

Western Australian Auditor General's Report



Local Government Contract Extensions and Variations and Ministerial Notice Not Required



Report 20: 2019-20

4 May 2020

**Office of the Auditor General
Western Australia**

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The Office of the Auditor General acknowledges the traditional custodians throughout Western Australia and their continuing connection to the land, waters and community. We pay our respects to all members of the Aboriginal communities and their cultures, and to Elders both past and present.

WESTERN AUSTRALIAN AUDITOR GENERAL'S REPORT

Local Government Contract Extensions and Variations and Ministerial Notice Not Required

Report 20: 2019-20
May 2020



**THE PRESIDENT
LEGISLATIVE COUNCIL**

**THE SPEAKER
LEGISLATIVE ASSEMBLY**

**LOCAL GOVERNMENT CONTRACT EXTENSIONS AND VARIATIONS AND
MINISTERIAL NOTICE NOT REQUIRED**

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

This focus area audit assessed if entities adequately managed extensions and variations to their contracts, and if they maintained comprehensive summaries of their contracts.

I wish to acknowledge the entities' staff for their cooperation with this report.

Also included is my determination that a section 82 notice was not required by the Minister for Water.

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

CAROLINE SPENCER
AUDITOR GENERAL
4 May 2020

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WESTERN AUSTRALIAN AUDITOR GENERAL'S REPORT

Local Government Contract Extensions and Variations

Executive summary

Background

Western Australia's 148 local government entities (entities) spend billions of dollars each year on purchasing a wide range of goods and services. A significant number of these purchases involve contracts.

Procurement contracts vary in complexity, value, duration and risk, but all benefit from a strong approach to contract management. Robust contract management processes centred around the principles of probity, accountability and transparency help to ensure that contracting is effective, meets the standards expected by the community and the Parliament and provides good value for money for the ratepayer.

Comprehensive policies and good management of contract extensions and variations are essential to achieving these outcomes. It is important for all entities to maintain a summary of their contracts in a register or database (hereafter referred to as register), with all key contract details, to help effectively manage contract extensions and variations. This is essential from an accountability perspective and also assists entities in meeting their financial reporting obligations.

Conclusion

At 5 entities there was insufficient documentation to demonstrate that extensions or variations were given due consideration, so we were unable to conclude if they were appropriately managed. At 3 entities, some extensions did not have evidence of contractor performance reviews, and at 3 entities some variations were not approved by delegated officers.

Most entities need to enhance their policies with comprehensive guidance. All entities' contract registers lacked key information essential to effective monitoring of contractual obligations.

What we did

The focus of this audit was to assess if entities adequately managed extensions and variations to their contracts, and if they maintained comprehensive summaries of their contracts.

We assessed the policies, procedures and practices for managing contract extensions and variations at 8 entities of varying sizes in both metropolitan and regional Western Australia. We assessed the following criteria:

- Do entities have adequate policies and procedures for managing contract extensions and variations?
- Do entities have complete and accurate summaries of their contracts?
- Are entities adequately:
 - controlling contract extensions, including the review of contractor performance before extending contracts
 - controlling contract variations, and determining if a variation significantly changes the original scope of the contract
 - complying with management approved delegations before a contract is extended or varied?

When testing against these criteria, we had regard for Part 4 of the Local Government (Functions and General) Regulations 1996, which deals with the provision of goods and services, and includes specific requirements relating to contract extensions and variations. In addition, we expected entities to meet the principles of the *Local Government Act 1995*, which requires entities to have policies, and to keep proper accounts and records. We also had regard to the broader principles of good internal control and governance and general better practice principles that help reduce procurement risks and support value for money.

The audit focused on whether controls were in place to support effective management of contract extensions and variations after a contract was finalised. It was not designed to review the adequacy of procurement processes undertaken prior to the signing of the original contracts.

The following 8 entities were included in this audit:

Entities
City of Bayswater (Bayswater)
City of Kwinana (Kwinana)
City of Rockingham (Rockingham)
City of Swan (Swan)
Shire of Narrogin (Narrogin)
Shire of Wagin (Wagin)
South Metropolitan Regional Council (SMRC)
Town of Cottesloe (Cottesloe)

Source: OAG

Table 1: Entities included in the audit

We assessed contract extensions and variations processed from 1 January 2018 to the date of the audits, in mid-2019.

