which is published on AusTender.<sup>103</sup> The definition of Open Tender is generally consistent between the CPGs and FMG No.15,<sup>104</sup> and is defined as:

A procurement procedure in which a request for tender is published inviting all suppliers that satisfy the conditions for participation to submit tenders.<sup>105</sup>

#### ***Select Tender and Direct Source***

**3.16** A Select Tender process is defined by both the CPGs and FMG No.15 as:

A procurement procedure in which the procuring agency selects which potential suppliers are invited to submit tenders.<sup>106</sup>

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<sup>102</sup> Finance, FMG No.15, 2007, p.16, paragraph 5.13.

<sup>103</sup> Finance, CPGs, 2008, p. 27, paragraph 8.12.

<sup>104</sup> The key difference between these two documents is that FMG No.15 refers to 'all *potential* suppliers' whereas the CPGs refer to 'all suppliers'.

<sup>105</sup> Finance, CPGs, 2008, p. 45.

<sup>106</sup> Finance, CPGs, 2008, p. 46. Finance, FMG No.15, 2007, p. 19, paragraph 5.20.

### 3.17 Similarly, a Direct Source process is defined as:

A procurement process in which an agency invites a potential supplier or suppliers of its choice to make submissions. Direct Sourcing may include a competitive process, for example obtaining quotes.<sup>107</sup>

### 3.18 GPP No.1<sup>108</sup> provides similar definitions to the CPGs and FMG No.15 for Direct Source and Select Tender, for non-covered procurements, by suggesting that:

Direct Sourcing may be done by obtaining oral quotes, written quotes or written submissions from one or several potential suppliers...

Select Tendering involves inviting a selected group of potential suppliers to submit tenders and evaluating the written responses to the tender.

### 3.19 There are no additional conditions or circumstances that are specified for *non-covered* procurements to further differentiate between a Direct Source or Select Tender process. The key points of differentiation appear to be: firstly, where only one potential supplier is approached the procurement is Direct Sourced; and, secondly, conducting a tender process for Select Tender and seeking submissions or quotes for Direct Source. The terms *tender*, *submission* and *quote* are not specifically defined for non-covered procurements. However, in the definitions section of the CPGs, submissions are defined as including tenders.<sup>109</sup> Therefore, where more than one potential supplier is approached for a submission or tender there appears to be no difference between non-covered Direct Source and Select Tender procurements.

### 3.20 For covered procurements the CPGs and FMG No.15 go on to specify requirements in the MPPs that clearly differentiate between the Select Tender and Direct Source procurement methods. For example, for covered procurements, agencies must conduct a Select Tender process from:

- a multi-use list;
- a list of potential suppliers that have responded to a request for expressions of interest; or

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<sup>107</sup> Finance, CPGs, 2008, p. 44.

<sup>108</sup> Finance, GPP No.1, 2006, p. 24, paragraphs 8.3 and 8.5.

<sup>109</sup> In Appendix C of the CPGs, some guidance is provided as to what constitutes invitations to tender, minimum content and format of submissions, request documentation and requests for tender. Appendix C also defines submissions as any formally submitted response from a potential supplier to an approach to market. Submissions include tenders, expressions of interest, and applications for inclusion on a multi-use list. Finance, CPGs, 2008, pp. 45 and 46.

- a list of all suppliers that hold a licence or meet a specific legal requirement.

**3.21** Similarly, covered procurements must only be Direct Sourced in certain circumstances that are outlined in paragraph 8.33 of the CPGs.<sup>110</sup> However, these circumstances do not dictate how Direct Source procurement would be conducted nor do they differentiate between its conduct for a covered and non-covered procurement. Instead, the circumstances seek to establish when it would be appropriate to use Direct Sourcing, for covered procurements, to comply with the CPGs.

**3.22** In effect, the CPGs and associated guidance give rise to different interpretations of Select Tender and Direct Source procurement, depending on whether procurements are covered or otherwise. In particular, Select Tender must be conducted in accordance with clear criteria for covered procurement, whereas there are no limiting criteria for non-covered Select Tenders. This implies that there is often no difference between non-covered Select Tenders and Direct Sourcing.

**3.23** In April 2010, Finance advised the ANAO that the intention of its policy on procurement methods may not be clear from the current guidance documents. In particular, the policy intention is that only procurements that follow one of the three procedures outlined in paragraph 8.22 of the MPPs (see paragraph 3.20) should be regarded as Select Tender, regardless of whether the procurement is covered or non-covered. Consequently, for reporting purposes on AusTender, the policy intention is as follows:

- if an Open Tender process is conducted, the procurement should be reported as an Open Tender;
- if a Select Tender process is conducted, which follows one of the three procedures outlined in paragraph 8.22 of the CPGs, the procurement should be reported as a Select Tender; and
- all other procurements should be reported as Direct Sourcing.

**3.24** Finance intends to review the relevant guidance to simplify and clarify the classification and reporting of procurement method at the earliest opportunity.

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<sup>110</sup> Refer to Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing, Table A 1, for details of these circumstances.



## Summary definitions of the procurement methods

**3.25** For the purposes of audit testing commencing in late 2009, the ANAO developed summary definitions of each procurement method based on the definitions provided in the CPGs, FMG No.15 and GPP No.1. While there appeared to be little difference between non-covered Select Tender and Direct Source procurement, the ANAO sought to differentiate between these two procurement methods to assess the consistency of agencies' approaches to their procurement classification and reporting. The definitions of the procurement methods are outlined in Table 3.1 below, and were applied when testing the sample of procurements.

**Table 3.1**

### Summary definitions of procurement method

	Definition of procurement method
Direct Source	A procurement process in which the agency invites a potential supplier or suppliers of its choice to make submissions. The procurement process may involve a competitive process, for example obtaining quotes. The procurement process does not involve an open approach to market.
Select Tender	<p>A procurement process (either covered or non-covered) in which the agency selects which potential suppliers are invited to submit tenders and is undertaken in accordance with the MPPs.</p> <p>This means agencies need to select potential suppliers from:</p> <ul style="list-style-type: none"> <li>• a multi-use list;</li> <li>• a list of potential suppliers that have responded to a request for expressions of interest; or</li> <li>• a list of all suppliers that hold a licence or meet a specific legal requirement.</li> </ul> <p>For non-covered procurements that were considered to be Select Tender by the agency, but that did not meet the MPPs for a Select Tender process, a further test was applied to the procurement process: specifically, whether the agency sought written tenders from a selected group of potential suppliers and evaluated those tenders using a tender evaluation process.</p>
Open Tender	<p>A procurement process (either covered or non-covered) in which a request for tender is published in AusTender inviting all potential suppliers that satisfy the conditions of participation to submit tenders.</p> <p>This includes a procurement process (either covered or non-covered) in which a procurement is arranged under a standing offer arrangement when the method reported for the creation of the standing offer was reported as Open, for example, procurements from a panel.<sup>111</sup></p>

Source: ANAO, based on extracts from the CPGs, FMG No.15 and GPP No.1.

<sup>111</sup> In a two-stage process the procurement method reported will reflect the stage at which the comparative assessment of value for money is made. For example, the procurement method reported for a contract made under a standing offer arrangement will be the same method reported for the creation of the standing offer (generally Open Tender). Finance, FMG No.15, 2007, p. 19, paragraph 5.21.

## Agency definitions of Direct Sourcing

**3.26** The agencies' procurement policy and guidance defined Direct Sourcing and/or outlined approaches for selecting a procurement method.

**3.27** Consistent with the definition in the CPGs, FaHCSIA's and Innovation's policy and guidance defined Direct Sourcing as a procurement process in which the department directly approaches a single supplier or suppliers of its choice to obtain a quote or detailed submission. However, FaHCSIA's guidance on the selection of a procurement method (outlined in Table 2.1) recommended *direct sourcing or obtaining quotes* for non-covered procurements, when both approaches appear to fit the definition of Direct Sourcing.

**3.28** Innovation's intranet provided further clarification of Direct Sourcing and Select Tendering by advising staff that for non-covered procurements, Select Tendering is similar to Direct Sourcing because you directly approach suppliers of your choice. The advice went on to say the documentation and process involved in Select Tendering is more like an Open Tender because you prepare a request for tender document and invite suppliers to submit a tender in reply. The guidance also indicated that the workload involved in Select Tendering is larger than that of Direct Sourcing.

**3.29** DVA's procurement policy and guidance did not define Direct Sourcing. Although, in its guidance on selecting a procurement method, the department highlighted the limited circumstances in which Direct Sourcing can be undertaken if a procurement exceeds \$80 000. DVA further advised the ANAO that it classifies non-covered procurements as Select Tenders where agency staff have sought more than one quote and no tender process has occurred, even though this does not appear to fit the definition of Select Tendering.

**3.30** ACC policy and guidance provided a limited definition of Direct Sourcing: *Direct Sourcing is very restrictive and does not involve any competitive element for the tenderer.* ACC's guidance on selecting a procurement method was prescriptive on the process to be followed but did not address how the agency defines Direct Sourcing. In addition, when discussing the use of panel arrangements, ACC's guidance stated that all panel arrangements are sourced using an Open Tender, but then indicated that once a panel is established a Select or Direct Source procurement can be made from the suppliers on the panel. In the context of the CPGs, procurement from a panel that has been

established using an Open Tender process should be classified as Open Tender rather than Select Tender or Direct Source for reporting purposes.

**3.31** Overall, Innovation's guidance on procurement method was relatively clear and consistent with the definitions listed in Table 3.1). As indicated below, for the audit sample, Innovation had relatively little by way of inconsistently classified procurements. On the other hand, FaHCSIA's, DVA's and ACC's guidance did not clearly define Direct Source and Select Tender non-covered procurements and, as could be expected, these agencies experienced more inconsistently classified procurements for the audit sample. This has implications for the transparency of published procurement information.

### **Audit sample testing: classifying procurement methods for reporting in AusTender**

**3.32** As outlined in paragraph 3.14, FMG No.15 requires agencies to report the procurement method for a contract by selecting one of the following methods provided on AusTender: Open Tender; Select Tender; or Direct Source.

#### *Sufficient documentation to determine the procurement method*

**3.33** The CPGs require agencies to maintain sufficient documentation to support accountability and transparency of all procurements. This includes ensuring there is sufficient documentation to provide an understanding of the procurement process that was followed.

**3.34** Of the 612 procurements in the adjusted audit sample, the agencies could provide sufficient documentation for the ANAO to test and validate the procurement method (as reported in AusTender) for only 95 per cent or 579 procurements.<sup>112</sup>

**3.35** DVA and the ACC were able to provide ANAO with sufficient supporting documentation to determine the procurement method used for all but one, and all of their selected procurements, respectively. Approximately nine percent of the audit sample (for FaHCSIA and Innovation) was

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<sup>112</sup> Examples of insufficient documentation included: in some cases, the agency being unable to locate any information about the procurement; and, in the majority of cases, the provision of purchase orders, contracts, invoices and/or emails that provided information about the procurement but not the process used to procure property and services.

insufficiently documented for the ANAO to conduct testing of the procurement method.

**3.36** These results are summarised in Table 3.2 below. The adequacy of procurement documentation is discussed further in Chapter 4.

**Table 3.2**

**Sufficiency of documentation on procurement process**

	FaHCSIA	Innovation	DVA	ACC	Total
Audit sample (Adjusted)	183	179	156	94	612
Insufficient or no documentation provided to enable validation of procurement method, no further testing conducted	13	19	1	-	33
Number of procurements examined	170	160	155	94	579
Value of contracts examined by \$ million	\$219.9	\$34.3	\$35.2	\$16.2	\$305.6

Source: ANAO sample testing.

***Inconsistent classification of procurement method***

**3.37** For the 579 procurements where the procurement method could be determined, the ANAO assessed whether the procurement method reported in AusTender was consistent with the CPG's definitions (see Table 3.1). All four agencies had instances of incorrect or inconsistent reporting of procurement method, ranging from 6 per cent (at Innovation) to around 28 per cent (at FaHCSIA) of procurements in the sample. While a small margin of error is to be expected, the results highlight a lack of clarity and understanding regarding how procurement methods should be classified. Of the 109 procurements that were misclassified, there were many different types of incorrect or inconsistent classification. However, there were two main areas of inconsistency and these are outlined below.

Reporting procurements from panels as Direct Sourced rather than Open Tender

**3.38** A major area of misclassification was procurements under a panel arrangement (a form of standing offer). In this circumstance procurements should be classified as Open Tender (when the panel was established using an

Open Tender process), whereas agencies often classified them as Direct Sourced.<sup>113</sup>

**3.39** All four agencies had instances of incorrectly reporting procurements made under a panel arrangement as Direct Source (rather than Open Tender) on AusTender. These instances accounted for 41 of the 109 (38 per cent) inconsistently classified procurements in the audit sample.<sup>114</sup> This suggests insufficient understanding in some agencies about how to classify procurements made under a standing offer arrangement, and the need for clear guidance in this area.

**3.40** There were three main reasons for agencies' misunderstanding of how to classify procurements from a panel. Firstly, agency staff involved in procurement from a panel did not generally have an understanding that the panel was formed as the result of an Open Tender process. Secondly, they did not understand that selecting directly from a panel in accordance with arrangements established for the panel should be classified as Open Tender.<sup>115</sup> Thirdly, in some cases staff did not document that the procurement was from a panel, making it difficult for the agency to identify panel procurements and report them accordingly.

Defining procurements as Select Tender rather than Direct Sourced

**3.41** The other major area of inconsistent classification of procurements was of Select Tenders:

- for non-covered procurements, Finance's policy intention (established in the CPGs and supporting guidance material) is that procurements should be classified as Direct Source if they: do not involve a tender

<sup>113</sup> For procurements from an Open Tender, agencies should report in AusTender the approach to market (ATM reference) for relevant contract notices. For procurements from a standing offer, agencies should report the Standing Offer Notice (SON) for the relevant contract notice. The purpose of such reporting is to provide greater transparency and understanding of agencies' procurement processes. Only FaHCSIA had recorded an ATM reference for all of the procurements it had classified as Open Tender in the audit sample. However, the ATM reference was generally not recorded by Innovation and DVA. ACC recorded an ATM reference for almost 60 per cent of its Open Tender procurements. Similar results were observed for reporting the SON reference for procurements from a standing offer notice. The ANAO considers that these findings probably contributed to incorrect classification of procurements from a panel.

<sup>114</sup> A further nine procurements were recorded as Direct Sourced when they were the result of an Open Tender process and the procurement was not from a panel arrangement.

<sup>115</sup> For example, as indicated above, ACC's guidance suggested that once a panel was formed you could Select Tender or Direct Source from the panel.

process (including a tender evaluation); approach one supplier;<sup>116</sup> or seek quotes from suppliers of the agency's choice (see the CPG's definitions in Table 3.1). Whereas agencies often called procurements Select Tenders in these circumstances; and

- for covered procurements, the CPGs' definition of Select Tender required a tender process where agencies needed to select potential suppliers from: a multi-use list; a list of potential suppliers that have responded to a request for expressions of interest; or a list of all suppliers that hold a licence or meet a specific legal requirement (see definitions in Table 3.1). There were a range of instances when these requirements were not met but agencies still defined procurements as Select Tender.<sup>117</sup>

**3.42** All four agencies categorised more procurements as Select Tender procurements than would be warranted based on the definitions in the CPGs and supporting guidance (which are reflected in the definitions shown in Table 3.1). For the audit sample, the four agencies reported a total of 58 Select Tender procurements in AusTender. The ANAO considered that only eleven of these procurements met the criteria for a Select Tender process. Thirty-nine (67 per cent) of the 58 procurements were Direct Sourced, (25 of the 39 were non-covered procurements).<sup>118</sup>

**3.43** There were two main reasons for agencies misunderstanding what a Select Tender was:

- firstly, and as previously indicated, under the CPGs the differences between a Select Tender and Direct Sourcing for non-covered procurement are subtle and not easily understood, and at times there is apparently no difference. It is therefore not surprising that agency staff have trouble distinguishing between these procurement methods. This audit's findings indicate agencies classify procurements that approach only one supplier or seek quotes as either Select Tender or Direct

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<sup>116</sup> The exception to this is if the supplier is selected in accordance with the MPPs (in particular paragraphs 8.20 through to 8.29 of the CPGs) from a multi-use list, a list of potential suppliers that have responded to a request for expressions of interest, or a list of potential suppliers that have been granted a specific licence or comply with a legal requirement.

<sup>117</sup> These covered procurements were classified as Direct Source procurements and were examined in Chapter 4, refer to paragraph 4.93.

<sup>118</sup> The ANAO also found agencies had sought and documented more than one quote for only seven of these 25 non-covered procurements.

Source (when Finance's policy intention is that they should be classified as Direct Source). This issue accounted for most of the 25 non-covered procurements which were inconsistently classified as Select Tender; and

- secondly, for most covered procurements Select Tender requires an Open Tender process as its basis (through a multi-use list or expressions of interest), whereas for non-covered procurements it does not require an Open Tender. This distinction may not be known by or understood by agency staff, particularly when their involvement in procurement is irregular. The ANAO considered a lack of understanding of the distinction was a key contributor to the incorrect classification of covered procurements as Select Tenders.

### *Estimate of misclassification of procurement method reported in AusTender*

**3.44** As mentioned previously, the ANAO selected a stratified random sample of procurements which included three strata (see paragraph 3.4). As a result, it was possible to estimate, based on sample results, the actual level of misclassification of procurement method reported in AusTender by each agency during the audit sample period, based on the definitions in the CPGs and supporting guidance (see the definitions in Table 3.1).

