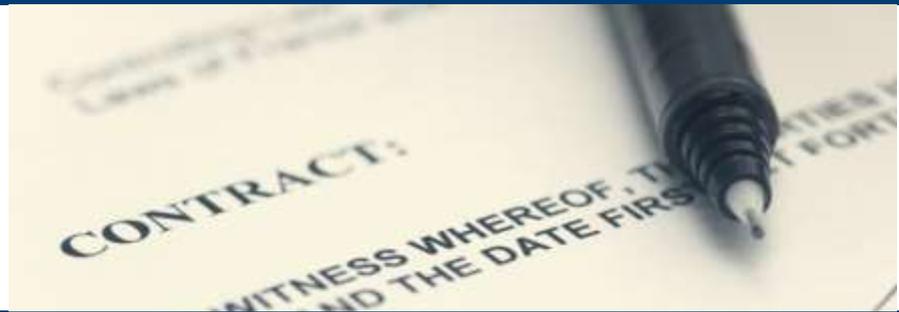


Western Australian Auditor General's Report



Tender Processes and Contract Extensions



Report 3: April 2017

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WESTERN AUSTRALIAN AUDITOR GENERAL'S REPORT

Tender Processes and Contract Extensions

Report 3
April 2017



**THE PRESIDENT
LEGISLATIVE COUNCIL**

**THE SPEAKER
LEGISLATIVE ASSEMBLY**

TENDER PROCESSES AND CONTRACT EXTENSIONS

This report has been prepared for submission to Parliament under the provisions of section 25 of the *Auditor General Act 2006*.

Across government benchmarking audits build on the annual financial audits of all agencies. We conduct these audits at a sample of agencies using more detailed testing than is required for the annual financial audits.

This audit assessed whether agencies have appropriate processes for tendering and extending existing contracts. We also assessed how well agencies manage procurement conflicts of interest. We found that, in general, agencies we sampled were satisfactorily managing tender processes and conflicts of interest, but need to improve how they manage contract extensions.

The findings of this report provide an insight to good practice, so all agencies including those not audited, can consider their own performance.

I wish to acknowledge the cooperation of the staff at the agencies included in this audit.

A handwritten signature in black ink, appearing to read 'C. Murphy'.

COLIN MURPHY
AUDITOR GENERAL
11 April 2017

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Tender Processes and Contract Extensions

Background

The Department of Finance has reported that for the 2014-15 financial year, WA government agencies undertook 5,571 procurement processes resulting in 6,198 individual supplier contracts with values over \$50,000. The combined value of these procurements was \$7.19 billion.

To ensure taxpayers receive value for money from government procurement, public authorities are required to comply with State Supply Commission procurement rules. These rules aim to provide suppliers with fair and equitable access to government supply opportunities and so ensure open competition.

The Department of Finance oversees these rules and supports agencies in implementation. Table 1 outlines the fundamental requirements.

| Monetary threshold ¹ | Minimum requirements |
|---------------------------------|---|
| Up to \$50,000 | <ul style="list-style-type: none"> Public authorities may determine the most appropriate procurement method including direct sourcing, or verbal or written quotations based on assessment of the nature of the market, complexity and risk, and process efficiency. Appropriate documentation of decisions must be retained. |
| \$50,000 up to \$250,000 | <ul style="list-style-type: none"> Request quotations in writing. Offers must be received in writing. |
| \$250,000 and above | <ul style="list-style-type: none"> Open tender through a public advertisement. |

Table 1: Minimum procurement requirements for public authorities

These rules apply unless purchasing through a common use contract or a specific exemption is approved.

Other rules also exist to ensure proper implementation of these minimum requirements. Individual agencies should incorporate the minimum requirements and other rules into their own more detailed procurement policies, along with controls to ensure requirements are met.

What we did

The focus of this audit was to assess whether agencies have appropriate processes for tendering and for extending existing contracts. We also assessed how well agencies manage conflicts of interest in their procurements.

¹ Monetary thresholds are based on the total estimated value, including any extension options, and are inclusive of GST.

We assessed the policies and documented practices at 8 agencies using the following lines of inquiry:

1. Are the policies for tendering and for contract extensions and renewals adequate?
2. Have the processes for tenders above \$250,000:
 - a. resulted in adequate testing of the market by giving all relevant suppliers appropriate opportunity and is the awarding of contracts appropriately reported?
 - b. provided adequate controls for managing conflicts of interest in procurement?
3. Are agencies adequately controlling:
 - a. contract extensions and renewals above \$50,000, including testing of the market before extending or renewing contracts?
 - b. contract variations, including approval of variations within delegated limits and where appropriate initiating a new tender process?