Detailed findings have been reported to audited entities. Their audit committees should follow up to ensure audit findings and recommendations are appropriately addressed by management in a timely manner.

We conducted this audit under section 18 of the *Auditor General Act 2006* and in accordance with Australian Auditing and Assurance Standards. The approximate cost of undertaking the audit and reporting was \$177,500.

What we found

The contract management policies and procedures at most entities lacked appropriate guidance for staff to correctly and consistently process extensions and variations. We also found contract registers at all 8 entities were missing key information required for effective contract management.

We found instances at 5 entities where sound practices were not always followed for assessment and approval of extensions and/or variations. We therefore could not conclude whether this represented probity in purchasing and value for money for the ratepayer.

Policies and procedures need to be enhanced to ensure consistent application by staff

Comprehensive policies and procedures provide clear guidance to staff, help ensure that regulatory requirements are complied with, and that better practices are consistently followed by all staff. It is also important to have clear documentation of delegated authorisations to ensure that all decisions on contract extensions and variations are made by officers within their delegated authority limits.

Kwinana had sound policies and procedures for managing contract extensions and variations, with scope for improvement at the other 7 entities.

We identified the following shortcomings:

- Four entities did not have clearly established authorisations and delegations for the approval of contract extensions and/or variations. Establishing clear lines of responsibility and accountability for all decision making is an important prerequisite to ensuring decisions are made by individuals the entity considers have the requisite skills, knowledge and experience.
- The policies of 5 entities lacked guidance on what constitutes an appropriate contract variation. For example, a contract variation to provide goods and services that is inconsistent with the scope of the original contract, or significantly alters the scope of the original contract is not appropriate. In such circumstances, a separate procurement process would normally be required.
- The policies of 6 entities did not outline the key requirements for processing contract extensions, including that contracts could be extended only if the terms of the original contract included extension options.
- The policies or procedures of 5 entities did not require a documented performance assessment of a contractor before a contract extension option was considered. This increases the risk that poor performing contractors may be granted extensions.
- No entities' policies or procedures required staff to maintain a contract register, with all key contract information.
- Six entities did not require a regular review of their contract registers to identify contracts that are due to expire, so that appropriate action starts 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 impact continuity in the provision of goods and services.

Contract registers did not include key information for effective contract oversight

It is important for all entities to maintain a summary of their contracts, with all key information, to help contract managers effectively manage contract extensions and variations.

The entities in our audit maintained records of their contracts on databases, registers, or a combination of both. One entity did not have any collective record of their contracts at the commencement of the audit, but subsequently provided us with a contract summary. The contract registers at the 8 entities did not include all key contract information. We identified the following:

- The contract registers at 2 entities were incomplete and did not include all current contracts. The register at another entity did not include the commencement, duration and end dates of contracts. A fourth entity's register included inaccurate and/or inconsistent information on key data such as contract values, term dates and the status of contracts. Inaccurate and incomplete contract registers can affect management's ability to effectively manage contracts.
- At 6 entities, the contract registers did not include the dollar value of contracts, or any contract extensions or variations. In addition, at 3 of these entities, registers did not include the estimated dollar value of Schedule of Rate¹ contracts. As a result, inadequate information was available to management on the total cost of their contracts.
- Where relevant, although details of contract variations are contained within individual contract management plans, none of the entities' contract registers included summarised information on approved contract variations, such as the number and dollar value of individual variations, and the total value of approved variations. This information is essential for contract managers to effectively track the cumulative value of contract variations, evaluate the impact on the scope of the original contracts, and initiate separate procurement processes where appropriate.
- At 4 entities, contract registers did not include information on the number and duration of extension options available under each contract and details of extension options that were exercised. This information would enable better monitoring of contracts, including the timely exercise of contract extension options.
- The contract registers at 6 entities did not have details of scheduled performance review dates, to ensure that timely reviews of contractor performance were performed prior to considering contract extension options.

Some entities need to improve their assessment of contractors' performance before extending contracts

A contract extension may extend the agreed terms for a further period and/or involve changes to price, personnel and services. We expected to find evidence that contract managers had performed an adequate and timely review of contractors' performance before granting an extension. This would provide management with adequate opportunity to assess if the contractor still offered value for money.