**3.45** Figure 3.1 shows the estimated proportion of procurements correctly classified (in terms of procurement method) by each agency.<sup>119</sup> The estimated proportion of procurements correctly classified, in terms of procurement method, ranges from 62 per cent (for FaHCSIA) to 91 per cent (for Innovation).<sup>120</sup> As discussed above, the main reasons for misclassification of procurement method were procurement from panels and Select Tender procurement. These sources of misclassification had a net offsetting effect involving Direct Source procurement, which meant that the level of Direct Sourcing reported by each agency in AusTender was generally consistent with the actual level of Direct Sourcing. However, the actual level of:

- Select Tendering was significantly less than that reported in AusTender by the four agencies; and

<sup>119</sup> The estimates presented in Figure 3.1 have 95 per cent confidence intervals of +/-10 percentage points or less.

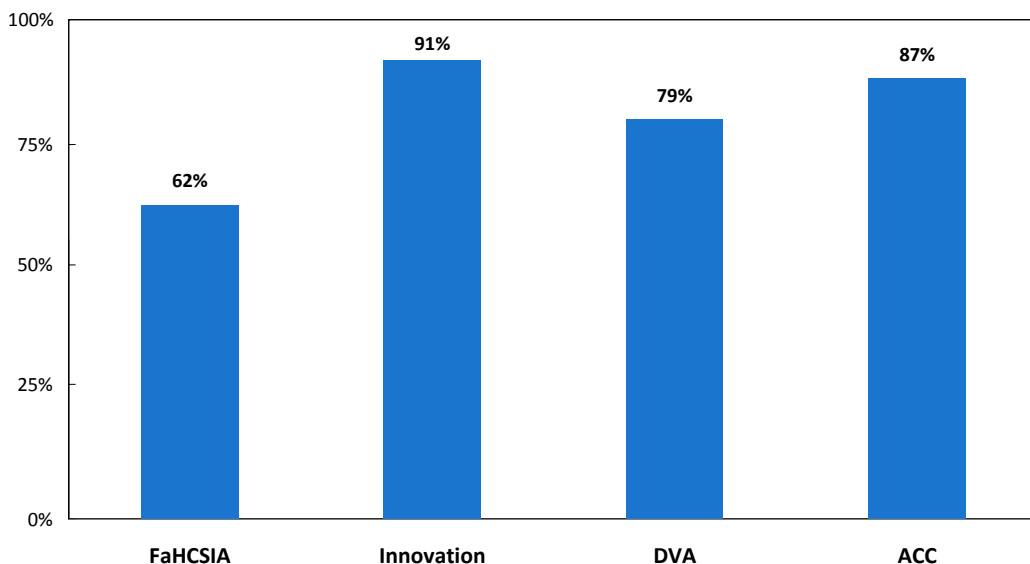
<sup>120</sup> This difference is statistically significant at a 95 per cent confidence level.

- Open Tendering was significantly more than that reported in AusTender by three of the agencies.

**Figure 3.1**

**The proportion of procurements correctly classified in terms of procurement method**

Estimated percentage of procurements



Source: Estimates based on ANAO audit sample data.

***Conclusion—consistent reporting of procurement methods and the need for clarification of the CPGs***

**3.46** Inconsistent and incorrect reporting of procurement method has the potential to create a misleading impression about how the procurement principle of encouraging competition has been applied to agency procurement. This in turn diminishes the transparency of Commonwealth procurement. Potential suppliers have a particular interest in the procurement method as it provides information about the opportunities a supplier might have to bid for the provision of property or services.<sup>121</sup>

<sup>121</sup> For example, when agencies only procure certain services through panel arrangements, accurate reporting in AusTender highlights to potential suppliers the importance of seeking to provide services through such panel arrangements.



**3.47** The ANAO considers that agencies should support staff undertaking procurement to enable a clearer understanding of procurement methods, and in particular, procurement from a panel, Direct Sourcing and Select Tendering. To assist agencies in this education process, there would be benefit in Finance exploring options to clarify in the CPGs, and supporting guidance, how agencies should define and report their procurement methods. In this respect, a key area of focus should be the difference between Direct Source and Select Tender procurement.

**3.48** The ANAO considers that defining Direct Source and Select Tender in terms of covered and non-covered procurement rather than using a single term to explain these procurement methods has contributed to agencies adopting inconsistent approaches to classifying procurements. Finance recognises this issue and has advised that it intends to clarify procurement method definitions.

**3.49** The ANAO also noted opportunities for Finance to clarify the CPGs to more clearly distinguish formal requirements from general guidance (refer to paragraphs 1.20 and 1.21). This would further assist agency staff to understand and implement the CPGs.

## Recommendation No.1

**3.50** To improve the transparency of Commonwealth procurement, the ANAO recommends that:

- (a) Finance review the clarity of the CPGs, including classification of procurement methods, specifically Direct Source and Select Tender procurements; and
- (b) agencies review their policy and guidance on classifying procurement methods to ensure consistency with the CPGs and related guidance.

## Agencies' responses

### *FaHCSIA*

**3.51** Agree. FaHCSIA would be supportive of any Department of Finance and Deregulation reviews that would enhance the clarity of the CPGs, in particular Direct Source and Selected Tender procurements. FaHCSIA regularly reviews its procurement policy to ensure it maintains consistency with the CPGs and related guidance.

## *Innovation*

**3.52** The Department of Innovation, Industry, Science and Research (Innovation) agrees with the recommendation and notes that it currently has, as highlighted in section 3.31 of the proposed report, 'guidance on procurement method that is relatively clear and consistent with the definitions listed in table 3. 1'. Section 3.37 of the report indicates that the department has very little by way of inconsistent procurement method classification (6 per cent).

## *DVA*

**3.53** Agreed. DVA welcomes clarity from Finance for classification of procurement methods. DVA's policies for non-covered procurements are consistent with the current classifications as set out in the CPGs for covered procurements.

## *ACC*

**3.54** Agreed.

## *Finance*

**3.55** Agreed. Anecdotal evidence suggests that, although it is five years since the inclusion of a revised definition of "direct sourcing" and "select tendering" in the Commonwealth Procurement Guidelines (CPGs) and the efforts of my Department, there is still confusion with the older terminology of "sole sourcing" (one quote) and "select tendering" (a few quotes). Neither of those definitions now applies in the CPGs. Direct sourcing and select tendering are explained in paragraphs 8.30 and 8.32 of the CPGs, respectively.

**3.56** Finance is in the process of revising its procurement guidance to, among other things, provide greater clarity around direct sourcing and select tendering procurement methods. Finance will also continue to assist agencies to develop their internal procurement policies and guidance to ensure consistency with the Australian Government Procurement Policy Framework.

## 4. Direct Source Procurement Processes

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*This chapter examines whether the agencies' procurement of property and services using Direct Sourcing has been in accordance with the CPGs and relevant FMA legislation.*

### Introduction

**4.1** The procurement principles established in Division 1 of the CPGs, apply to all Australian Government procurement. The procurement principles require that for Direct Source procurement:

- (a) value for money is considered when making the procurement decision;
- (b) the procurement process encourages competition;
- (c) the procurement method selected supports efficient, effective and ethical use of Commonwealth resources and is in accordance with the CPGs; and
- (d) key procurement decisions and actions are documented to support accountability and transparency.

**4.2** Value for money is the core procurement principle and is enhanced and complemented by the other procurement principles.

**4.3** Covered procurements must comply with procedures outlined in Division 2 of the CPGs (the MPPs). Under the MPPs, Direct Sourcing can only be undertaken for covered procurements in limited circumstances, as specified by paragraph 8.33 of the CPGs (see Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing, Table A 1).

**4.4** Using its sample of Direct Source procurements undertaken by the agencies, the ANAO examined whether the procurement principles had been met (for both covered and non-covered procurements), and if decisions to Direct Source covered procurements were compliant with the MPPs. Agency results were considered in light of their established procedures for Direct Source procurement.

**4.5** For all Direct Source procurements the ANAO assessed whether the documentation appropriately supported the principles of accountability and transparency in decision-making required by the CPGs (see Appendix 6:

Documentation obligations, requirements and sound practices).<sup>122</sup> Findings in relation to the procurement documentation are included in the ANAO's discussion for the following sections, which examine:

- the ANAO's sample of Direct Source procurements;
- value for money and encouraging competition when Direct Sourcing;
- efficient, effective and ethical use of resources when Direct Sourcing;
- Direct Source procurement approval;
- exempt Direct Source procurements; and
- covered Direct Source procurements.

## Sample of Direct Source procurements examined

**4.6** As discussed in Chapter 3 (see Table 3.2 on page 76), the ANAO examined 579 procurements and classified 285 as Direct Source procurements. Table 4.1, on page 85, provides a summary of the number of Direct Source procurements examined in each of the agencies by value.

**4.7** Thirty-seven of the 285 Direct Source procurements related to one of three categories: Exemption 2 from the MPPs (where legislation or Government policy requires procurement from another Government entity); taxi fares; and advertising costs for Telstra's White Pages and Yellow Pages.<sup>123</sup> In the absence of alternative providers or options, these procurements were treated as out of scope when conducting tests of the procurement principles of value for money, encouraging competition and efficient, effective and ethical use of resources. In all cases agencies should still have regard to the reasonableness of the cost of these property or services. The ANAO applied these tests of the procurement principles of value for money, encouraging competition and efficient, effective and ethical use of resources to the remaining 248 Direct Source procurements.

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<sup>122</sup> Finance, CPGs, 2008, p. 18, paragraph 7.9.

<sup>123</sup> Twenty-nine of the 37 procurements had a value in excess of the covered procurement thresholds, although only four procurements were covered procurements.

**Table 4.1****Composition of Direct Source procurements examined in the audit sample**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Number of Direct Source procurements that were valued at less than or equal to the covered procurement thresholds	27	44	17	33	121
Number of Direct Source procurements that were valued at in excess of the covered procurement thresholds	46	50	34	34	164
Total number of Direct Source procurements examined	73	94	51	67	285
Number of Direct Source procurements examined where all procurement principles were tested	58	83	48	59	248

Source: ANAO sample testing.

## Value for money and encouraging competition when Direct Sourcing

**4.8** Value for money and encouraging competition are requirements of the CPGs to be applied to all procurement. Value for money is the core principle underpinning Commonwealth procurement. This principle requires a comparative analysis of all relevant costs and benefits throughout the whole procurement cycle (whole-of-life costing).<sup>124</sup> Competitive procurement processes are more likely to achieve value for money.

**4.9** A whole-of-life value for money assessment includes consideration of factors such as:<sup>125</sup> fitness for purpose; the performance history of each prospective supplier; the relative risk of each proposal; the flexibility to adapt to possible change over the lifecycle of the property or service; financial considerations; and the evaluation of contract options.

**4.10** Obtaining quotes assists agencies in demonstrating value for money by providing a basis for a comparative analysis of costs. It also introduces competition into a Direct Source procurement process. Australian Government policy does not directly specify a minimum number of quotes to be obtained.

<sup>124</sup> Finance, CPGs, 2008, p. 10, paragraph 4.1.

<sup>125</sup> Finance, CPGs, 2008, p. 10, paragraph 4.4.

Procurement processes impose costs on both agencies and potential suppliers. Accordingly, agencies should have regard to the scale, scope and relative risk of procurement in deciding what process ensures a competitive, value for money outcome.<sup>126</sup>

**4.11** For covered Direct Source procurement, all of the agencies required compliance with the MPPs, but were not specific on the procedures to be followed to encourage competition and achieve value for money. For Direct Source procurements with an estimated value of less than or equal to \$80 000, FaHCSIA and ACC required varying numbers or types of quotes depending on value, and required at least three quotes for higher valued purchases (see Table 2.1). Conversely, Innovation and DVA were not specific on the procedures to be followed for non-covered Direct Source procurement (see Table 2.1).

**4.12** Taking account of agency procedures, the ANAO assessed whether agencies had documented, and thereby demonstrated, value for money considerations as part of the procurement process for 248 Direct Source procurements (see Table 4.2).<sup>127</sup>

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<sup>126</sup> MAC, Report No.7, 2007, p. 36. The MAC report seeks to reduce the burden of administrative processes, without undermining accountability.

<sup>127</sup> For testing purposes the ANAO regarded value for money to be demonstrated by agencies undertaking a comparison of quotes or, in the absence of multiple quotes, the agency would need to document that the procurement represented value for money based on a range of factors consistent with those outlined in paragraph 4.9.

**Table 4.2****Documented value for money considerations for Direct Source procurements**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total Direct Source procurements	58	83	48	59	248
Percentage where documentation supporting an assessment of value for money was provided to ANAO	43%	24%	31%	7%	26%
Percentage where no documentation supporting an assessment of value for money was provided to ANAO <sup>128</sup>	57%	76%	69%	93%	74%

Source: ANAO sample testing.

**4.13** The above assessment shows that agencies generally did not retain documentation demonstrating how value for money was assessed and provided for.<sup>129</sup>

**4.14** Table 4.3 below shows the results of ANAO's sample testing of the number of quotes sought. The results indicate substantial scope for improvement in agencies' approaches to encouraging competition and achieving value for money for Direct Source procurement:

- for 85 per cent of the audit sample, from available evidence only one, or no quotes were sought, with many of these procurements being covered or of considerable value;
- while FaHCSIA and ACC required staff to obtain three quotes for non-covered Direct Source procurement, from available evidence this was regularly not being applied in practice; and
- as indicated earlier, Innovation and DVA did not require more than one quote be sought for non-covered Direct Source procurements, which is reflected in the results.

<sup>128</sup> This included situations where the agency could not provide any evidence to support a value for money assessment, and a few instances where the agency asserted that the procurement represented value for money but the assertion was not supported.

<sup>129</sup> In response to the proposed audit report Innovation commented that, 'Table 4.2 of the report states that 76 per cent of Innovation's documentation did not support an assessment of value for money. The introduction of the Contracts Module on 1 October 2009 has introduced greater controls, scrutiny and visibility for documentation associated with all covered procurements — improving the quality and compliance of documentation. In addition, Innovation has developed a two day procurement and contract management course — this course includes the requirements for adequate levels of documentation.'

**Table 4.3****Number of quotes sought for Direct Source procurements in the audit sample**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total Direct Source procurements	58	83	48	59	248
Percentage where from available evidence no quotes sought <sup>130</sup>	29%	12%	25%	69%	32%
Percentage where from available evidence one quote sought	54%	70%	65%	19%	53%
Percentage where from available evidence more than one quote sought	17%	18%	10%	12%	15%

Source: ANAO sample testing.

**4.15** The regularity of agencies seeking one or no quotes reflects a tendency to follow minimal process when Direct Sourcing, rather than adapting the level of process commensurate to the scale and relative risk of the procurement.<sup>131</sup> In particular, for Direct Source procurements valued at more than \$80 000, more than one quote was sought for only 14 procurements (10 per cent). This means that 121 Direct Source procurements (that were each valued in excess of \$80 000), with a total reported value of almost \$183 million sought one or no quotes prior to procuring their property or services.

**4.16** The practical application of the CPGs can justify Direct Sourcing in certain instances, for example, for simple low cost items where market forces readily determine product price. Agencies may implement efficient working arrangements to manage basic, low cost purchases. However, as the scale and risk profile of the procurement increases, seeking more than one quote would generally assist in providing assurance that a value for money outcome was achieved.

**4.17** For complex procurements, there may not be an obvious competitive market. In these cases, where Direct Sourcing can be justified, it is prudent for agencies to obtain a small number of quotes from suppliers with a history of proven performance, and to maintain the visibility of the procurement process

<sup>130</sup> This includes situations where the agency did not seek quotes, and a few instances where the agency could not provide evidence that quotes were sought.

<sup>131</sup> The Direct Sourcing approaches to seeking quotes adopted by agencies also have implications for ethics and probity, which are discussed in the following section.



by clearly documenting key procurement decisions and the reasons for those decisions.

**4.18** A greater focus on all the components that contribute to achieving value for money when Direct Sourcing would encourage more competitive procurement processes.

## Efficient, effective and ethical use of resources when Direct Sourcing

**4.19** Consistent with the requirements of the FMA Act and Regulations, the CPGs establish efficient, effective and ethical use of resources as procurement principles that apply to all procurements. To achieve these procurement principles, prior to commencing procurement, it is important to consider the procurement need and process, including the value of the procurement, the level of risk, and prevailing market circumstances. This will assist with the selection of an appropriate procurement method. Such consideration may take the form of a business case,<sup>132</sup> procurement planning<sup>133</sup> or equivalent, or can be built into established working arrangements. In all cases the approach taken should be commensurate with the scale and risk profile of the procurement. It is also prudent to address any ethical considerations at this point in the procurement process.

### Efficiency and effectiveness—consideration of the procurement need and process

**4.20** Efficiency and effectiveness are requirements of the CPGs to be applied to all procurement. Efficiency in procurement includes the selection of a procurement process that is consistent with government policy and is the most appropriate to the procurement objective under the prevailing circumstances.<sup>134</sup> A critical step in selecting a procurement process is in

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<sup>132</sup> Finance, CPGs, 2008, p. 19. The CPGs identify, as part of the phase of identifying the procurement need, the preparation of documentation that outlines the business case, risk assessment and procurement method decision. Similar requirements are outlined in Finance, FMG No.13, *Guidance on the Mandatory Procurement Procedures*, January 2005, pp. 8 and 19. FMG No.13 is primarily directed at covered procurements. The practices outlined in this guidance are considered better practice. In this regard, it is considered that it could be to an agency's advantage to apply these practices to non-covered procurement as these practices would assist the agency to comply with the procurement policy framework. FMG No.13, 2005, p. 4.

<sup>133</sup> Finance, FMG No.13, 2005, pp. 8–19.

<sup>134</sup> Finance, CPGs, 2008, p. 14, paragraph 6.3.

calculating a reasonable estimate of the maximum anticipated value of the procurement, as this value determines whether the procurement should be treated as a covered procurement.<sup>135</sup> Efficiency is enhanced by conducting transparent, fair and appropriately competitive processes of a scale commensurate with the scale and risk profile of each particular project.<sup>136</sup> Therefore, officials involved in individual procurements are required to:

- select a procurement process that is consistent with government policy and is the most appropriate to the procurement objective under the prevailing circumstances, under paragraph 6.3 of the CPGs; and
- value the procurement to determine whether it is a covered procurement, under paragraph 8.5 of the CPGs.