Where State Supply Commission policies and regulations applied to our lines of inquiry, we tested for compliance.

We included Western Power in the audit even though it is not bound by State Supply Commission requirements, being a state owned corporation rather than a public sector agency. In our view, the State Supply Commission requirements represent good practice and in this context are relevant to Western Power.

We assessed tender processes finalised after 1 July 2015, and contract extensions processed from 1 July 2014 to the time of our audit in the fourth quarter of 2016.

We conducted this across government benchmarking audit (AGBA) under section 18 of the *Auditor General Act 2006* and in accordance with Australian Auditing and Assurance Standards. AGBAs assess and benchmark agencies against common business practices to identify good practices and control weaknesses so that agencies, including those not audited, can compare their own performance.

Conclusion

Tendering practices of most agencies were satisfactory, with adequate testing of the market and management of conflicts of interest. Controls over contract variations were also generally satisfactory. However, management of contract extensions was poor at half the agencies in our sample. In addition, 2 agencies did not fully comply with delegation limits for approving extensions or variations. Most agencies also need to improve their procurement policies.

What did we find?

Western Power displayed good procurement practices across all our lines of enquiry. The other 7 agencies need to improve various aspects of their policies or practices. In particular, controls over contract extensions need to be improved at most agencies.

Table 2 is a summary of our findings using a 3 point scale of 'poor', 'fair' or 'good'.

| Agencies | Policies and procedures (LOI 1) | Adequate market testing and reporting of tenders (LOI 2a) | Managing conflicts of interest for tenders (LOI 2b) | Effective management and monitoring of contract extensions (LOI 3a) | Adequate controls over contract variations (LOI 3b) |
|---|---------------------------------|---|---|---|---|
| Department of Parks and Wildlife (DPAW) | Fair | Good | Good | Poor | Good |
| Department of Treasury | Good | Good | Good | Fair | Good |
| Disability Services Commission | Fair | Good | Good | Good | Good |
| Housing Authority | Fair | Poor | Fair | Poor | Fair |
| WA Land Information Authority (Landgate) | Fair | Good | Good | Poor | Fair |
| North Metropolitan TAFE | Fair | Good | Good | Fair | Good |
| Western Australian Sports Centre Trust (VenuesWest) | Fair | Fair | Good | Poor | Fair |
| Western Power | Good | Good | Good | Good | Good |

Table 2: Agency ratings against our criteria

Most agencies need to improve their procurement policies and procedures, and contract recordkeeping

Policies and procedures

Comprehensive policies and procedures that are regularly reviewed and easily accessible to staff, help ensure that good procurement practices are consistently followed by all staff. Good policies also help promote compliance with any relevant regulatory requirements, in this case, State Supply Commission policies.

Most agencies had procurement policies, which were easily accessible to staff. Staff were generally made aware of the agency's code of conduct and conflict of interest policy as part of their induction. In addition, agencies were informing staff involved in procurement activities of changes to procurement policies through email updates, training etc.

The Department of Treasury and Western Power had sound procurement policies and procedures, with the other 6 agencies needing to improve. Three agencies had not updated their policies to reflect current State Supply Commission requirements. The policy for VenuesWest did not cover capital works procurement, while at the Housing Authority several aspects of the capital works policy were non-specific and provided staff with significant capacity to interpret the policy in different ways.

We identified the following shortcomings:

- The policies of 6 agencies lacked guidance on what constitutes an appropriate contract variation. For example, using a contract variation to provide goods or services that are inconsistent with the scope and terms of the original contract is inappropriate. In such circumstances, a separate procurement process is required.
- The policies of DPAW and North Metropolitan TAFE did not address requirements for processing or approving contract variations and extensions. This increases the likelihood that variations or extensions are not properly approved and justified.
- The policies of 5 agencies did not include a requirement to review the current contractor's performance before exercising a contract extension option. This increases the risk that poor performing contractors may be granted extensions.
- Five agencies did not require the regular review of their contract register to identify contracts that are due to expire, so that appropriate action commences well before the contract expiry date. Lack of a review process increases the risk that contract extension decisions may be rushed, leading to inappropriate extensions, and potentially impacting continuity in the provision of goods and services.
- Policies at 4 agencies did not specify the minimum number of members for tender evaluation panels.
- Five agencies did not require members of tender evaluation panels to complete conflict of interest declarations. In the absence of completed conflict of interest declarations, there is no evidence that existing or emerging conflicts of interest were considered.
- The Housing Authority's delegation of authority register did not clearly outline the approval limits for contract variations and extensions for all of its functions.