¹ Schedule of Rates contracts are used where the nature of contract work is certain, but the exact amount of work to be performed cannot be predicted at the outset and is inherently provisional in nature. Nonetheless, tenders are usually invited and awarded based on the range of estimated quantities.

All entities except Rockingham and Kwinana exercised contract extension options during our audit period. One of the 6 did not have detailed records of the total number and value of contract extension options exercised. Based on the contract registers of the remaining 5 entities, 51 contract extension options totalling \$19.6 million were exercised during the audit period.

We tested a sample of 18 contract extensions totalling \$13.6 million across the 6 entities. Narrogin, Wagin and SMRC had adequate processes in place for the extension of contracts.

At the other 3 entities, we noted the following shortcomings:

- At 2 entities, 6 of 7 contract extensions did not have any formal documentation to demonstrate that an assessment of contractor performance was conducted before the contract extensions were approved. We were therefore unable to conclude if there was adequate review of contractor performance before exercising the extension options. This increases the risk that poor performing contractors may be granted extensions. The total value of 5 of these extensions was \$1.4 million, while the value of the remaining extension could not be determined as the original contract was not available.
- Three extensions at 2 entities totalling \$1.48 million were approved after the expiry of the initial contracts. One of the entities advised that there were extenuating circumstances that resulted in a short period when some key functions were performed later than usual. Renewal processes that are not initiated well before the expiry of contracts, limit the entities' ability to assess whether the contracts still offer the best value for money. This also potentially impacts the continued supply of goods and services.
- For 2 of 5 contract extensions at 1 entity, there was no mutually accepted agreement or correspondence between both the parties to extend the contract.

Contract variations were not always adequately explained at 2 entities

Contract variations are amendments to a contract that change the original terms or conditions. Variations are usually used to alter the scope of the supply or services provided or to change pricing. We considered if contract variations, individually or cumulatively, significantly altered the scope of the original contract. This may indicate that an entity was using variations to avoid undertaking a new procurement process.

All entities except Wagin undertook contract variations during the period of our audit, although only 5 were able to provide detailed information of the total number and value of their contract variations processed. The contract registers of these 5 entities showed 63 variations totalling \$6 million. We reviewed 27 contract variations totalling \$5.2 million across the 7 entities.

At 2 entities, 4 of 12 variations were not supported by detailed proposals with descriptions of the nature and reasons for the variations, including associated cost, time and scope implications. We were therefore unable to conclude whether the variations had been approved based on adequate analysis of these implications and whether value for money assessments had been performed.

Delegation levels were not always complied with when extending or varying contracts

It is important that all decisions relating to the approval of contract extensions and variations are made in accordance with approved authorisation limits. This ensures that these decisions are valid, and are made by staff with the experience and knowledge commensurate with the value and complexity of the contracts involved.

We reviewed the approval processes of 27 variations valued at \$5.2 million and 18 contract extensions totalling \$13.6 million across all 8 entities and identified the following shortcomings:

- At 2 entities, 7 variations totalling \$1.2 million were approved by officers in excess of their delegated authority.
- At a third entity, we identified 2 variations to a contract totalling \$77,395 that significantly changed the scope of the original contract, increasing the contract value in excess of the \$150,000 tender threshold limit. The consequent waiver from tender was approved by an officer who did not have the delegated authority.
- Two extensions totalling \$73,058 at 1 entity did not have any documented evidence of their approval. We were therefore unable to conclude if an appropriate officer had approved them. This reduces transparency and accountability in decision making and increases the risk that the mandated level of scrutiny is not applied.

Recommendations

1. All local government entities, including those not sampled in this audit, should:
 - a. ensure their policies and procedures include comprehensive guidance to staff on recording of contract information and management of contract extensions and variations, so that better practices are consistently applied across the organisation
 - b. establish specific delegated authorisation limits for the approval of contract extensions and variations
 - c. ensure their contract summaries include all key information relating to contracts. The level of information should be based on their assessment of the significance, number and complexity of their contractual arrangements
 - d. ensure that records of key decisions are retained in accordance with their recordkeeping plans and are readily available
 - e. improve review processes relating to contract extensions, including timely and documented reviews of contractor performance before exercising contract extension options
 - f. ensure that contract variations are supported by adequate documentation describing the nature and reasons for the variations, including the associated cost, time and scope implications. The cumulative impact of variations on a contract should also be reviewed and an assessment made of whether a separate procurement process should be undertaken
 - g. ensure that all contract extensions and variations are approved in accordance with approved delegations, to ensure that all contracting decisions are subject to appropriate levels of scrutiny.
2. Entities should review their policies and procedures against the principles in Appendix 1.