**4.21** Effectiveness in procurement can be achieved by ensuring that the property or service being sought will make the maximum possible contribution to the relevant outcome. This entails correctly identifying the need, accurately drafting functional specifications, rigorously assessing responses and negotiating the final contract, and then diligently managing the contract. Comprehensive monitoring and assessment at all stages of the procurement process further contributes to effectiveness.<sup>137</sup> Therefore, officials involved in individual procurements are required to identify the procurement need (including documenting the requirement), under paragraph 6.6 of the CPGs.<sup>138</sup>

**4.22** Procurement planning is fundamental to achieving efficiency and effectiveness requirements.<sup>139</sup> Where Direct Sourcing is selected as the procurement method, an agency needs to be able to support its decision to

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<sup>135</sup> Finance, CPGs, 2008, p. 26, paragraph 8.5.

<sup>136</sup> Finance, CPGs, 2008, p. 14, paragraph 6.4.

<sup>137</sup> Finance, CPGs, 2008, p. 14, paragraph 6.6.

<sup>138</sup> The ANAO has previously found that agencies need to improve their analysis of procurement requirements as, at times, requirements have tended to be too narrowly focused and did not consider reasonably foreseeable needs. Incomplete requirements lead to additional procurement activity and the inappropriate use of direct sourcing and contract variations. ANAO, Audit Report No.21, 2006–07, *Implementation of the revised Commonwealth Procurement Guidelines*, p. 15.

<sup>139</sup> In this context procurement planning refers to the consideration of the procurement need, the estimated value of the procurement, and the selection of an appropriate procurement process. These considerations may or may not be documented depending on agency requirements which should reflect the scale and risk profile of the procurement.

Direct Source, which should have regard to the estimate of the expected value of the procurement.

**4.23** MAC Report No.7 comments that it may be possible to simplify relatively low risk procurements by minimising or removing requirements that prescribe detailed procurement planning and risk management processes.<sup>140</sup> This observation does not diminish the need to undertake procurement planning and assess the level of risk associated with the procurement, but rather highlights the importance of agency requirements reflecting the scale and risk profile of the procurement.

**4.24** The ANAO assessed the agencies' approaches to procurement planning, including consideration of the estimated value of the planned procurement, the procurement method and the rationale for Direct Sourcing. The assessment included analysis of procurement planning for the sample of Direct Source procurements at each agency.

*Procurement planning or equivalent documentation—consideration of the procurement need, estimated value and associated matters*

**4.25** For minor acquisitions a formal plan will generally not be required. In some cases, such as Innovation, agencies have determined through their guidance that by employing established working arrangements for basic purchases formal planning is not required for low value procurements.<sup>141</sup> However, as the scale and risk profile of the procurement increases more formal procurement planning would assist agency officials to address efficiency and effectiveness considerations when undertaking procurement to facilitate a better procurement outcome.<sup>142</sup>

**4.26** Three of the four agencies (FaHCSIA, Innovation and DVA) required a procurement plan or business case to be completed for all procurements in excess of \$80 000 (as a proxy for covered procurements). FaHCSIA and DVA also required completion of a plan for non-covered procurements. Meanwhile, for procurements valued at less than \$80 000, stage one of Innovation's phased approval minutes also acted as an opportunity to address key considerations in

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<sup>140</sup> MAC, Report No.7, 2007, p. 25.

<sup>141</sup> Innovation does not require completion of their equivalent of a procurement plan for procurements valued at less than \$25 000.

<sup>142</sup> Procurements where more formal planning may take place would include covered procurements, procurements approaching the covered procurement thresholds and procurements where the maximum value cannot be reliably estimated.

the planning phase for non-covered procurements (valued at \$25 000 or more). ACC provided a procurement plan template to staff but did not require that it be completed.<sup>143</sup>

**4.27** Taking account of these agency requirements, for the sample of Direct Source procurements, the ANAO assessed whether from available documentation the agencies had taken account of efficiency and effectiveness considerations through procurement planning. Agency guidance generally required a procurement plan, business case or equivalent documentation, which outlined: the procurement need and process; as well as some associated considerations such as the value of the procurement, the level of risk and the prevailing market circumstances, which assisted in the selection of an appropriate procurement method.

**4.28** Overall, for 60 per cent of the Direct Source procurements examined, there was limited evidence of the aforementioned efficiency and effectiveness considerations prior to commencing the procurement. For procurement valued in excess of \$80 000, 85 (63 per cent) procurements did not demonstrate these considerations had taken place. In comparison 56 per cent of procurements valued at \$80 000 or less did not demonstrate that these considerations had taken place.

**4.29** As indicated above the ANAO recognises for lower value procurements that these considerations may be built into established working arrangements for basic purchases and may not be specifically documented for each procurement. As indicated in Chapter 2 (see paragraphs 2.13 to 2.20), agency guidance can introduce additional thresholds for non-covered procurements and suggest appropriate procurement approaches which have regard to the nature, scale and risk profile of the procurement. Such thresholds need to give sufficient emphasis to the procurement principles, and should promote efficient and effective procurement processes.

**4.30** Table 4.4 shows the results of sample testing. Innovation prepared a procurement plan or equivalent for the majority of its Direct Source procurements (84 per cent of procurements examined, even when there was no requirement to prepare planning documentation). The remaining agencies generally did not prepare a procurement plan, which was contrary to the

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<sup>143</sup> Refer to Table A 4 on page 147 of Appendix 7: Audited agency requirements for documenting Direct Source procurements. Staff were required to complete a purchase order request which was not a plan but was a record of the procurement process and decision (see paragraph 4.44).

planning requirements of FaHCSIA and DVA. As discussed above, ACC did not require documentation of a procurement plan, however, for 7 per cent of the Direct Source procurements examined a plan was prepared.<sup>144</sup> A lack of due consideration of the procurement need at the planning stage does not support optimisation of the procurement approach.<sup>145</sup> This is illustrated later in the chapter, where a number of Direct Source procurements in the audit sample were considered non-compliant with the MPPs. These cases concerned the continuation of property or services, or the acquisition of additional property and services with an existing supplier (where this future need had not been sufficiently or appropriately addressed in the previous procurement).<sup>146</sup>

**Table 4.4**

**Procurement planning or equivalent documentation prepared in accordance with agency guidance to support Direct Source procurements**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total Direct Source procurements	58	83	48	59	248
Total number of Direct Source procurements where a procurement plan or equivalent documentation was not required by agency guidance	-	23	-	59	82
Total number of Direct Source procurements where agency guidance required a plan or equivalent documentation	58	60	48	-	166
Percentage of Direct Source procurements where agency guidance required a plan and a plan was provided to the ANAO (A)	33%	83%	15%	-	46%

Source: ANAO sample testing.

- (A) For the remaining procurements, the agencies either did not prepare a procurement plan or in a few instances the agencies were unable to provide a procurement plan although documentation suggested a plan may have been prepared.

<sup>144</sup> The value of each of these procurements ranged from \$13 000 to \$30 000.

<sup>145</sup> There was limited evidence that agencies had considered alternate opportunities that may have been pursued in place of the approach selected for the procurement. Finance, FMG No.13, 2005, p. 17, suggests that alternative opportunities include: examining annual procurement plans of other agencies to identify procurements that share common characteristics with the proposed procurement and entering into cooperative arrangements; accessing existing standing offer arrangements where it is possible for the agency to enter into a cooperative procurement arrangement, called "piggy-backing"; and joining a whole-of-government arrangement or cluster.

<sup>146</sup> See paragraph 4.89.

**4.31** For the 100 Direct Source procurements where the ANAO recognised some form of documented procurement planning, for more than half of these procurements the documentation included the results of the procurement process, for example quotes received, rather than consideration of the need and the process prior to commencing the procurement.<sup>147</sup> This meant that the delegate had not been able to agree to the planning process, because this was already underway.<sup>148</sup>

**4.32** Not involving the delegate in the selection of the approach to a procurement may be appropriate for:

- routine and low risk procurements that are planned and undertaken in accordance with agency requirements and apply the procurement principles; and
- where there is a pre-existing understanding of the approach that will satisfy the delegate's reasonable inquiries.

**4.33** However, completion of the procurement process prior to delegate involvement limits the ability of the delegate to influence the type of procurement process chosen. This could also affect the ability of the delegate to assure that the process will give value for money. Involvement of the delegate in selecting the method of procurement is most important when the procurement is:

- not routine;
- considered to be medium or high risk;
- has not been planned in accordance with agency requirements and the procurement principles; and
- where relevant, has not been planned to meet the requirements of the MPPs. In these circumstances the delegate should be consulted about the approach prior to commencing the procurement process.

**4.34** For non-routine procurements, it may be prudent for agencies to separate the process for agreeing the procurement processes from that of

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<sup>147</sup> Of the 100 plans prepared 57 plans included the results of the procurement process.

<sup>148</sup> The delegate is then left with a decision to: stop the process if it is considered non-compliant with the CPGs; go without the product or services; or to approve a spending proposal that may not satisfy the delegate's reasonable enquiries or be compliant with agency requirements and the CPGs (which would be inappropriate).

approving the spending proposal.<sup>149</sup> This separation of duties enables delegates to undertake reasonable inquiries and influence the procurement approach so that they can be satisfied that it is consistent with government policy and is an efficient, effective and ethical use of resources. Separation of duties and responsibilities is one of few avenues available to agencies to demonstrate that expected standards of probity and ethical conduct have been met (see paragraphs 4.58 and 4.59), and is an important consideration where Direct Source procurement is used.

#### *Estimated value of the procurement—procurement planning*

**4.35** Correctly estimating the value of a planned procurement is critical when determining whether it is a covered procurement and selecting an appropriate procurement method.<sup>150</sup> It requires that agencies apply a sufficiently robust estimation process, based on an understanding of market values derived before any quotes or tender process takes place. Agencies should include all procurement elements in forecast amounts, which includes taking into account likely contract extensions, renewals or other variations that may be executed over the life of the contract.

**4.36** For low value procurements documentation supporting the estimation process will generally not be required, as agencies may determine through their guidance that employing established working arrangements for basic purchases would be sufficient for these procurements. However, as the scale and risk profile of the procurement increases, key information from the estimation process should be documented and made available for delegates when approving the proposed procurement process and/or spending proposal.<sup>151</sup> Where the total maximum value of a contract (over its duration) cannot be estimated, the procurement must be treated as being valued over the MPP thresholds.<sup>152</sup> MAC Report No.7 states that where the procurement is

<sup>149</sup> Finance, FMG No.13, p. 18. Consideration of issues such as the procurement need, the prevailing market circumstances, timelines, the associated risks, and any viable alternatives should form the basis of a business case which explains why the procurement should be undertaken and how it delivers value for money. Once completed, the business case should be sent to the appropriate official for approval. When approving the business case the official should take into consideration FMA regulations 9, 10 and 12.

<sup>150</sup> Finance, CPGs, 2008, p. 26, paragraph 8.5. Procurements must not be divided into separate smaller procurements to circumvent a threshold (Finance, CPGs, 2008, p. 27, paragraph 8.10).

<sup>151</sup> Procurements where documentation of key information from the estimation process may take place would include covered procurements, procurements approaching the covered procurement thresholds and procurements where the maximum value cannot be reliably estimated.

<sup>152</sup> Finance, CPGs, 2008, p. 27, paragraph 8.9.

close to a threshold and could exceed the threshold, the procurement must be treated as a covered procurement.<sup>153</sup>

**4.37** The procurement guidelines at Innovation, DVA and the ACC contained information on the procurement elements to be included when estimating the value of a procurement. However, FaHCSIA would benefit from strengthening its procurement guidelines to include some information on how to value procurements having regard to the CPGs. More broadly, all agencies would benefit from some additional guidance (and, where appropriate, supporting documentation requirements) on processes that should be followed to achieve reliable estimates. For example, for simple procurements unlikely to be approaching the procurement threshold, agency staff may be able to draw on the cost of similar procurements undertaken by their agency and other agencies in the recent past. Alternatively, for more complex procurements, more in-depth market analysis would be appropriate.

**4.38** For the 100 instances where, from available documentation, procurement planning had occurred,<sup>154</sup> the documentation generally contained an estimate of the value of the procurement. Nevertheless, in the majority of these cases the estimates were actual quotes sought. As reflected on above, this meant that the procurement process was already underway, prior to estimation of the procurement value. In order for agencies to determine whether or not the MPPs apply, the first step is to value the procurement, as a basis for determining which procurement methods may be used.

**4.39** Of the 100 procurements where planning documentation was made available to the ANAO, only 43 included an estimate other than quotes sought. Five of the estimates significantly underestimated the value of the property or services agreed in the contract or purchase order.<sup>155</sup> In particular, two of these estimates valued the procurement as non-covered but the actual value of the procurement exceeded the covered procurement thresholds, and the estimates undervalued the procurement by 50 to 100 per cent (see Table 4.5).

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<sup>153</sup> MAC, Report No.7, 2007, p. 29.

<sup>154</sup> Refer to paragraphs 4.25 and 4.27 for the criteria used to determine whether a document was a procurement plan or equivalent.

<sup>155</sup> There were also four instances where the agency significantly overestimated the value of the procurement.



**Table 4.5****Example of not being able to reliably estimate the value of the procurement**

In one case, an agency estimated that the cost of services, based on past experience, would be between \$40 000 and \$80 000. Subsequently, following a Select Tender process that did not comply with MPP requirements, a contract in excess of \$100 000 was approved. In this situation, the wide variance in the likely cost of services suggested that the procurement could not be reliably valued. Paragraph 8.9 of the CPGs requires that where the total maximum value of the contract cannot be estimated, the procurement must be treated as being valued over the covered procurement threshold. On this basis the agency should have modified its approach so as to be compliant with the MPPs.

Source: ANAO sample testing.

**4.40** At times, agency officials perceive benefits in treating procurements as non-covered on the basis that they may then follow less onerous procurement processes.<sup>156</sup> The extent of such practice within an agency is an area worthy of consideration by CPUs, with a view to informing the development of policy and guidance, as well as monitoring and review activities to ensure procurement processes within the agency adequately promote the adoption of open procurement approaches.

***Rationale for Direct Sourcing***

**4.41** Given that Direct Sourcing is less competitive than other procurement methods, it is important that procurement planning provides a clear rationale for decisions to Direct Source. For low value, basic purchases, this would normally involve employing established working arrangements. As the scale and risk profile of the procurement increases, a rationale that specifically considers and applies the procurement principles, and where relevant the MPPs, becomes more important.

**4.42** For all procurements, agencies need to ensure there is sufficient documentation to provide an understanding of the procurement process that was followed and the basis for using it.<sup>157</sup> Documentation should be commensurate with the scale and risk profile of the procurement. Again, for low value, basic purchases, this would normally involve agency officials employing established working arrangements and maintaining sufficient documentation to demonstrate that the procurement has met the agency's

<sup>156</sup> See footnote 174 (on page 102) and Table 4.15 (on page 119) which refer to contract splitting.

<sup>157</sup> Finance, CPGs, 2008, p. 18, paragraph 7.9.

minimum requirements. As the scale and risk profile of the procurement increases, it would generally be expected that agencies would specifically document reasons for undertaking Direct Source procurement. This documentation may occur as part of planning the procurement, or as a record of the approach undertaken to meet documentation requirements. For covered Direct Source procurement, the MPPs require agencies to prepare and file a written report that includes: the value and kind of property or services procured; and a statement indicating the circumstances and conditions that justify the use of Direct Sourcing.<sup>158</sup>

**4.43** Only two of the four agencies' policies (Innovation and ACC) required documentation of the reasons for Direct Sourcing below \$80 000.<sup>159</sup> For covered Direct Source procurements, all of the agencies required compliance with the MPPs, although, for procurements in excess of \$80 000 where there was a requirement to justify a decision to Direct Source, the agencies did not specify that the justification needed to include both:

- a reference to a circumstance or exemption outlined in the MPPs or Appendix A of the CPGs; and
- evidence of investigations of relevant market conditions and how they justified the decision to Direct Source.<sup>160</sup>

**4.44** Taking account of agency requirements, the ANAO assessed whether the available procurement plans or equivalent documentation outlined the reasons or rationale for selecting the Direct Source procurement method. Table 4.6 shows the results of sample testing of rationales in procurement plans. As ACC did not require a procurement plan to be prepared the ANAO also examined purchase order requests, which sought to capture information about what was being procured, the approach and the reason for Direct Sourcing.<sup>161</sup> Around 36 per cent of ACC's Direct Source procurements examined documented a reason for Direct Sourcing in the purchase order

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<sup>158</sup> Finance, CPGs, 2008, p. 32, paragraph 8.34.

<sup>159</sup> Innovation and ACC both include a requirement to justify Direct Sourcing, regardless of value, however, in practice the justification in these agencies was that Direct Sourcing is appropriate for non-covered procurements.

<sup>160</sup> Finance, FMG No.14, January 2005, p. 20, paragraph 6.3.

<sup>161</sup> The purchase order request was generally completed at the time agency staff were seeking final approval for the purchase, this meant that it was not a plan, but it was a record of the procurement process and decision.

request as required by the ACC's purchase order request (the results of purchase order request testing are not included in the Table 4.6).<sup>162</sup>

**Table 4.6**

**Procurement plan or equivalent documentation provided a reason or rationale for selecting Direct Sourcing as the procurement method**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total Direct Source procurements that had a procurement plan or equivalent documentation	19	70	7	4	100
Percentage of procurement plans with no rationale for selecting Direct Sourcing	16%	23%	43%	50%	24%
Percentage of procurement plans with a rationale for selecting Direct Sourcing	84%	77%	57%	50%	76%

Source: ANAO sample testing.