Exemption registers

The State Supply Commission's *Open and Effective Competition* policy permits exemptions under certain circumstances and with the approval of the accountable authority. These circumstances include, for example, a bona fide sole source of supply, a similar contract awarded through a competitive process in the previous 12 months or purchase from a registered Australian Disability Enterprise or Aboriginal Business (where the purchase does not exceed \$250,000). Agencies are required to maintain a register of all exemptions granted by the accountable authority.

All agencies complied with the above requirements.

Contract registers

Maintaining a contract register with key contract details is essential for effective accountability and financial management, and accurate financial reporting. It assists management to monitor contract end dates, manage contract extensions, and commence new procurements in a timely manner.

Western Power maintained a comprehensive register of all its contracts. The contract registers at the other 7 agencies did not include all relevant key information, including:

- information on approved contract variations, such as the number and dollar value of individual variations, and the total value of approved variations. Lack of this information could limit the ability of an agency to effectively track the cumulative value of contract variations, evaluate the impact on the scope of the original contract, and initiate separate procurement processes where appropriate

- the counterparty contact details
- the name/position of the contract manager.

In addition, the contract registers of 5 agencies did not include detailed information on contract extensions, such as the number and duration of extension options available, and the number and dates of extension options exercised. This information would enable the agencies to effectively monitor and manage their contracts, including the exercise of contract extension options.

A new *Treasurer's Instruction 820 Register of Contracts*, effective from September 2016, formalises the requirement for agencies to maintain a register of all contracts with a value of more than \$50,000.

Contract recordkeeping

In the course of our audit, there were many instances where approvals for contact variations/extensions were not retained on contract files. Although the agencies were eventually able to provide these approvals for our review, we nevertheless regarded this as contrary to good practice which is to have records of all key decisions readily available and filed, in accordance with agency recordkeeping plans. Without readily available and comprehensive records, it is difficult for agencies to effectively manage their contracts.

Agencies generally had satisfactory tendering practices and were managing conflicts of interest

For the 2015-16 financial year, the 8 agencies awarded 225 contracts for goods, services or capital works, each over \$250,000 and totalling \$662 million.

We reviewed tendering practices and conflict of interest management for 47 contracts, with a total value of \$222.8 million. Our testing focused on whether the agencies had transparent processes to review and evaluate tender submissions, appropriate management of conflicts of interest, procurement processes compliant with relevant regulatory requirements, and that approvals were within delegated authorisation limits.

We identified the following shortcomings:

- At VenuesWest, the tender evaluation panel for 2 of 8 tenders that we sampled had only 2 members rather than the minimum required number of 3 members. The 2 tenders had a value of \$829,122.
- At Housing Authority:
 - for 2 of the 7 tenders we sampled, members of the tender evaluation panel did not complete conflict of interest declarations. These 2 tenders had a value of \$4,567,882
 - no documentary evidence was available for a tender valued at \$314,786. We were therefore unable to conclude whether appropriate tendering processes had been followed prior to the awarding of the contract.
- Most agencies reported all contracts over \$50,000 on Tenders WA, as required by State Supply Commission policies. However, at Department of Treasury and VenuesWest, we found that 3 of 46 contracts and 8 of 22 contracts respectively were not published on Tenders WA.

Most agencies did not perform adequate contractor performance reviews before extending or renewing contracts

It is essential that agencies only extend contracts if the contractor's performance is satisfactory. We expected to find:

- evidence that management had reviewed contractor performance before an appropriately delegated officer approved each contract extension
- that contracts were only extended if the original contract included an extension option.

A contract extension is the exercise of a contract option to extend the agreed terms for a further period. This may also involve changes to price, personnel and/or services.

Contract extensions should be negotiated and agreed before expiry of the contract. If agencies commence contract extension processes late, this can affect the quality of management's review of contractor performance. If the extension process is rushed, management may also not adequately test the provider's price in the current market, modify contractual terms and conditions, and/or assess whether the contractor still offers best value for money. Continued supply of goods or services may also be impacted.

The value of all contract extensions could not be determined for all agencies, due to inconsistent recording of contract extension information in the contract registers. In the 3 agencies where the information was readily available: Housing Authority, North Metropolitan TAFE and Disability Services Commission, 78 contract extensions totalling \$86 million were approved from 1 July 2014 to the time of our audit in late 2016.