**4.45** Three-quarters of the procurement plans contained a rationale for selecting Direct Sourcing as the procurement method.<sup>163</sup>

- where the procurement was a non-covered procurement the rationale tended to be limited. Reflecting the findings of Chapter 2, in accordance with agency policy and guidance, Direct Sourcing was considered an appropriate method to employ for non-covered procurement;
- for covered Direct Source procurements, justifications were often limited to a reference to the circumstance or exemption outlined in the MPPs that the agency considered applied. As discussed later in this chapter, for a large proportion of the sample of covered Direct Source procurements, it was not evident from the circumstances of the procurement and/or procurement documentation that a valid circumstance applied.<sup>164</sup> In most cases, to demonstrate that a

<sup>162</sup> For the purposes of this test the ANAO examined a total of 59 Direct Source procurements where ACC required the reasons for Direct Sourcing to be documented. Reasons for Direct Sourcing were generally not supported by relevant facts. The reasons for Direct Sourcing were generally limited to: there was a Finance embargo which prevented ACC approaching the market (see paragraph 4.91); a circumstance applied under paragraph 8.33diii or 8.33e of the CPGs; or the provider was a sole supplier.

<sup>163</sup> Forty-two (55 per cent) of the procurements that provided a rationale for Direct Sourcing were covered procurements. However, as discussed later in this chapter rationales for Direct Sourcing were not always supported by the circumstances of the procurement and/or supporting documentation (see paragraph 4.89).

<sup>164</sup> See paragraphs 4.87 and 4.89.

circumstance applied, agencies would need to show how relevant market conditions had been considered and applied;<sup>165</sup> and

- in FaHCSIA staff were required to seek the approval of the CPU Branch Head for Direct Source procurements in excess of \$80 000 prior to delegate approval. This requirement was generally met in practice and allowed FaHCSIA to demonstrate that a circumstance outlined in the MPPs justified the decision to Direct Source.

**4.46** In summary, rationales for Direct Sourcing need to have regard for the procurement principles, the MPPs and the scale, nature and relative risk of the procurement.<sup>166</sup>

#### *Level of risk and risk assessment*

**4.47** Risk management is a sound practice to be applied to all elements of public administration. The CPGs state that risk management should be built into an agency's procurement processes. Agencies should ensure that appropriate procedures are in place to identify and consider all relevant risks throughout the procurement cycle. The extent of risk management required will vary, depending on the nature of the procurement being undertaken.<sup>167</sup> MAC Report No.7 states that red tape occurs when risk management processes are excessive for their purpose. Extensive processes will generally only be appropriate for medium and high risk procurements.<sup>168</sup>

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<sup>165</sup> The Faulkner Inquiry made a similar assessment in the context of the Green Loans programs. For example, while the Department of Environment, Water, Heritage and the Arts (DEWHA) quoted a circumstance from paragraph 8.33 when preparing a written report for the Direct Source procurement, none of the reasoning was adequately substantiated to demonstrate support for the conditions outlined in the CPGs. In particular, the documentation on file failed to substantiate the following: the circumstances of extreme urgency and why they were unforeseen by DEWHA (paragraph 8.33b of the CPGs); how the absence of competition for technical reasons was determined (paragraph 8.33diii of the CPGs); and how the supplier/s approached for Direct Sourcing were selected. *Independent Inquiry into the Green Loans Program – Review of procurement processes and contractual arrangements by Ms Patricia Faulkner AO*, 8 July 2010, p. 22.

<sup>166</sup> In response to the proposed audit report Innovation commented that, '*Table 4.6 of the report states that 23 per cent of Innovation's documentation did not include a rationale for direct sourcing. The introduction of the Contracts Module on 1 October 2009 has introduced greater controls, scrutiny and visibility for documentation associated with all covered procurements — improving the quality and compliance of documentation.*'

<sup>167</sup> Finance, CPGs, 2008, p. 14, paragraph 6.8.

<sup>168</sup> MAC, Report No.7, 2007, p. 37. The MAC report dispels the myth that extensive risk management processes are required for all procurements, by stating that they are generally only appropriate for medium and high risk procurements.

**4.48** Agencies adopt different approaches to risk management when undertaking procurement. For low risk procurements this may simply involve following routine procurement processes; whereas for procurements of medium and high risk, agencies should, at a minimum, acknowledge the level of risk, and mitigation strategies, in procurement documentation. The benefit of such an approach is that it signals to those with formal roles in procurement approval that there is a heightened risk to the procurement, and prompts officials to both understand and manage any significant procurement risks.

**4.49** Each of the agencies addressed risk management to some extent through policies and guidance, and provided templates to support the assessment of risk for individual procurements. However, risk management was often addressed in a separate template from the procurement plan and spending proposal. Where multiple templates were available to cover different aspects of procurement decisions and actions, the ANAO considered there was a risk that not all templates would be completed, as the focus would be on obtaining approval to spend public money and approval of the procurement.<sup>169</sup>

**4.50** For the sample of Direct Source procurements, it was not evident from procurement documentation that risk had been specifically considered in relation to individual procurements by FaHCSIA,<sup>170</sup> DVA<sup>171</sup> and ACC. Meanwhile, Innovation was able to demonstrate specific consideration of risk in a limited number of cases.<sup>172</sup> While for many low risk procurements these findings reflect the application of routine procurement processes, the scale and nature of procurements examined by the ANAO suggested some of these procurements were likely to be of medium to high risk. Sound practice in such instances would be to more explicitly consider risk. Further, the approach

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<sup>169</sup> Findings in this chapter indicate that spending proposal and procurement approval templates were more likely to be completed than other templates such as those for risk assessment, business and procurement plans and conflict of interest declarations.

<sup>170</sup> FaHCSIA require a risk assessment for all procurements in excess of \$80 000. Risk was only documented for one of FaHCSIA's covered Direct Sourced procurements in its Departure from Mandatory CPG Requirements Template (refer to Table A 4 on page 147 for details of Direct Sourcing templates).

<sup>171</sup> DVA requires risk assessments for all procurement processes. Risk assessments should be included in procurement plans.

<sup>172</sup> Requirements for risk assessment varied between the agencies. With the exception of FaHCSIA, at a minimum agencies required an assessment of risk for the majority of procurements. For procurements undertaken by Innovation and ACC this would involve the completion of a risk assessment template (refer to Table A 4 on page 147 for details of Direct Sourcing templates).

adopted to risk management for the majority of procurements examined did not meet requirements established in agency procedures.

## **Demonstrating ethical procurement**

**4.51** Adopting ethical practices, behaviour and approvals when undertaking procurement is a requirement of the CPGs. The CPGs consider ethics to be the moral boundaries or values within which officials work. Ethical behaviour encompasses the concepts of honesty, integrity, probity, diligence, fairness, trust, respect and consistency. Ethical behaviour identifies and avoids conflicts of interests, and does not make improper use of an individual's position. A specific aspect of ethical behaviour relevant to procurement is an overarching obligation to treat potential suppliers as equitably as possible.<sup>173</sup>

**4.52** Paragraph 6.19 of the CPGs requires agencies to ensure that the officials involved in procurement, particularly those dealing directly with suppliers and potential suppliers:

- recognise and deal with any conflicts of interest, including perceived conflicts of interest;
- deal with suppliers and potential suppliers even-handedly; and
- consider seeking advice where probity issues arise.

**4.53** Agencies reduce the risk of unethical dealings, and the associated consequences for an agency's reputation, by setting expectations for staff behaviour, such as through values and a code of conduct. As the scale and/or risk profile of particular procurements increase, more formal requirements should be applied to protect the integrity of the procurement processes. Recent reviews have highlighted particular risks in relation to Direct Source procurements.<sup>174</sup>

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<sup>173</sup> Finance, CPGs, 2008, p. 16, paragraphs 6.17 to 6.18.

<sup>174</sup> The Faulkner Inquiry of the Green Loans program identified a range of risks associated with non-covered procurements including: extensive use of Direct Source procurement where only one supplier was approached contrary to requirements of the agency's CEIs; unsubstantiated perceptions of inappropriate relationships with suppliers; contract splitting which may have sought to avoid covered procurement thresholds of the CPGs; contract splitting which may have sought to avoid internal delegation thresholds; significant cost escalations through contract variations; lack of commercial terms in contracts; poor management of supplier requests for quote; and engagement of a supplier where the supplier had an apparent conflict of interest that was not addressed through the procurement process. Faulkner, *The Independent Inquiry into the Green Loans Program (the Faulkner review): the Review of procurement processes and contractual arrangements*, July 2010, pp. 15, 16, 18–21, available at <<http://www.climatechange.gov.au/en/publications/green-loans/review-of-procurement-process.aspx>>.

Footnote continued on the next page...

**4.54** It is particularly important to address ethical considerations in relation to Direct Source procurement as the use of this procurement method generally does not treat all potential suppliers even-handedly. Instead, the agency selects a supplier or suppliers of its choice, which heightens opportunities to inappropriately use or favour certain suppliers. For Direct Sourcing procurement processes, agencies should conduct procurement in an ethical manner through an appropriately competitive process (as discussed in other sections of this chapter), managing conflicts of interest, and employing appropriate separation of duties and responsibilities.

*Recognising and managing conflict of interest*

**4.55** Appropriate recognition and management of conflicts of interest and perceived conflicts of interest supports selection of the most appropriate supplier of a good or service in the prevailing circumstances, and enhances an agency's reputation in the market place.

**4.56** The procurement policy and guidance of each of the agencies required consideration of conflict of interest as part of the procurement process. Despite this finding, the agencies' Direct Source procurement templates (to be completed by staff when undertaking Direct Source procurement) did not generally address conflict of interest.<sup>175</sup>

**4.57** Reflecting this finding, for the sample of 248 Direct Source procurements, there were only two procurements for which there was documentary evidence that potential conflicts of interest had been considered. Agencies instead considered that their values and code of conduct would ensure that staff reported and appropriately managed potential conflicts of interest. The outcome contrasts with Open and Select Tender processes for

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In response to the findings of this inquiry the Department of Environment, Water, the Heritage and the Arts (DEWHA) has introduced a range of new procurement measures aimed at tightening controls over procurement, including specific measures for Direct Source procurements. The new departmental arrangements requires a central gatekeeper (the Branch containing the CPU) to approve all new procurement plans. DEWHA has outlined these arrangements in *Doing our Business Better, Response to the Review of the Administration of the Home Insulation Program (the Hawke review) and the Independent Inquiry into the Green Loans Program (the Faulkner review)*, <<http://www.environment.gov.au/about/publications/review/pubs/faulkner-response.pdf>>, pp. 2 and 3.

<sup>175</sup> Although, if officers conducting a Direct Source covered procurement at FaHCSIA completed the procurement plan template, they would be prompted to consider the need for a Conflict of Interest Declaration. ACC's procurement guidelines cover how to manage conflict of interest in procurement generally and require staff to report potential conflicts of interest to the CPU. The ACC CPU advised the ANAO that no staff have reported a potential conflict of interest in respect of a Direct Source procurement process.

which the agencies employed more rigorous processes to ensure they reported and managed potential conflicts of interest. A greater focus on documenting considerations of potential conflicts of interest as the scale and risk profile of procurement increases (regardless of procurement methods) would improve agencies' management of ethical matters and the associated reputational risks.

#### *Separation of duties in procurement processes*

**4.58** To meet good probity standards, agencies should ensure there is appropriate separation of procurement duties and responsibilities,<sup>176</sup> such that different officials are responsible for:

- requesting the procurement and, subsequently, recommending a potential supplier;
- spending approval; and
- authorisation of payment.

**4.59** The ANAO observed that for Direct Source procurements there often was not appropriate separation of duties in relation to requesting a procurement, approving the procurement process, and approving the recommended supplier. This was particularly evident at DVA, where documentation requirements, regardless of value, did not dictate that it was necessary to separate procurement requests from procurement approval processes. This translated in practice to some delegates inadvertently acting as the requesting officer and approver of Direct Source procurements, including for higher valued procurements.

#### *Dealing with suppliers and potential suppliers even-handedly*

**4.60** One avenue available to agencies to help deal with suppliers and potential suppliers even-handedly when Direct Sourcing, is to maintain a record of request for quotes and supplier responses, and provide this information as supporting documentation when seeking procurement approval by delegates. There may also be benefit in agencies supplementing this information by documenting the reasons for approaching selected suppliers to assist with the defensibility and transparency of decision-making. Such approaches are increasingly important as the scale and risk profile of procurement increases.

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<sup>176</sup> Finance, FMG No.14, 2005, p. 16.



**4.61** The ANAO reviewed information provided to agency delegates during Direct Source procurement processes and found that request for quote (RFQ) documentation and supplier responses (particularly for unsuccessful suppliers), or even a synopsis comparing quotes, was not provided to delegates in the majority of procurements, when seeking procurement approvals. As a result, the delegate may not be well placed to make informed decisions, especially in relation to matters such as ethics, probity, value for money and effectiveness. Furthermore, for most of the Direct Source procurements examined,<sup>177</sup> the procurement documentation presented to delegates also provided little insight into the decision to select a supplier or suppliers to quote.<sup>178</sup> When Direct Sourcing this should be a key consideration, particularly given the lack of competition, the need to consider value for money and the potential for conflict of interests to arise.

## Direct Source procurement approval

**4.62** It is commonplace for agency Chief Executives to delegate their authority to approve spending proposals to individuals within their agency. Delegates are responsible for ensuring that the spending of public money is efficient, effective and ethical, and in accordance with government policy. It is important that delegates understand their responsibilities and are provided with sufficient information and support to enable them to exercise their delegation appropriately.

**4.63** As discussed in Chapter 2, based on interviews with a selection of delegates across the agencies, the ANAO considered there was scope for improvement in delegates' awareness of their responsibilities and their level of understanding of procurement requirements. This following section assesses delegate approval of procurement, (in particular Regulation 9 approval) for the sample of Direct Source procurements.

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<sup>177</sup> There were some expectations, where advice was sought from other agencies, or other parts of the procuring agency, that this advice involved the procurement team requesting a list of suppliers and information regarding their past performance.

<sup>178</sup> As mentioned above, often the procurement documentation suggested that the supplier was a sole supplier, but there was no evidence to support this assertion and often there was a readily identifiable group of suppliers (on AusTender) able to supply the property or services being procured.

## Delegate approval of procurement

### *Documented terms of the approval*

**4.64** Finance Circular No. 2008/06<sup>179</sup> provides agencies with guidance to assist them to comply with the FMA Regulations when making commitments to spend public money.<sup>180</sup> In relation to recording decisions, FMA Regulation 12 provides a key accountability mechanism, requiring the ‘terms of the approval’ provided under FMA Regulation 9 to be recorded in a document, generally at the time of the approval, or as soon as practicable after the approval. Where the ‘terms of the approval’ are not documented it could be difficult to show compliance with Regulations 9 and 13, and would not comply with Regulation 12.<sup>181</sup>

**4.65** The document form and ‘terms of the approval’ should be commensurate to the significance, value, level of risk and sensitivities associated with the spending proposal. The approval can be recorded in many different forms including emails, electronic approvals in information systems, signed briefs or minutes, signed purchase orders or purchase order requests. As a minimum, the documentation of the ‘terms of approval’ should include:

- an approval by a delegate who has Regulation 9 delegation where the terms (including the value) of the spending proposal are within the limits and directions established for their delegation; and
- the key elements of the spending proposal, such as the items, cost, parties, and timeframes.<sup>182</sup>

**4.66** For each of the 285 Direct Source procurements, the ANAO assessed whether the audited agency was able to provide documentation of the

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<sup>179</sup> Finance, Finance Circular No. 2008/06, *Commitments to Spend Public Money*, 20 June 2008.

<sup>180</sup> Finance, Finance Circular No. 2009/05, *Commitments to Spend Public Money*, was issued on 29 June 2009. It contained the same requirements for recording decisions in relation to Regulation 12, the documentation of Regulation 9 approvals.

<sup>181</sup> Regulation 12 documentation provides evidence of compliance with Regulation 13, which regulates the ability of a person to enter into an arrangement to spend public money.

<sup>182</sup> Other information that should be recorded includes: the source of authority to act as an approver, compliance with FMA Regulation 10, compliance with the CPGs, compliance with the relevant policies under Regulation 9, the basis for assessing the proposed expenditure as efficient and effective under FMA Regulation 9, any risks associated with the proposal, details of any contingent liabilities and a risk assessment of those contingent liabilities, and whether subsequent processes and approvals may be necessary. Finance, Finance Circular No. 2008/06, p. 9, paragraph 48, and Finance, Finance Circular No. 2009/05, p. 11, paragraph 54.

Regulation 9 approval.<sup>183</sup> FaHCSIA was able to demonstrate documentation of Regulation 9 approval by the delegate for all sample items because it employed a suitable workflow system in its FMIS.<sup>184</sup> Innovation and ACC were able to provide evidence of Regulation 9 delegate approval of spending proposals for 81 and 90 per cent, respectively, of their sample of Direct Source procurements. However, DVA was only able to demonstrate documentation of the Regulation 9 approval for 57 per cent of its sample of Direct Source procurements.<sup>185</sup>

### *Reasonable inquiries by the approver*

**4.67** Under Regulation 9, when making a decision to approve a spending proposal the approver must be satisfied, after making reasonable inquiries, that the spending proposal: is in accordance with policies of the Commonwealth; and will make efficient, effective and ethical use of public money.<sup>186</sup> However, there is no requirement for delegates to document their inquiries.

**4.68** The CPGs establish the Australian Government's procurement policy framework and articulate Government expectations for all departments and agencies that are subject to the FMA Act. As such, they establish requirements to be met when undertaking procurement. Therefore, in relation to procurement, an approver for the purposes of Regulation 9 must be satisfied that the CPGs' requirements have been met when assessing whether spending proposals are in accordance with the policies of the Commonwealth.<sup>187</sup> Paragraph 7.9 of the CPGs requires documentation to provide an understanding of the reasons for the procurement, the process that was

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<sup>183</sup> To satisfy this test the documented approval needed to contain an approval by a delegate and details of the property or services being procured, the value of the property or services, and who the property or services were being procured from.

<sup>184</sup> The workflow required delegate approval to progress to the next stage of the procurement.

<sup>185</sup> For some of the Direct Source procurements where there was no documentation of Regulation 9 approval, DVA was able to provide documentation showing Regulation 10 approval.

<sup>186</sup> Finance, Finance Circular No. 2008/06, *Commitments to Spend Public Money*, 20 June 2008, p. 7, paragraph 32. Finance Circular No. 2009/05 (p. 9, paragraph 41) provides a similar requirement by stating that the approver must be satisfied after making reasonable inquiries that giving effect to the spending proposal would be a proper use of Commonwealth resources. This means that the spending proposal would be an efficient, effective and ethical use of Commonwealth resources that is not inconsistent with the policies of the Commonwealth.

<sup>187</sup> Finance, Finance Circular No. 2008/06, p. 6, paragraph 30 and Finance, Finance Circular No. 2009/05, p. 8, paragraph 36.

followed and all relevant decisions, including approvals and authorisations, and the basis of those decisions.

**4.69** For the sample of Direct Source procurements, documentation forming procurement approvals was of varying standards, and often did not clearly set out the basis for delegates' decisions. For example, there was often a lack of documentation of value for money considerations including reliance in many cases on a single quote. In addition, there was often no evidence that decisions had taken into account the requirements of the CPGs<sup>188</sup> or that actions were being taken in relation to the FMA Regulations.<sup>189</sup> There were also instances where the delegate approved procurements in which parts of agency procurement templates were incomplete or not prepared.

**4.70** This does not mean that delegates did not undertake reasonable inquiries prior to approving spending, as there is no specific requirement to document delegates' inquiries under in the FMA Regulations. Nevertheless, under the CPGs agencies need to ensure there is sufficient documentation to provide an understanding of approvals and authorisations, and the basis of these decisions.

**4.71** Table 4.7 outlines instances that highlight the importance of agency procurement documentation addressing the key requirements of the CPGs. The above findings also highlight the importance of delegates having access to sufficient training and support. Overall, there is need to improve the quality, documentation and timeliness of Regulation 9 approvals to ensure compliance with the FMA Act.

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<sup>188</sup> For example, there was generally poor documentation of exemptions for Direct Sourced procurements and application of circumstances under the MPPs for covered Direct Sourced procurements.

<sup>189</sup> For example, while DVA had developed a standard template for Regulation 9 approval, its use was not a requirement for the approval of spending proposals. The ANAO observed that, in practice, DVA's documentation often did not establish that the delegate understood that they were approving spending proposals in accordance with Regulation 9 as the standard template was often not used by DVA officers undertaking Direct Source Procurement. Standard templates were generally used in FaHCSIA, Innovation and ACC, and the template made it clear that the delegates were exercising their delegation to approve spending proposals.

**Table 4.7****Example of delegates making reasonable inquiries**

Three instances were identified where a delegate's inquiries indicated that the procurement process was non-compliant with the CPGs. In these circumstances the delegates had to seek additional information to the information presented in the spending proposal. Once the non-compliance was identified, the delegates then needed to decide between: approving a non-compliant process (which would be inappropriate); foregoing the property or service for a period of time; or stopping the non-compliant process, notifying suppliers involved in the non-compliant process and commencing a new procurement process that is consistent with the CPGs.

Source: ANAO sample testing.

## Direct Source procurements that are covered by, or exempt from, the Mandatory Procurement Procedures

**4.72** If a Direct Source procurement exceeds the procurement thresholds established by Division 2 (the MPPs) of the CPGs it must be either:

- a covered procurement, which must comply with paragraph 8.33 of the MPPs (see Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing, Table A 1 for a full list of circumstances); or
- a non-covered procurement because it is exempt under Appendix A of the CPGs (see Appendix 5: Mandatory Procurement Procedures: exemptions, Table A 2 for a full list of exemptions).

**4.73** Paragraph 7.9 of the CPGs establishes an obligation for agencies to maintain appropriate documentation for each procurement. As a consequence agencies are required to document key decisions and actions in the procurement process, and the basis of their decisions. In the case of exempt procurements, this would include recording that the procurement is exempt and the circumstances that support the application of the exemption.

**4.74** For Direct Source procurements in the audit sample that exceeded the procurement thresholds<sup>190</sup> established by Division 2 of the CPGs, the ANAO assessed whether the procurement was a covered procurement or exempt in accordance with Appendix A of the CPGs.

<sup>190</sup> For most procurement this would involve a threshold of \$80 000 for FMA agencies, however, a \$9 million threshold applies for procurement of construction services.

**4.75** Of the 285 Direct Sourced procurements in the audit sample, the ANAO considered that 164 had values in excess of the procurement thresholds established by Division 2 of the CPGs (refer to Table 4.1). Table 4.8 shows the results of testing these procurements. Depending on the agency, from 21 to 45 per cent of the Direct Source procurements that exceeded the thresholds for the application of the MPPs were covered by an exemption listed in Appendix A of the CPGs (refer to Appendix 5: Mandatory Procurement Procedures: exemptions, Table A 2 for a list of the exemptions). The remaining procurements in each agency were classified as covered Direct Sourced procurements.

**Table 4.8**

**Direct Source procurements that were covered procurements or exempt from the MPPs**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total examined	46	50	34	34	164
Percentage covered Direct Source procurements	63%	60%	56%	79%	64%
Percentage exempt	37%	40%	44%	21%	36%

Source: ANAO sample testing.

**4.76** Of the 59 exemptions that applied to procurements in the sample, the majority were:

- exemption 2 (24 procurements)—procurement from other government entities where no commercial market exists or where legislation or general government policy requires the use of a government provider;
- exemption 1 (13 procurements)—leasing or purchase of real property or accommodation;
- exemption 15 (6 procurements)—contracts for labour hire where an agency engages an individual to provide labour, where the individual is engaged either directly or through a firm which primarily exists to provide the services of only that individual (not including the engagement of consultants);
- exemption 8 (6 procurements)—procurement of property or services outside Australian territory; and

- exemption 6 (5 procurements)—procurement of research and development services, but not the inputs to research and development undertaken by the agency.<sup>191</sup>

**4.77** The ANAO also assessed whether agencies documented their exemptions. Table 4.9 shows the results of sample testing. The agencies did not document the application of an exemption for the majority of exempt Direct Sourced procurements examined.

**4.78** Appropriate documentation of the reasons for selecting a procurement method and how that method complies with the CPGs (regardless of whether the procurement is covered or exempt), would assist agencies to meet the accountability and transparency obligations and requirements referred to in the CPGs. In this regard, appropriate documentation means that it is commensurate with the size and risk profile of the procurement. Where agencies have established streamlined templates, it would be possible to demonstrate compliance, for low value procurements, by the requesting officer ticking relevant boxes in the template. As the scale and risk profile of procurement increases, agencies should supplement this information by providing supporting information and/or brief statements regarding actions and decisions.<sup>192</sup>

**Table 4.9**

**Documentation of the Exemption**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total exempt procurements	17	20	15	7	59
Percentage not documented	94%	65%	87%	71%	81%
Percentage documented	6%	35%	13%	29%	19%

Source: ANAO sample testing.

<sup>191</sup> All of the procurements where Exemption 6 applied were conducted by DVA. For all of these procurements the documentation of procurement deliberations in relation to the CPGs was inadequate as they did not sufficiently address considerations such as: the procurement need and process (as part of procurement planning), value for money in relation to the selection of a supplier, competition or the existence of an exemption.

<sup>192</sup> In response to the proposed audit report Innovation commented that, '*Table 4.9 of the report states that 65 per cent of procurements exempt from the Mandatory Procurement Procedures did not adequately document the details surrounding this exemption. The introduction of the Contracts Module on 1 October 2009 has provided greater controls, scrutiny and visibility for documentation associated with all covered procurements — improving the quality and compliance of documentation.*'

## Covered Direct Source procurements

**4.79** The MPPs establish obligations for covered procurements that must be complied with when conducting procurement processes. For covered procurements, an agency may only conduct procurement through Direct Sourcing in one of the circumstances outlined in paragraph 8.33 (refer to Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing). For covered procurements, under paragraph 8.34 of the CPGs, for each contract awarded through Direct Sourcing, agencies must prepare and appropriately file within the agency's central filing system, a written report that includes:

- (a) the value and kind of property or service procured; and
- (b) a statement indicating the circumstances and conditions that justify the use of a procedure other than an Open or Select Tender process.

**4.80** As discussed in Chapter 2, all of the agencies required covered Direct Source procurement to be undertaken in accordance with the MPPs.<sup>193</sup> To assess the extent to which the agencies' decisions to procure property and services using the Direct Source method complied with the MPPs for covered procurements, the ANAO assessed whether:

- a circumstance arose for the use of Direct Sourcing as per Division 2 paragraph 8.33 of the CPGs (see Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing), and where a circumstance arose it was adequately documented in accordance with paragraph 8.34 of the CPGs (see Appendix 6: Documentation obligations, requirements and sound practices); or
- the Chief Executive of an agency made a determination that measures were necessary under paragraph 2.7<sup>194</sup> of the CPGs, and whether the determination was adequately documented.

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<sup>193</sup> Refer to Table 2.1 and paragraph 2.16.

<sup>194</sup> The CPGs state that nothing in any part of these CPGs prevents an agency from applying measures determined by their Chief Executive to be necessary: for the maintenance or restoration of international peace and security; to protect human health; for the protection of essential security interests; or to protect national treasures of artistic, historic or archaeological value. Applying such measures does not diminish the responsibility of Chief Executives under section 44 of the FMA Act to promote the efficient, effective and ethical use of Commonwealth resources. Finance, CPGs, 2008, p. 4, paragraph 2.7.



**4.81** Table 4.10 shows the results of sample testing. In some cases, from the circumstances of procurements they were either clearly compliant or non-compliant with paragraph 8.33 of the CPGs. In the remaining cases, from the circumstances of the procurement and/or procurement documentation, compliance with paragraph 8.33 was not evident.

**Table 4.10**

**Compliance with the MPPs – Covered Direct Source procurements**

Agency	FAHCSIA	Innovation	DVA	ACC	Total
Total covered Direct Sourced procurements	29	30	19	27	105
Percentage where there was insufficient documentation to determine compliance	-	-	5%	4%	2%
Percentage where there was a Secretary Determination under paragraph 2.7	-	-	5%	-	1%
Percentage that were compliant with Paragraph 8.33	76%	33%	48%	26%	46%
Percentage that were non-compliant with paragraph 8.33, or where compliance was not evident based on the circumstances of the procurement and/or procurement documentation	24%	67% <sup>(A)</sup>	42%	70%	51%

Source: ANAO sample testing.

(A) This includes the eight procurements resulting from a single procurement decision that are discussed in paragraph 4.83 and Table 4.11. The 67 per cent is made up of these eight procurements (27 per cent) and a further 12 procurements (40 per cent) from Innovation's 30 covered Direct Source procurements in the audit sample.<sup>195</sup>

**4.82** It was not evident that half of the covered Direct Source procurements examined complied with paragraph 8.33 of the CPGs. The extent to which procurements complied with paragraph 8.33 of the CPGs varied significantly

<sup>195</sup> In its response to the proposed audit report Innovation commented that, 'Table 4.10 of the report states that 67 per cent of Innovation's covered direct source procurements were not compliant with paragraph 8.33 of the CPGs. Section 4.83 goes on to explain that eight of the procurements identified as being non-compliant were a result of a single procurement decision. Innovation formally disagrees with the findings highlighted in this table. The procurement, resulting in eight contracts that were included in the audit sample, was undertaken in accordance with the requirements of 8.33 d (iii) which states that 'where the property or services can only be supplied by a particular business and there is no reasonable alternative or substitute for the following reason: due to an absence of competition for technical reasons'. Consequently, Innovation considers that the percentage of direct source procurements that are not compliant with paragraph 8.33 of the CPGs is 40 per cent and the percentage compliant 60 per cent.' A discussion of the circumstances surrounding the procurement decision for these eight contracts is outlined in Table 4.11.

at an agency level from 30 per cent compliance for ACC to 76 per cent compliance for FaHCSIA. The results were generally consistent with the relative level of Direct Sourcing undertaken by each agency (see Table 1.1).

**4.83** Innovation had a relatively high level of covered procurements for which they could not clearly demonstrate compliance with paragraph 8.33 of the CPGs. This was in part the result of a single procurement decision, which resulted in the department entering into 14 contracts in 2009. Eight of the 14 contracts were included in the audit sample. The circumstances surrounding the procurement decision are outlined in Table 4.11. This example highlights the importance of agencies acting in a timely manner to address procurement needs. It also illustrates the prescriptive nature of the Mandatory Procurement Procedures, which means that agencies do not have discretion in their application.

**4.84** Many other non-compliant procurements (across the four agencies) also reflected the need for better procurement planning, and for agencies to put in place revised procurement arrangements in a timely manner.

**Table 4.11**

**Example of where compliance with paragraph 8.33 could not be demonstrated by an agency**

Audit testing found that Innovation had a high level of procurements where it was not evident that the procurements were compliant (67 per cent) with paragraph 8.33. This finding was influenced by eight contracts (representing 27 per cent of Innovation's covered Direct Source procurements in the audit sample) resulting from a single procurement decision. The value of each of these contracts exceeded the MPP thresholds and therefore they were treated as covered procurements.

In this instance, Innovation considered that there was no reasonable alternative but to continue relationships with existing suppliers, citing paragraph 8.33diii of the MPPs as the relevant circumstance that allowed Direct Source procurement to be undertaken. This paragraph states that Direct Source procurement may be undertaken where the property or services can only be supplied by a particular business and there is no reasonable alternative or substitute for the following reason: due to an absence of competition for technical reasons.

As part of Innovation's two stage procurement planning and approval process, which commenced in late April 2009, the officials involved in the procurement consulted with the CPU, and documented the key factors that they considered contributed to the application of paragraph 8.33diii. In this documentation, Innovation made the case that the incumbent suppliers possessed technical knowledge of the program's existing customers, its processes and potential customers in the pipeline, which created an absence of competition. While Innovation recognised that the technical knowledge of existing providers could be replicated over time, the department considered there was no reasonable alternative given the relatively short timeframe remaining for the program, for which funding was only available until June 2011. Innovation estimated that it would take five months to run an open procurement process and then a further nine to twelve months for new contractors to be fully operational. Based on these factors, Innovation considered that it would not be an effective or efficient use of resources to approach the market and engage new providers for the program; Innovation was of the view that such an approach would disrupt service provision and have a detrimental impact on customers, and therefore government objectives.

Innovation's approach had the advantage of limiting the costs to industry of participating in a procurement process where the incumbent supplier had a competitive advantage. Key factors taken into account by Innovation in making a decision on the procurement approach were also well documented, although should have more thoroughly addressed reasons for concluding there was an absence of competition, based on the maturity of the industry, and the extent that other advisers were, or were not, positioned to deliver the services.

Notwithstanding these factors, the ANAO considered that there were not sufficient grounds to demonstrate that paragraph 8.33diii, which requires 'an absence of competition for technical reasons' applied. In particular, while the incumbent suppliers would be well positioned in an open procurement process, there was still two years for the program to run, and there was likely to be a market for the services, as was demonstrated by applications at the time of procuring the incumbent suppliers.

This example illustrates the limited exceptions to the general presumption of agencies approaching the open market for high value procurements; the benefits of procurement planning, especially consideration of ongoing procurement needs and service continuity; and the complexities that can arise in interpreting and applying the Mandatory Procurement Procedures. The previous contracts were entered into in 2004, at which time Innovation established contracts that would be exhausted in June 2009. At the time of entering into these contracts Innovation was also aware that there was funding for the program until June 2011.<sup>196</sup> Appropriate consideration of the whole-of-life of the procurement need, as part of initial planning, would have better positioned the department to put in place arrangements appropriate to the program's duration until 2011.

Source: ANAO sample testing.

**4.85** In the sample, where a circumstance arose under paragraph 8.33 it generally related to one of three circumstances:<sup>197</sup>

- additional deliveries of property or services by the original supplier for existing equipment, software, services or installation, where a change of supplier would compel the agency to procure goods or services that do not meet the requirements of compatibility with existing equipment or services—8.33e (22 procurements);
- an absence of competition such that there is not a reasonable alternative or substitute for technical reasons—8.33diii (16 procurements); and
- extreme urgency brought about by events unforeseen by the agency,<sup>198</sup> paragraph—8.33b (9 procurements).

**4.86** Where a circumstance applied to a covered Direct Source procurement in the sample, more than half of the circumstances were documented in accordance with paragraph 8.34 (see Table 4.12). There was significant

<sup>196</sup> Innovation advised that the period of the contracts was based on the evaluation timetable of the program, and possible extension of the program.

<sup>197</sup> There was also one procurement where circumstance 8.33aiii applied — Where in response to an approach to market: no potential suppliers satisfied the conditions for participation and the agency does not substantially modify the essential requirements of the procurement.

<sup>198</sup> Most of these procurements related to FaHCSIA's involvement in the Northern Territory emergency response.

variation in the documentation of circumstances for individual agencies with Innovation documenting in accordance with paragraph 8.34 for 100 per cent of relevant procurements compared to DVA documenting circumstances for only 11 per cent of relevant procurements.

**Table 4.12**

**Documentation of circumstance in accordance with paragraph 8.34 of the CPGs where paragraph 8.33 applied**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Number of covered Direct Source procurements where paragraph 8.33 circumstance applied (A)	22	10	9	7	48
Percentage where paragraph 8.33 circumstance was documented in accordance with 8.34 (B)	64%	100%	11%	71%	63%

Source: ANAO sample testing.

- (A) This test examined whether circumstances under paragraph 8.33 of the CPGs applied. Refer to Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing for details of these circumstances.
- (B) This test examined whether the circumstance that applied under paragraph 8.33 of CPGs was documented in accordance with paragraph 8.34 of the CPGs.