We reviewed 45 contract extensions for goods and services processed by the 8 agencies, totalling \$92.4 million and identified the following shortcomings:

- At Housing Authority, 2 contract extensions totalling \$3.725 million were not approved. Failure to obtain approval can mean that commitments are entered into without sufficient justification and/or budget support. Also, 7 officers have delegation to approve contracts or contract extensions for goods and services to any value. Having many officers with unlimited contract authority increases the risk of financial loss.
- At North Metropolitan TAFE², a contract extension valued at \$1.6 million was approved by an officer with a delegation limit of \$1 million. Significantly exceeding delegation limits can mean that commitments are entered into without sufficient justification and/or budget support.
- Fourteen of 28 contract extensions we sampled at 5 agencies lacked documentation or an evaluation/conclusion on the performance of the contractor over the prior contract period. The total value of the 14 extensions was \$19.1 million. We were therefore unable to determine if there was adequate review of contractor performance before exercising the extension options. This increases the risk that poor performing contractors were granted extensions.
- At DPAW and Housing Authority, decisions to exercise contract extension options for 3 out of 12 contracts were made after the initial contracts had expired.

² Former Central Institute of Technology.

Contracts often have extension options to allow agencies to extend them for a further agreed period – 26 of the 45 contracts we sampled had extensions that in total exceeded the original term of the contract. The convenience of contract extensions, which avoid the need to re-test the market, makes it important to have sound controls in place to ensure it only occurs with good justification.

Most agencies were effectively controlling the use of contract variations

Contract variations are amendments that change the original terms or conditions of the contract. Although most variations relate to the price for the contract, some also relate to the nature of the supply or services provided. We assessed whether contract variations, individually or cumulatively, significantly changed the scope of the original contract as this may indicate that the agency was using the variations to avoid undertaking a new procurement process.

All 8 agencies undertook contract variations during our period of audit, though only 5 of the 8 agencies could readily provide detailed information of the total number and value of contract variations. These 5 agencies approved 70 variations valued at over \$20.5 million during our period of audit, of which 11 were individually valued at over \$250,000, and totalled \$13.8 million.

We reviewed 40 contract variations totalling \$20.9 million across all 8 agencies and found that the agencies generally had adequate controls to manage and monitor contract variations. None of the additional services or supply obtained via contract variations substantially changed the scope of the contract to the extent that a new procurement process was warranted.

However, we identified the following shortcomings:

- at Housing Authority, 1 contract variation of \$577,830 was approved by an officer above his delegated authorisation limit of \$500,000
- 2 contract variations above \$50,000 at Landgate (\$97,806) and VenuesWest (\$59,245), were not published on Tenders WA in a timely manner, as required by State Supply Commission policies. The variations were published 2 and 9 months respectively after being approved.

Recommendations

All WA government agencies should:

1. ensure their procurement policies and procedures include comprehensive guidance to staff, so that procurement practices are consistently applied across the organisation. Agencies should also regularly review and update their policies and procedures to ensure compliance with relevant policies and guidelines, and contemporary better practice
2. update their contract registers to include all key information, including the minimum information requirements specified in *Treasurer's Instruction 820 Register of Contracts*
3. ensure that adequate documentation is retained for all tenders, including conflict of interest declarations by evaluation panel members, to demonstrate that an open and effective procurement process was followed and that relevant government policies and guidelines were complied with
4. publish contract award and contract variation details on Tenders WA where required by State Supply Commission policies
5. ensure that all new contracts, extensions and variations are approved by officers within their delegated authorisation limits. The delegation register should provide clear guidelines for the approval of contract extensions and variations
6. improve review processes relating to contract extensions, including comprehensive and timely performance reviews before exercising contract extension options
7. review processes for maintenance of contract records to ensure that key decisions are documented and readily available, in accordance with recordkeeping plan.

Agency responses

Agencies in our sample generally accepted our recommendations and confirmed that they either have, or will improve their policies and practices for managing tender processes and contract extensions.

Landgate advised it considers its rating of poor for 'Effective management and monitoring of contract extensions' does not accurately reflect its process. Landgate informed us that contracts are monitored and assessed on a regular, in some cases daily, and ongoing basis and that there were no issues regarding contractor performance when the extension options were exercised, and that evidence of that performance was on the contract management files.

Note: Our rating of poor arose from a lack of evidence that contractor performance was assessed when extending contracts.

The Housing Authority acknowledged the findings and recommendations of the report and advised that since our audit, it has taken steps to address a number of matters including establishment of a procurement training suite, endorsement of the procurement operational framework and enhancements to the delegations of authority register.

Auditor General's Reports

| Report number | 2017 Reports | Date tabled |
|---------------|-------------------------------------|---------------|
| 2 | Opinion on Ministerial Notification | 6 April 2017 |
| 1 | Opinion on Ministerial Notification | 30 March 2017 |

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