**4.87** The ANAO also observed that the documentation supporting the decision to Direct Source often did not make reference to a range of factors that should have been taken into account when making the decision. For example, there was often little evidence that there had been an examination of the prevailing market circumstances, or of detailed consideration of the business requirement and the nature of any compatibility issues with existing property or services.

**Reasons for not complying with paragraph 8.33 of the CPGs**

**4.88** Based on the circumstances of the procurement and/or procurement documentation it was not evident that 51 per cent of covered Direct Source procurements examined complied with paragraph 8.33 of the CPGs. For about half of these procurements the agencies had considered the CPGs and/or government policy when making the procurement decision (see paragraph 4.91 below). Table 4.13 shows the results of sample testing, and agencies' use of the CPGs and/or government policy when making procurement decisions. In some cases, more than one of the reported considerations applied to a non-compliant procurement.

**Table 4.13****Agencies' consideration of the MPPs and/or government policy**

Agency	FaHCSIA	Innovation	DVA	ACC	Total
Total number of covered Direct Source procurements that were non-compliant with paragraph 8.33, or where compliance was not evident based on the circumstances of the procurement and/or procurement documentation	7	20	8	19	54
(A) Percentage of these procurements that reported that paragraph 8.33 circumstance applied when seeking approval of the spending proposal	-	60%	50%	5%	31%
(B) Percentage of these procurements where the agency considered that government policy prevented them from conducting an Open Tender process	-	-	-	26%	9%
(C) Percentage of these procurements where the agency considered that the procurement was not a covered procurement	-	5%	40%	26%	17%
(D) Percentage of these procurements where the agency considered that the procurement process was not Direct Sourcing	43%	10%	12.5%	5%	13%

Source: ANAO sample testing.

- (A) This test examined whether when seeking approval of the procurement the agency documented a circumstance under paragraph 8.33 of the CPGs that it considered applied. Refer to Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing for details of these circumstances. Also see Table 4.11.
- (B) This test examined whether the agency considered that the government policy prevented the agency from conducting an Open Tender process. See Table 4.14.
- (C) This test examined whether the similar or the same property or services were procured from the same supplier on a recurring basis, and the cumulative value of the services exceeded the procurement threshold. It also included a situation where the agency considered that the services being procured were construction services and, therefore, a \$9 million threshold applied. However, the services procured were not within the definition of construction services as defined by the CPGs and related guidance.
- (D) This test examined whether the agency considered that the procurement method was a Select Tender process or a panel procurement (where the panel was formed using an Open Tender process).

***Demonstrating the application of paragraph 8.33 of the CPGs***

**4.89** For the majority of covered Direct Source procurements where it was not evident that they complied with paragraph 8.33 of the CPGs, Innovation and DVA documented a circumstance in accordance with paragraph 8.34. In particular, they sought to apply paragraph 8.33diii<sup>199</sup> or 8.33e and to continue an existing supplier relationship rather than approach the market, but did not

<sup>199</sup> FaHCSIA did not document a justification for five of the seven non-compliant procurements. However, where it did document a justification it sought to apply 8.33diii.

demonstrate how the circumstance applied (see Table 4.11).<sup>200</sup> Finance advised the ANAO that in such circumstances agencies cannot make an assessment without factual evidence and investigation that there is no competition in the market place, or that there is a compatibility issue.<sup>201</sup>

**4.90** The frequency of such instances raises concerns about the appropriateness of original estimates, including whether agencies have adequately considered the possibility of contract variations beyond those included in the original contract. More broadly, there was a tendency for weaknesses in procurement planning to result in Direct Source procurement when the existing contract and its options had been exhausted.

*The application of other government policy to the CPGs*

**4.91** For half of ACC's procurements where compliance was not evident, a justification was provided for Direct Sourcing. In most cases the justification was:

- that the supplier was a single supplier<sup>202</sup> (but there was no supporting evidence or analysis); or
- that a Finance embargo<sup>203</sup> applied to ICT procurement as Finance was undertaking a scoping study<sup>204</sup> for the purpose of establishing a coordinated procurement arrangement for the Commonwealth. The interaction of this policy with the CPGs and prior procurement decision is outlined in Table 4.14.

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<sup>200</sup> Through the nature of the property or services being procured or by providing supporting evidence or analysis (of the market for particular services or specific compatibility constraints) in documentation.

<sup>201</sup> That is, agencies should not anticipate the market response.

<sup>202</sup> Four of the 19 procurements sought to justify the procurement as there was a single supplier.

<sup>203</sup> Five of the 19 procurements involved the application of the Finance embargo.

<sup>204</sup> Scoping studies are conducted to determine the suitability of goods and services for coordinated procurement contracting. These studies examine government procurement arrangements, other jurisdictions, industry issues and the potential market impact of a coordinated approach. During the conduct of a scoping study agencies' procurement is subject to transitional arrangements. Once a scoping study is initiated agencies cannot enter into or extend an existing contract for more than 12 months for goods and services subject to a scoping study without the approval of their Minister and the Minister for Finance and Deregulation (or their authorised officials). This includes contracts to purchase items with a useful life of more than 12 months.

**Table 4.14****Example of the interaction of the CPGs with other government policy**

Where the ACC's procurements involved the application of the Finance embargo, the original procurement was also not based on a competitive procurement process that complied with the MPPs. The procurement being examined was, therefore, also considered non-compliant. ACC also acknowledged that these procurements had not been competitive, and intended to seek Ministerial approval to go to market in the future for these property and services, should the Finance embargo still apply.

Source: ANAO sample testing.

*Inappropriately estimating the value of procurements*

**4.92** The MPPs state that procurements must not be divided into separate smaller procurements to circumvent a threshold.<sup>205</sup> However, in some instances where DVA and ACC<sup>206</sup> procurements were reported as contract notices with values of \$80 000 or less, the agencies had procured the same services from the same supplier on a continuing basis, and the cumulative value of services exceeded the procurement thresholds (see Table 4.15). In these instances the MPPs should have been applied to the procurement.

**Table 4.15****Example of dividing procurements into separate smaller procurements**

In one case, ACC let a contract valued at around \$25 000 every three months for the same services with the same provider. The cumulative value of these contracts in 2009 was over \$100 000, and the arrangement had been in place for many years. When selecting a procurement method, ACC had not estimated the value of the services (including likely future services) that it sought to procure as it is required to by the MPPs.

Source: ANAO sample testing.

*Not understanding the procurement method undertaken*

**4.93** A number of procurements where compliance was not evident were the result of agencies not understanding that the procurement method adopted was Direct Sourcing. The majority of instances involved agencies considering that the process undertaken was a Select Tender process. However, the process did not meet the obligations and requirements for conducting a covered Select Tender procurement as outlined in paragraphs 8.20 to 8.29 of the CPGs (also see paragraphs 3.20 to 3.23 in Chapter 3). Table 4.16 provides examples of covered procurements where the agency considered that they were adopting

<sup>205</sup> MAC Report No.7, *Reducing Red Tape in the Australian Public Service*, Section 8.1, p. 29.

<sup>206</sup> Two at DVA and five at ACC.

an Open or Select Tender procurement process, when they were Direct Sourcing.

**Table 4.16**

**Examples of not understanding the procurement method**

FaHCSIA procured services from another agency's panel, but FaHCSIA was not listed as a participating agency for the panel.
In two instances, FaHCSIA procured from a standing offer notice. In each case the standing offer notice had not been established using an Open Tender process.
DVA originally procured services from a Select Tender process. However, subsequent contract variations to extend the contract were made when the list of suppliers had been discontinued.

Source: ANAO sample testing.

*Conclusion: Reasons for non-compliance with paragraph 8.33 of the CPGs*

**4.94** Agencies' concerns about the more rigorous procedures required for Open Tender processes, versus the likely benefits, are an influencing factor in their continued use of arrangements that did not fully meet the CPGs' requirements. This was particularly evident where existing arrangements were working well and an open approach to the market was seen as complex and time consuming. Agencies need to undertake effective procurement planning to assess procurement needs and their timeframe, while taking advantage of changing market conditions over time and the new opportunities they present to achieve value for money.

**4.95** Overall, further work is required for agencies to meet the intent of the CPGs—that open approaches to the market are used for covered procurements except in selective circumstances. In support of this, agencies need to better document and more closely scrutinise covered Direct Sourced procurement to ensure that it meets the requirements of the MPPs.

**Identifying and responding to non-compliance issues**

**4.96** The ANAO assessed whether the agencies identified non-compliance with paragraph 8.33 of the CPGs, during or after the procurement process. The ACC identified non-compliance for seven of the 19 procurements where it was not evident that they complied with paragraph 8.33. Non-compliance was identified after the procurement had occurred for four of the procurement processes. For the other three procurement processes the non-compliance was identified prior to approval of the procurement. Where non-compliance was identified, ACC planned to go to the market in the future for these property or services. The other agencies generally did not identify non-compliance with the MPPs.



## Conclusion

**4.97** Direct Source procurement can be used when the procurement fits within one of the following categories:

- its scale and risk profile are consistent with CPG and agency requirements for the use of Direct Source procurement;
- there is an Exemption listed in Appendix A of the CPGs that applies; or
- there is a circumstance listed in paragraph 8.33 of the CPGs that applies.

**4.98** There is considerable opportunity to improve Direct Source procurement in practice. Particular areas for improvement include:

- demonstrating through the procurement process and supporting documentation that the procurement principles have been applied when undertaking procurement;
- complying with the MPPs;
- documenting key decisions and actions (to support recordkeeping requirements and the principle of accountability and transparency in decision-making); and
- addressing gaps in relation to the policy and guidance that support Direct Source procurement processes.<sup>207</sup>

**4.99** Given the relatively high level of procurements where compliance with the MPPs was not evident, the ANAO also considers that there may be a need for agencies to introduce targeted assurance review mechanisms to identify and address non-compliance. Relative to the other agencies, FaHCSIA had a larger proportion of covered Direct Source procurements that complied with the circumstances outlined in paragraph 8.33 of the CPGs. The ANAO considered that the level of compliance achieved by FaHCSIA was, to some extent, due to the requirement for agency staff to involve the CPU and obtain approval from the Branch Manager of the CPU for all Direct Source

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<sup>207</sup> Chapter 2 identified that improvements were needed in relation to outlining requirements for Direct Source procurement and documenting aspects (such as risk management and conflict of interest) of the procurement process.

procurement in excess of \$80 000, prior to approval by the delegate.<sup>208</sup> Such an approach may also be beneficial to other agencies.

## Recommendation No.2

**4.100** Having regard to the scale and risk profile of different procurements, the ANAO recommends that agencies develop concise guidance and templates, covering:

- (a) methodology for estimating the value of procurements to inform decisions about whether the procurement should be treated as covered;
- (b) the expected level of documentation to support decisions to undertake Direct Source procurement (covered and non-covered); and
- (c) consideration of the level of risk and the existence of conflicts of interest for the Direct Source procurement, consistent with the CPGs and Management Advisory Committee Report No.7.

### Agencies' Responses

#### *FaHCSIA*

**4.101** Agree. FaHCSIA regularly reviews all components of procurement and contract management policy, procedures, guidance and templates which takes into consideration the scale and risk profile of different procurements. In addition, with a centralised Procurement Unit, FaHCSIA considers that it has adequate processes in place to support the appropriate use of Direct Source procurement.

#### *Innovation*

**4.102** Innovation agrees with the recommendation and will undertake a review of the department's procurement guidance material to ensure that it provides officers with appropriate levels of assistance.

#### *DVA*

**4.103** Agreed. DVA has guidance and templates covering methodology for estimating the value of procurements and risk assessment templates for

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<sup>208</sup> A previous procurement audit made a recommendation relevant to improving decision-making on procurement methods by requiring entities to review arrangements for the approval of exemptions from the MPPs and for approval of Direct Source procurements. ANAO, Audit Report No.21, 2006–07, Recommendation No.1, p. 40.

consideration of the level of risk. DVA has templates for declaration of conflicts of interest during various stages of the procurement process, and has recently developed check lists for stages in the procurement process that may require declarations of conflicts of interest. DVA has recently developed templates to support decisions to undertake Direct Source procurement for covered and non-covered procurements.

## ACC

### 4.104 Agreed.

## Finance

**4.105** Agreed. Finance notes the ANAO's concerns about the apparent lack of accurate estimation of the value of proposed procurements being undertaken by agencies prior to commencing procurement processes. Reasonable estimation of the value of proposed procurements is crucial in assessing if the procurement will be subject to the Mandatory Procurement Procedures, which are intended to promote accountable, value for money outcomes.

**4.106** For covered procurements, the CPGs establish an expectation of an open tender process unless otherwise justified in accordance with the CPGs. Any departure from the open tender process in these circumstances must be appropriately justified and documented, and are still required to achieve a value for money outcome.

## Recommendation No.3

**4.107** Having regard to the scale and risk profile of different procurements and to improve compliance with the CPGs, the ANAO recommends that agencies assist delegates to address reasonable inquiry requirements prior to procurement approval, by:

- (a) documenting the procurement need, the prevailing market circumstances and other matters that support the use of Direct Sourcing;
- (b) documenting value for money assessments when Direct Sourcing; and
- (c) reviewing, and where necessary strengthening, pre-approval compliance assurance mechanisms when Direct Sourcing.

## **Agencies' responses**

### *FaHCSIA*

**4.108** Agree. FaHCSIA considers that it has adequate controls in place, which support a thorough consideration and approval process which effectively covers all aspects of this recommendation.

### *Innovation*

**4.109** Innovation agrees with the recommendation. This recommendation will be addressed through our training regime with the development of a half day procurement course specifically for delegates. The course material will be reviewed to ensure that it adequately addresses the above recommendations (a) and (b).

**4.110** In addition, the introduction of the Contracts Module in the department's Financial Management Information System in October 2009 has addressed part (c) of the above recommendation as all procurements valued at \$80,000 or more are automatically workflowed to the Procurement Team for comment prior to approval by the delegate. This provides the delegate assurance that the Procurement Team has reviewed both the approach to market justification and the value for money assessment and provides the delegate full visibility of any comments or concerns raised by the Procurement Team.

### *DVA*

**4.111** Agreed. DVA has already taken a number of steps in this area, including;

- the development and provision of templates for documenting information on the procurement need, the prevailing market circumstances and other relevant matters that support the use of Direct Sourcing;
- the development and provision of value for money templates when Direct Sourcing; and
- the development of mechanisms for strengthening pre-approval compliances when Direct Sourcing.

### *ACC*

**4.112** Agreed.

*Finance*

**4.113** Agreed. In exercising procurement responsibilities, delegates must be satisfied that the procurement would be an efficient, effective and ethical use of Commonwealth resources that is not inconsistent with the policies of the Commonwealth and represents value for money. Finance will continue to work with agency procurement officials, Chief Financial Officers and financial delegates to assist them to understand their procurement responsibilities.

## 5. Procurement Monitoring and Review

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*This chapter examines whether the agencies effectively monitor and review procurement activity to support compliance with the CPGs and inform strategic procurement planning and management.*

### Introduction

**5.1** Effective monitoring and review of procurement activity supports agencies' application of the procurement principles, and compliance with the MPPs:

- understanding the nature, value and spread of their procurement, and the contributions of different suppliers, enables agencies to adopt more efficient ways to approach the market and achieve better value for money; and
- monitoring of procurement activity against expectations helps agencies to identify and investigate procurement risks, and where necessary to take corrective action to comply with the CPGs.

**5.2** Agencies may use a variety of mechanisms to monitor and review procurement activity, including through CPU oversight and analysis, internal audits, their Certificate of Compliance and management reporting. The capture of and ability to collate accurate procurement data provides a sound basis for review.

**5.3** The ANAO's assessment of the agencies covered:

- the quality of procurement data captured;
- monitoring and review of procurement activity by CPUs, internal audit areas, as part of agencies' Certificate of Compliance, and through management reporting; and
- evidence of strategic procurement planning and management.

### Quality of procurement data captured

**5.4** The types of procurement data agencies may elect to monitor and review include:

- the number and value of procurements undertaken using different procurement methods;

- the number of contracts with suppliers<sup>209</sup> and the performance history of suppliers;<sup>210</sup>
- contracts for the supply of the same or similar goods or services with different suppliers;
- timeliness of procurement of property and services; and
- proportions of high, medium and low risk procurements.

5.5 The agencies captured data on the nature and value of their procurements, as well as supplier details, through their procurement documentation, contract registers and FMISs. Although, as indicated in earlier chapters, there was incorrect reporting of contract notices and procurement methods, and there was scope for improvement in assessing and recording the risk level of procurements.

5.6 The agencies did not generally use their contract registers and/or FMIS to prepare reports on procurement information. These systems were either not designed or configured to produce such information on a routine basis.<sup>211</sup> This constrained the ability of agencies to undertake systematic analysis or review of procurement activities, including as a means to help assess compliance with the CPGs.

## Monitoring and reviewing procurement information

### Central procurement units

5.7 The role of the audited agencies' CPUs in procurement monitoring and review was generally confined to their involvement with individual procurements. As indicated in Chapter 2, the level of CPU involvement in individual procurements was variable, and depended on the scale or method of procurement being undertaken.

5.8 Despite the lack of formal arrangements and systematic data capture, the ANAO noted the ACC's CPU had recently undertaken some monitoring of

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<sup>209</sup> This would include assessing the number of multiple contracts awarded to the same supplier in a short period, to identify possible instances of order splitting to avoid Open Tendering.

<sup>210</sup> That is, whether the contractors generally complete work on time, within budget and to a high standard, as well as the number and extent of variations.

<sup>211</sup> FaHCSIA and ACC could not produce routine reports because they did not have a standard suite of reports for procurement and were unable to produce ad hoc reports without the assistance of an expert.

CPG compliance by reviewing procurements undertaken, and had taken action to address identified non-compliance, including in relation to Direct Source procurement. The CPU presented the details of non-compliance on the agency intranet to alert staff and reinforce the need to seek advice from the CPU when Direct Sourcing.<sup>212</sup>

## Internal audit coverage

**5.9** Internal audit is one of a number of assurance and review functions agencies may use to provide assurance on the effectiveness of procurement activities, and the extent of compliance with the CPGs. Whether an agency's internal audit area undertakes audits in relation to procurement will depend on a number of factors, including the agency's risk profile.<sup>213</sup>

**5.10** The ANAO examined whether the audited agencies had undertaken any recent internal audits relevant to procurement and, in particular, Direct Source procurement. FaHCSIA, Innovation and DVA completed procurement audits in 2008–09. The ACC undertook audits of procurement in 2004–05, 2006–07 and 2007–08. While all of the audits across the agencies had different objectives, scope and focus, none were specifically targeted at Direct Source procurement.

**5.11** The findings from the internal audits of procurement were generally consistent with the findings from this audit. In particular, the internal audits made recommendations to improve accountability and transparency by:

- documenting procurement processes,<sup>214</sup> approvals and decisions, and demonstrating consideration of risk management and conflict of interest. In some cases the internal audits specifically recommended improved justification of Direct Sourcing; and
- timely reporting in AusTender.

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<sup>212</sup> A previous procurement audit made a recommendation that entities should undertake targeted quality assurance reviews as an integral part of their procurement activities. ANAO, Audit Report No.21, 2006–07, p. 48, Recommendation No.3.

<sup>213</sup> The agencies' enterprise-wide risk assessments generally focused on the risk of non-compliance with the FMA legislation (which would include non-compliance with the CPGs). Specific risks relating to procurement tended only to be included in risk assessments at Group, Division or Branch level.

<sup>214</sup> Some of these audits found agency staff had not completed procurement forms and templates.



**5.12** The consistency of many of the internal audit findings and those made by the ANAO in this audit demonstrates the importance of the assurance and review role played by internal audit, and the need for agencies to be responsive to issues identified by internal audit.

## **Reporting Breaches of the FMA Act and Regulations in the Certificate of Compliance**

**5.13** The Certificate of Compliance provides a means to improve compliance with the Australian Government's financial management framework and to ensure that Ministers are kept informed of compliance issues within their portfolios.<sup>215</sup> Each financial year FMA agencies' Chief Executives are required to prepare a Certificate of Compliance that reports on their agency's compliance with legislative and policy requirements including:<sup>216</sup> the FMA Act; the FMA Regulations; and the FMA (Finance Minister to Chief Executives) Delegation 2009.

**5.14** The ANAO reviewed each agency's Certificate of Compliance for 2008–09 and compared the reported breaches with procurements from the audit sample where it was not evident that they complied with requirements of FMA Regulations and the CPGs (see Chapters 3 and 4).<sup>217</sup> This analysis showed a higher level of non-compliance than that reported by the agencies. As the Certificate of Compliance process relies largely on self-reporting, these differences may be attributed to a variety of reasons, including delegates' level of awareness of the relevant FMA requirements including the CPGs (also see paragraphs 2.29 and 2.30).<sup>218</sup> In some instances, it also reflected a lack of understanding of the procurement method being undertaken, and the need for Finance to clarify the CPGs and supporting guidance for how agencies should define and report procurement methods.<sup>219</sup>

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<sup>215</sup> Finance, *2008–09 Certificate of Compliance Report to Parliament*, December 2009, p. 2.

<sup>216</sup> Chief Executives are also required to report on: the Australian Government's foreign exchange risk management requirements; the legal and financial requirements for the management of Special Accounts; and selected financial management policies of the Australian Government that apply to the operations and functions performed by the agency.

<sup>217</sup> For example, Chapter 4 discusses Direct Source procurements that were assessed as not complying with: paragraphs 8.33 and 8.34 of the CPGs; and documentation requirements for FMA Regulation 12.

<sup>218</sup> Relevant FMA obligations include: Regulation 12 of the FMA Act; and paragraphs 8.33 and 8.34 of the CPGs.

<sup>219</sup> See paragraphs 3.47 and 4.93, as well as Tables 4.13 and 4.16.

**5.15** As discussed in Chapter 4 agencies need to improve the identification of non-compliance with relevant FMA requirements (including the CPGs), and take action to reduce its occurrence for future procurement activities.

### **Internal reporting to agency senior management**

**5.16** Effective management reporting to senior management or an agency's executive on procurement activity involves the routine provision of information on procurement activities, such as the number, value, nature and timeliness of procurements. Such reporting also helps to identify potential compliance risks for further investigation; areas where additional guidance and support are needed; and opportunities to improve the efficiency and effectiveness of procurement.

**5.17** To assist with interpreting the reporting of procurement information, agencies should use their understanding of the business and the likely nature of procurement processes. For example, agencies could analyse the procurement methods they have employed, considering whether the approaches seem generally consistent with the agency's requirements, the CPGs and the nature and risk profile of the procurements. This could provide useful information to inform an annual review of procurement performance.

**5.18** Innovation and the ACC reported procurement-related issues on a regular basis to senior management with overall responsibility for procurement in the agency (Innovation reported monthly and ACC weekly). These reports mainly provided information on the status of large procurements and current procurement activities, rather than performance results or assurance regarding the level of compliance with the CPGs. FaHCSIA also reported procurement-related statistics on a weekly basis to senior management, focusing on the volume of activity in areas such as inquiries, request for quote/tender documentation, contracts and contract variations. DVA advised that procurement-related issues are reported to senior management formally on a weekly basis, but did not provide evidence to

demonstrate this occurred.<sup>220</sup> None of the four agencies regularly reported on procurement issues to the agency executive.<sup>221</sup>

## Strategic procurement planning and management

### Annual procurement plans

**5.19** The CPGs require agencies to publish an Annual Procurement Plan on AusTender by 1 July of each financial year. The purpose of an Annual Procurement Plan is to draw suppliers' attention to potential procurement opportunities. The plan should contain a short strategic outlook for the agency supported by details of any planned procurement. This planning process is an opportunity for agencies to review their overall procurement requirements and identify opportunities to achieve better value for money in the way they approach procurement.

**5.20** Each of the agencies had published an Annual Procurement Plan on AusTender and could broadly describe their overall procurement requirements.<sup>222</sup> However, none could provide the ANAO with documentation of their overall procurement requirements or analysis supporting their procurement plan. As indicated above, by improving data capture, monitoring and reporting arrangements, agencies will be better positioned to drive process improvement, including timely procurement planning, at a whole of agency level.

### Panel arrangements

**5.21** Another way for agencies to adopt a strategic approach to procurement is to use panels effectively. Panels are established using an Open Tender process and provide the agency with the opportunity to approach the market

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<sup>220</sup> In its response to the proposed report DVA advised ANAO that, '*DVA procurement-related issues are reported to senior management formally on a weekly basis and informally more frequently. Specific issues are raised on an as-required basis with the Chief Executive, and the CPU is directly involved in all Tender Steering Committees for complex procurement processes.*'

<sup>221</sup> A previous procurement audit made a recommendation that, having regard to the significance of procurement activity, entities needed to incorporate reporting on procurement activities as an element of management reporting arrangements. ANAO Audit Report No.21, 2006–07, p. 49, Recommendation No.4.

<sup>222</sup> In this context, broadly describing the agencies' overall procurement requirements would include profiling by type of procurement (that is, the specific property or service being procured), matters such as: the frequency; the source within the agency; the scale; the type of the procurement methods used; and the suppliers used.

once to identify a group of suitable suppliers to provide property or services that may be frequently or periodically used by the agency. This reduces costs to the agency and the suppliers by having a single approach rather than multiple approaches to the market for these property or services, while also satisfying the requirements of the CPGs.

**5.22** Each of the agencies had established panel arrangements for some types of procurement. Further, in examining documentation for the sample of procurements:<sup>223</sup>

- all four agencies had used whole-of-government (WoG) panels;<sup>224</sup> and
- two agencies had used cooperative procurement arrangements.<sup>225</sup>

### **Other evidence of strategic procurement planning**

**5.23** The ACC's CPU had recently taken steps towards adopting a more strategic procurement approach by identifying:

- purchases of the same or similar property or services to obtain better information on the annual cost of these property and services; and
- options for establishing standing offer arrangements or multiple year contracts with single suppliers for groups of property and services. Where new arrangements were put in place the CPU advised staff of these arrangements on the agency intranet.

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<sup>223</sup> The results in paragraph 5.22 are based on the audit sample tested and may not reflect all arrangements in place at each agency.

<sup>224</sup> Whole-of-government arrangements are established for a number of reasons, including to give effect to government policy decisions, to improve consistency and control and to deliver savings and efficiencies. Whole-of-government arrangements may take the form of a contract, standing offer and /or the use of standard documentation. These contracts and arrangements have been variously established by lead agencies including Defence and Finance. Generally, whole-of-government contracts and arrangements are for use by FMA Act agencies and their use may be mandated. Examples of whole-of-government panels used by the audited agencies include the Fleet Management Agreement, the Master Media Panel and the APSC Capability and Development panel. <<http://www.finance.gov.au/procurement/wog-procurement/wog.html>>.

<sup>225</sup> Piggybacking or cooperative procurement enables the use of a procurement contract by more than one agency. This can be achieved through either a joint approach to the market and/or where an agency or agencies establish a contract or standing offer arrangement that allows other agencies access (often referred to as piggybacking). Cooperative procurement makes better use of agencies' resources by reducing the number of administrative processes and sharing the procurement and contract management process workload. For example, efficiencies may be derived from conducting one procurement process and maintaining one contract in lieu of many. Agencies may also be able to leverage better prices and services arrangements where they consolidate their procurement needs. Examples of where piggybacking arrangements had been used in the sample were the Centrelink panel for ICT contractor services and the AGD panels for financial and legal services. <<http://www.finance.gov.au/procurement/wog-procurement/cooperative-procurement.htm>>.

**5.24** The ANAO considers there are opportunities for the other audited agencies to adopt a more strategic approach to procurement by better appreciating their overall procurement requirements. This would enable the agencies to achieve more efficient processes and better value for money in procurement by, for example, identifying situations where a standing offer arrangement may be more appropriate than separate procurement arrangements.<sup>226</sup> It would also be consistent with the MAC focus on reducing the burden of administrative processes by, among other strategies, minimising processes that are too frequent and result in duplication.<sup>227</sup>

## Recommendation No.4

**5.25** To enhance the annual procurement planning process and provide a basis for adopting more strategic and efficient procurement processes, the ANAO recommends that agencies regularly analyse their procurement activities with a view to streamlining multiple approaches to the market for similar types of property or services.

### Agencies' responses

#### *FaHCSIA*

**5.26** Agree. FaHCSIA's centralised Procurement Unit conducts quality assurance on procurement processes and any proposed procurement activities included in FaHCSIA's annual procurement plan. FaHCSIA regularly analyses procurement patterns in an attempt to improve consistency and reduce duplication in its procurement activities.

#### *Innovation*

**5.27** Innovation agrees with the recommendation and will implement measures to analyse procurement activities undertaken across the department.

#### *DVA*

**5.28** Agreed. DVA undertakes a number of streamlined multiple approaches to the market for similar types of property or services and has recently initiated

<sup>226</sup> A previous procurement audit made a recommendation that, to assist with the achievement of value for money, entities needed to take a strategic approach to procurement including assessing the opportunities to aggregate some requirements into a single procurement and determine whether there are opportunities to better utilise standing offer arrangements. ANAO, Audit Report No.21, 2006–07, p. 51, Recommendation No.6.

<sup>227</sup> MAC Report No.7, *Reducing Red Tape in the Australian Public Service*, pp. iii, 25 and 26.

processes to analyse procurement activities with a view to assisting contract managers in annual procurement planning.

**ACC**

**5.29** Agreed.

***Finance***

**5.30** Agreed. The CPGs provide a variety of mechanisms, such as multi-use lists, panels and cooperative and coordinated agency procurement that can reduce the administrative overhead to suppliers and agencies when procuring multiple and similar types of property or services. As appropriate, agencies should seek to use these mechanisms to meet their current and potential future procurement requirements.

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Ian McPhee  
Auditor-General

Canberra ACT  
30 September 2010

# Appendices





## Appendix 1: Recent ANAO audits that addressed aspects of procurement

1. Recent ANAO performance audits that examined aspects of procurement include:

- ANAO, Audit Report No.45, 2009–10, *Contracting for Defence Force Recruiting Services*;
- ANAO, Audit Report No.24, 2009–10, *Procurement of Explosive Ordnance for the Australian Defence Force*;
- ANAO, Audit Report No.14, 2009–10, *Agencies' Contract Management*;
- ANAO, Audit Report No.11, 2009–10, *Garrison Support Services*;
- ANAO, Audit Report No.1, 2009–10, *Representations to the Department of the Treasury in Relation to Motor Dealer Financing Arrangements*;
- ANAO, Audit Report No.19, 2008–09, *CMAX Communications Contract for the 2020 Summit*; and
- ANAO, Audit Report No.37, 2007–08, *Management of Credit Cards*.

## Appendix 2: Finance guidance material for procurement

1. All guidance material can be found on the Finance website: <<http://www.finance.gov.au/procurement/procurement-policy-and-guidance/index.html>>. This guidance material includes:

- publications in the Financial Management Guidance (FMG) series including: FMG No.15 *Guidance on Publishing Obligations* – July 2007, FMG No.10 *Complying with Legislation and Government Policy in Procurement*, and FMG No.13 *Mandatory Procurement Procedures*;
- the Good Procurement Practice (GPP) series: particularly, GPP No.1, *Chief Executive's Instructions and Operational Guidelines for Procurement*; and
- Finance Circulars: particularly 2007/02 – *Commonwealth Procurement Guidelines – Threshold for Procurement of Construction Services*, and 2006/02 – *Commonwealth Procurement Guidelines – Clarification*.

## Appendix 3: Finance's procurement support

### Activities undertaken by Finance's Procurement Division to assist Commonwealth agencies manage their procurement obligations

#### *Procurement Bulletins*

- Sent monthly to approximately 1200 self-nominated recipients across the Commonwealth.
- Timely source of information about emerging procurement and/or contract management issues as well as changes to the Financial and Procurement policy frameworks—includes links and contact details to enable recipients to obtain more detailed information, if they wish.

#### *Procurement Discussion Forum*

- Five times per year—bi-monthly except January.
- Timely provision of detailed information about emerging procurement and/or contract management issues as well as changes to the Financial and Procurement policy frameworks from the 'owners' of the issues or policies.

#### *Procurement Website ([www.finance.gov.au/procurement](http://www.finance.gov.au/procurement))*

- News items updated weekly.
- Central repository for a full range of up-to-date information related to Commonwealth procurement. As well as Finance's information and guidance material the site includes a range of links to other useful topical sites.

#### *Introduction to Procurement Seminars*

- Demand driven—4 Canberra Seminars and 1 Melbourne Seminar in 2009/10—100 participants each session.
- Provide participants with detailed information on the Commonwealth's Financial and Procurement policy frameworks that all officers undertaking procurements need to know. The Seminars are primarily aimed at officers new to procurement, but officers seeking to refresh their knowledge also find the information useful. In addition to the Financial and Procurement policy frameworks, speakers present on a diverse range of topics, including risk management, ethics, reporting and contract management. The presentations are supported by two practical exercises based on case studies.

### *Chief Financial Officer Forum*

- Monthly (except July and December).
- Finance's Procurement Division has a permanent speaking engagement at this Forum to enable timely dissemination of information about emerging procurement and/or contract management issues as well as about changes to the Financial and Procurement policy frameworks.

### **Support provided by Finance's Procurement Division to assist Commonwealth agencies manage their procurement obligations**

#### *Agency Advice Inbox (ProcurementAgencyAdvice@finance.gov.au)*

Allows centralised procurement teams from agencies to email questions relating to procurement issues and the procurement framework. Provides a clarification and interpretation service to assist agencies in their application of the CPGs.

#### *Informal visits to agencies*

Informal visits take place to discuss general procurement related issues and improve external relationships. These visits allow Finance's Procurement Division to advise agencies of the latest issues in procurement and provide agencies with the opportunity to raise general procurement matters and also provide feedback on both the framework and the support provided by Finance's Procurement Division.

#### *Senior Procurement Officials Resource Group (SPORG)*

The SPORG Group is a new initiative, which will involve regular meetings of centralised procurement teams (CPTs). Prior to the SPORG, no forum existed that allowed senior, more experienced procuring officials from the Commonwealth to gather and discuss the issues they are experiencing in procurement. The SPORG will allow CPTs to meet and discuss issues in procurement and contribute to future reviews of the procurement framework.

#### *Practical advice to supplement the CPGs*

Includes Good Procurement Practice Guides and Finance Circulars, as well as training sessions at procurement training programs.

## Appendix 4: Mandatory Procurement Procedures: conditions for Direct Sourcing

1. Covered procurements that are Direct Sourced must meet one or more of the conditions outlined in paragraph 8.33 of the CPGs. If an agency cannot meet any of these conditions then it should conduct either an Open or Select Tender procurement process. The list of conditions is shown in Table A 1.

**Table A 1**

### Conditions for Direct Sourcing (paragraph 8.33 of the CPGs)

Paragraph Reference	Type of Condition	Definition/Description from CPGs
A	Open approach to market where no submissions are received	Where, in response to an approach to the market: <ul style="list-style-type: none"> <li>i. no submissions were received (this includes where no submissions were received which represented value for money);</li> <li>ii. no submissions were received that conform to the minimum content and format of submission as stated in the request documentation; or</li> <li>iii. no potential suppliers satisfied the conditions for participation, and the agency does not substantially modify the essential requirements of the procurement.</li> </ul>
B	Extreme urgency brought about by events unforeseen by the agency	Where, for reasons of extreme urgency brought about by events unforeseen by the agency, the property or services could not be obtained in time under Open Tendering procedures.
C	Advantageous conditions that only arise in the short term	For purchases made under extremely advantageous conditions that only arise in the very short term, such as from unusual disposals, unsolicited innovative proposals, liquidation, bankruptcy, or receivership and which are not routine purchases from regular suppliers.
D	One supplier where there is no reasonable alternative or substitute	Where the property or services can only be supplied by a particular business and there is no reasonable alternative or substitute for the following reason: <ul style="list-style-type: none"> <li>i. the requirement is for works of art;</li> <li>ii. to protect patents, copyrights, or other exclusive rights, or proprietary information; or</li> <li>iii. due to an absence of competition for technical reasons.</li> </ul>

Paragraph Reference	Type of Condition	Definition/Description from CPGs
E	Additional services by original supplier for compatibility reasons	For additional deliveries of property or services by the original supplier or authorised representative that are intended either as replacement parts, extensions, or continuing services for existing equipment, software, services, or installations, where a change of supplier would compel the agency to procure property or services that do not meet requirements of compatibility with existing equipment or services.
F	Commodity market	For purchases on a commodity market.
G	Prototype	Where an agency procures a prototype or a first property or service that is intended for limited trial or that is developed at its request in the course of, and for, a particular contract for research, experiment, study, or original development.
H	Design contest	In the case of a contract awarded to the winner of a design contest provided that: <ul style="list-style-type: none"> <li>i. the contest has been organised in a manner that is consistent with this Division; and</li> <li>ii. the contest is judged by an independent jury with a view to a design contract being awarded to the winner.</li> </ul>
I	New construction services that repeat similar services where the original contract was awarded following an Open or Select Tender process	For new construction services consisting of the repetition of similar construction services that conform to a basic project for which an initial contract was awarded following an Open or Select Tender process, and where the initial approach to the market indicated that Direct Sourcing might be used for those subsequent construction services.

Source: Finance, CPGs, 2008, pp. 30–32, paragraph 8.33.

## Appendix 5: Mandatory Procurement Procedures: exemptions

1. The CPGs outline specific situations in which an agency is exempt from complying with the MPPs. These exemptions are to be used at the discretion of the agency and an agency must still demonstrate that it has applied the procurement principles to the procurement process. The full list of exemptions can be found in Table A 2.

**Table A 2**

### Exemptions from Mandatory Procurement Procedures (Appendix A of the CPGs)

No.	Type of Exemption	Definition from CPGs
1	Lease, purchase of accommodation	Leasing or purchase of real property or accommodation (note: the procurement of construction services is not exempt).
2	Procurement from other Commonwealth, state or territory entity	Procurement of property or services by an agency from other Commonwealth, state, territory or local government entities where no commercial market exists or where legislation or general government policy requires the use of a government provider (for example tied legal services).
3	International grants and loans	Purchases funded by international grants, loans or other assistance, where the provision of such assistance is subject to conditions inconsistent with [the CPGs].
4	Grants / sponsorships	Purchases funded by grants and sponsorship payments.
5	Foreign assistance	Procurement for the direct purpose of providing foreign assistance.
6	Research and development	Procurement of research and development services, but not the procurement of inputs to research and development undertaken by an agency.
7	Expert or neutral person	The engagement of an expert or neutral person, including engaging counsel or barristers, for any current or anticipated litigation or dispute.
8	Procurement outside Australia	Procurement of property or services (including construction) outside Australian territory, for consumption outside Australian territory.
9	Government debt	Acquisition of fiscal agency or depository services, liquidation and management services for regulated financial institutions, and sale and distribution services for government debt.
10	Motor vehicles	Procurement of motor vehicles.

No.	Type of Exemption	Definition from CPGs
11	Superannuation / Future Fund	Procurement, by the Australian Reward Investment Alliance (ARIA) or the Future Fund Management Agency, of investment management, investment advisory, or master custody and safekeeping services for the purposes of managing and investing the regulated superannuation assets under the trusteeship of ARIA or for the purpose of investing the assets of the Future Fund.
12	Blood plasma services	Procurement of blood plasma products or plasma fractionation services.
13	Government advertising	Procurement of government advertising services.
14	Defence	Procurement of property or services by, or on behalf of, the Defence Intelligence Organisation, the Defence Signals Directorate, or the Defence Imagery and Geospatial Organisation.
15	Labour hire	Contracts for labour hire but not to contracting with an intermediary (for example, a personnel firm) for the provision of an individual to supply labour (other than an intermediary that is a firm which primarily exists to provide the services of only that individual).
16	Disability	Procurement of property or services from a business that primarily exists to provide the services of persons with a disability.

Source: Finance, CPGs, 2008, Appendix A, pp. 40–41.



## Appendix 6: Documentation obligations, requirements and sound practices

1. The CPGs establish documentation obligations, requirements and sound practices for procurements including specific obligations for Direct Source procurements. These requirements and obligations are presented in Table A 3 below.

**Table A 3**

**Documentation obligations, requirements and sound practices established by the CPGs**

Paragraph number of the CPGs	Paragraph text	Status: obligation, requirement or sound practice
7.8	Documentation is critical to accountability and transparency. It provides a record of procurement activities and how they have been conducted, and facilitates scrutiny of these activities.	Requirement
7.9	Agencies must maintain appropriate documentation for each procurement. The appropriate mix and level of documentation depends on the nature and risk profile of the procurement being undertaken. Agencies need to ensure there is sufficient documentation to provide an understanding of the reasons for the procurement, the process that was followed and all relevant decisions, including approvals and authorisations, and the basis of those decisions.	Obligation and requirements
7.10	Documentation relating to a procurement must be retained for a period of three years or for a longer period if required by legislation or other reason for a specific procurement. In addition, the <i>Archives Act 1983</i> sets out requirements in relation to Commonwealth records, including dealings with, and access to, such records.	Obligation
7.11	The FMA Regulations set out specific requirements for the preparation of documentation when making commitments to spend public money.	Obligation
7.12	Agencies should ensure there is a written contract with the supplier in a procurement process. Where a written contract does not exist, agencies should ensure that sufficient written documentation or a written contract is formulated as soon as practicable. For low value, routine purchases a purchase order would be considered sufficient documentation.	Sound practice

Paragraph number of the CPGs	Paragraph text	Status: obligation, requirement or sound practice
7.13	<p>Documentation requirements vary throughout the procurement cycle. Documentation that may be appropriate for each stage includes, but is not limited to, that shown in Table 1. It is an agency's responsibility to ensure that adequate and appropriate documentation is kept for each stage of a procurement.</p> <p><b>Table 1—Examples of documentation requirements at different stages of the procurement process</b></p> <p><b>Identify Need (example of documentation requirements):</b> annual procurement plan; budget papers; business case; risk assessment; legal advice; procurement method decision; evaluation plan, including selection criteria; procurement budget.</p> <p><b>Determine Suitable Process (example of documentation requirements):</b> time limits and timetable; approach to the market; probity plan; request documentation (including draft contract); due diligence process.</p> <p><b>Conduct Procurement Process (example of documentation requirements):</b> tenders received and acknowledgements; value for money assessment; evaluation report and recommended decision; probity report; decisions (including relevant approvals/or authorisations) and their basis; contract negotiations and contract; advice to unsuccessful tenderers; reporting of contract (if ≥\$10,000).</p> <p><b>Manage Contract Relationship (example of documentation requirements):</b> contract management plan; performance indicators; milestones; performance reports; correspondence between the parties; variations of the contract; decisions regarding variation, records of the receipt of orders; evaluations of property and/or services; payment information.</p>	A combination of obligations, requirements and sound practices.
8.34	<p>In accordance with the general accountability requirements set out in these CPGs, for each contract awarded through direct sourcing, agencies must prepare and appropriately file within the agency's central filing system, a written report that includes:</p> <ul style="list-style-type: none"> <li>a. the value and kind of property or services procured; and</li> <li>b. a statement indicating the circumstances and conditions that justify the use of a procedure other than an open or select tender process.</li> </ul>	Obligation

Source: Finance, CPGs, 2008, pp. 18, 19 and 32.

## Appendix 7: Audited agency requirements for documenting Direct Source procurements

**Table A 4**

### Requirements for documenting Direct Source procurements

Agency	Procurement value	Templates to be completed for Direct Source procurements
FaHCSIA	Between \$10 000 and \$80 000	Procurement Plan—Under \$80 000. Purchase Order Request Form and contractual agreement.
	Over \$80 000	Procurement Plan—Over \$80 000. Purchase Order Request Form and contractual agreement. Risk Assessment. Departure from Mandatory CPG Requirements Template including a justification for the use of Direct Sourcing. A tender evaluation plan, which includes a justification for the procurement method in the case of Direct Source and Select Tender procurements.
Innovation	Under \$25 000	Purchase orders and quote documentation.
	\$25 000 to \$80 000	Risk assessments for services valued at more than \$25 000 and high risk procurements. Stage 1 and 2 approval minutes including a justification for the use of Direct Sourcing. Contracts, deeds and purchase orders.
	\$80 000	Risk assessments for services and goods. Procurement plans. Contracts, deeds and purchase orders. Stage 1 and 2 approval minutes, including a justification for the use of Direct Sourcing.
DVA	Between \$10 000 and \$80 000	For low risk procurements the Request for Quote and Agreement Template. For moderate and high risk procurements the Request for Tender and Deed of Agreement.
	Over \$80 000	Business Case Template. Request for Tender and Deed of Agreement.
	Any value	Although there is no requirement to complete a template, DVA requires staff to prepare a procurement plan for all procurements (a procurement plan includes a business case, a risk assessment and appropriate approvals for the procurement process).

Agency	Procurement value	Templates to be completed for Direct Source procurements
ACC	Under \$5 000	Purchase order request.
	\$5 000 to \$10 000	Purchase order request and contractual agreement.
	\$10 000 to \$80 000	Minimum three written quotes, purchase order request and contractual agreement.
	Over \$80 000	Purchase order request and contractual agreement.
	Any value	Other templates available to staff included: <ul style="list-style-type: none"> <li>• a risk assessment template; and</li> <li>• a procurement plan/business case template.</li> </ul>

Source: Agencies' CEIs, procurement guidance and procurement intranet sites.

## **Appendix 8: Positive examples of procurement documentation requirements for Direct Sourcing**

1. Chapters 2 and 4 discuss documentation requirements and practices for Direct Source procurement. There were some positive examples of documentation requirements established by the agencies which were to be used by agency officials when Direct Sourcing. These positive examples included elements of the following templates:

- FaHCSIA’s Departure from Mandatory CPG Requirements Template provided a comprehensive approach to documenting the procurement process for covered Direct Source procurement. This template provides guidance for setting out a business case where the proposed procurement seeks to depart from the Mandatory Procurement Procedures (MPPs).
- Innovation’s Stage 1 and 2 approval minutes gave a clear picture of the procurement process followed. The Stage 1 minute sought approval of the procurement method and Stage 2 sought approval of suppliers and expenditure. The minutes required the documentation of key decisions, actions and other procurement information, including:
  - compliance with the CPGs, the CEIs and with any relevant policies under Regulation 9;
  - a description of the property/service and justification for its purchase;
  - the estimated value of the procurement, any related costs and the source of funding;
  - a summary of the procurement process/methodology, and justification of how the procurement process/methodology will result in a value for money outcome (for Direct Sourcing, this includes details of the recommended supplier and an outline of the circumstances and conditions that justify the use of Direct Sourcing);
  - details of the recommended suppliers, the price and timeframes, including (where relevant) the initial term of

- the contract, any extension options and any reimbursable expenses or other costs;
  - the basis for assessing the proposed expenditure as efficient and effective under Regulation 9;
  - any potential criticisms and risks of significance, including details of any contingent liabilities and how they have been managed;
  - a statement of whether or not Regulation 10 authorisation is required and the Regulation 10 reference number; and
  - whether subsequent processes or approvals may be necessary.
- The ACC provided a more streamlined approach to capturing key information through its purchase order request form, including: a description of the good or service being supplied, its value, the proposed supplier, details of the procurement method, an opportunity to include a justification for Direct Sourcing, an opportunity to provide electronic links and references to documents supporting the procurement process,<sup>228</sup> and the Regulation 9 and, where necessary, Regulation 10 approval of the procurement. Other templates were available for use, but were not required to be completed for Direct Source procurement. These templates included a business case/procurement plan and risk assessment.

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<sup>228</sup> This might include a link to the procurement plan, risk assessment, copies of relevant quotes and related documentation.

## Appendix 9: Agencies' responses

Each of the agencies involved in the audit were provided with the opportunity to comment on the proposed audit report in accordance with the provisions of section 19 of the *Auditor-General Act 1997*.

Agencies' responses to the recommendations have been included in the main body of the report under the subheading 'Agencies' responses' directly following the recommendation. Specific comments in response to audit findings have also been noted in footnotes to the main body of the report.

A summary of the agencies' responses is provided below.

### **Department of Families, Housing, Community Services and Indigenous Affairs**

Overall, FaHCSIA considers that this report is well targeted and has made sound recommendations which the Department supports. In addition, FaHCSIA looks forward to the Department of Finance and Deregulation reviewing the clarity of the Commonwealth Procurement Guidelines relating to classification of procurement methods. It is pleasing to note that FaHCSIA was recognised as having good practices in several areas covered by the audit. FaHCSIA continuously reviews its procurement policies and practices to ensure they reflect better practice.

### **Department of Innovation, Industry, Science and Research**

The Department of Innovation, Industry, Science and Research acknowledges the findings of the ANAO Audit of Direct Source Procurement and supports the recommendations proposed in the report. The department found the audit process to be a valuable exercise and is continuing to implement measures to further improve its performance in this area.

### **Department of Veterans' Affairs**

The Department of Veterans' Affairs (DVA) agrees with the overall findings and recommendations of the ANAO report. In regard to the observation that DVA has a lower than average percentage of direct sourcing procurements it should be pointed out that DVA has health services contracts with a value in excess of \$4 billion annually which include a large volume of small value procurements being delivered by way of standing offers with individual health providers. The lower than average percentage of Direct Sourcing procurements within these large procurement processes undertaken by DVA highlights

DVA's commitment to increasing the number and scope of procurement opportunities offered to the open market.

## **Australian Crime Commission**

The Australian Crime Commission (ACC) agrees with the findings of the audit and will undertake the appropriate action to implement the relevant recommendations.

In response to the findings of the audit the ACC has already implemented changes to its processes to ensure the accuracy and timeliness of reporting contract information on AusTender. In addition to this the ACC is currently undertaking a full review of its procurement framework and guidance material to ensure that it is current and addresses these findings. This review will be followed by a training and awareness program advising staff and delegates of their responsibilities in relation to direct sourcing. It is planned that this training will focus on the findings of the audit, in particular the requirement for adequate documentation to support the justification for direct sourcing and the documented evidence of the approvals.

## **Department of Finance and Deregulation**

This Audit Report highlights practices that are of concern because they indicate a lack of understanding of key rules and procedures in Commonwealth procurement, underpinned by legislation, and an appreciation that these are intended to promote value for money and accountability. These practices included either not estimating the value, or significantly underestimating the value, of a proposed procurement to avoid an open approach to the market, required by Mandatory Procurement Procedures of the CPGs.

As outlined in Appendix 3 of the Report, Finance continues to provide a broad range of support to agencies to assist them to manage their procurement obligations. In addition, Finance is in the process of reviewing its procurement policy guidance to both simplify and better target it towards the specific needs of new procurers, experienced procurers and financial delegates.

Improved understanding and procurement practice within agencies is necessary to support enhanced value for money outcomes. In this regard, Chief Executives could be encouraged to consider providing the central procurement areas of their agencies with clear authority to advise line areas on effective and compliant procurement processes. These central procurement areas have a



direct link to procurement advice from Finance and are encouraged to participate in proposed developments to the procurement framework and activities.

# Series Titles

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## **ANAO Audit Report No.1 2010–11**

*Implementation of the Family Relationship Centres Initiative*

Attorney-General's Department

Department of Families, Housing, Community Services and Indigenous Affairs

## **ANAO Audit Report No.2 2010–11**

*Conduct by Infrastructure Australia of the First National Infrastructure Audit and Development of the Infrastructure Priority List*

Infrastructure Australia

## **ANAO Audit Report No.3 2010–11**

*The Establishment, Implementation and Administration of the Strategic Projects Component of the Regional and Local Community Infrastructure Program*

Department of Infrastructure, Transport, Regional Development and Local Government

## **ANAO Audit Report No.4 2010–11**

*National Security Hotline*

Australian Security Intelligence Organisation

Attorney-General's Department

Australian Federal Police

## **ANAO Audit Report No.5 2010–11**

*Practice Incentives Program*

Department of Health and Ageing

Medicare Australia

## **ANAO Audit Report No.6 2010–11**

*The Tax Office's implementation of the Client Contact - Work Management - Case Management System*

Australian Taxation Office

## **ANAO Audit Report No.7 2010–11**

*Confidentiality in Government Contracts: Senate Order for Departmental and Agency Contracts (Calendar Year 2009 Compliance)*

## **ANAO Audit Report No.8 2010–11**

*Multifunctional Aboriginal Children's Services (MACS) and Crèches*

Department of Education, Employment and Workplace Relations

**ANAO Audit Report No.9 2010–11**

*Green Loans Program*

Department of the Environment, Water, Heritage and the Arts

Department of Climate Change and Energy Efficiency

**ANAO Audit Report No.10 2010–11**

*Centrelink Fraud Investigations*

Centrelink

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SAP ECC 6.0 Security and Control	June 2009
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Rehabilitation: Managing Return to Work	June 2001
Building a Better Financial Management Framework	Nov 1999
Building Better Financial Management Support	Nov 1999
Commonwealth Agency Energy Management	June 1999
Controlling Performance and Outcomes	Dec 1997
Protective Security Principles (in Audit Report No.21 1997–98)	Dec 1997