Under section 7.12A of the *Local Government Act 1995*, all sampled entities are required to prepare an action plan addressing significant matters relevant to their entity for submission to the Minister for Local Government within 3 months of this report being tabled in Parliament and for publication on the entity's website. This action plan should address the points above, to the extent that they are relevant to their entity, as indicated in this report.

Response from entities

Entities in our sample generally accepted the recommendations and confirmed that, where relevant, they have amended policies and administrative systems, or will improve practices for managing contract extensions and variations.

Appendix 1: Better practice principles

The following table shows control principles on which our audit focused. They are not intended to be an exhaustive list.

Management of contract extensions and variations	Focus area	What we expected to see
Policy	Policies and procedures	<ul style="list-style-type: none"> Contract management policies and procedures are regularly reviewed to ensure compliance with current legislation and relevance to current operations. Policies or procedures include a requirement to maintain a comprehensive register or database of all contracts, including: <ul style="list-style-type: none"> the dollar value above which contracts are to be included in the register, and the custodian of the register with responsibility for regular review and update of the contract register or database. Policies include clear guidance on what constitutes a contract variation and when a separate procurement process is required. The policies or procedures provide guidance on the key processes for contract extensions, including timely and documented assessments of contractor performance prior to exercising an extension option.
	Delegations	<ul style="list-style-type: none"> There are appropriate delegations and authorisations in place for procurement as well as for contract extensions and variations.
Records	Comprehensive register of contracts	<ul style="list-style-type: none"> A comprehensive register of all contracts is maintained, with all key contract information.
Contract extensions	Contract terms	<ul style="list-style-type: none"> Contracts are extended only if the original contract includes extension options.
	Approval	<ul style="list-style-type: none"> Contract extensions are approved by an appropriate officer, in accordance with delegated authorisation limits. Extensions are approved before the expiration date of the original contract or previously extended term, for continuity in the provision of services.
	Contractor performance review	<ul style="list-style-type: none"> There is documented evidence that contractor performance has been assessed before a contract extension is approved.

Management of contract extensions and variations	Focus area	What we expected to see
	Recordkeeping	<ul style="list-style-type: none"> • There is documented evidence that the terms of the contract extension have been mutually agreed by the entity and the contractor. • Documents for approval of contract extensions are retained in accordance with recordkeeping plans, to promote accountability and transparency in decision making.
Contract variations	Approval	<ul style="list-style-type: none"> • Contract variations are approved by an appropriate officer, in accordance with delegated authorisation limits. • Consideration is given to the cumulative impact of variations, to ensure that the scope of the original contract is not significantly altered, and that a separate procurement process is not required.
	Proposal for variation	<ul style="list-style-type: none"> • Contract variations are supported by proposals with detailed description of the nature of the variation, with associated cost, time and scope implications.
	Recordkeeping	<ul style="list-style-type: none"> • The variation proposals and approval documents are retained in accordance with recordkeeping plans, to promote accountability and transparency in decision making.

Source: OAG

Ministerial Notice Not Required

Ministerial notice not required

On 24 March 2020, we received 2 notices from the Minister for Water, the Hon David Kelly MLA, under section 82 of the *Financial Management Act 2006* (FMA) in relation to Legislative Assembly Questions on Notice 5872 part (6) and 5873 part (c).

On 10 December 2019, the Hon Terry Redman MLA asked the Minister for the following information:

Legislative Assembly Question on Notice 5872

(1) I refer to the recent Freedom of Information (FOI) released by Water Corporation including a redacted copy of "PRA Business Case" arguing the value of "insourcing the Perth Region Alliance", and ask?

(6) Will the Minister table a copy of the "Alliance Agreement" referenced on page 10 of the business case?

On 19 March 2020, the Minister replied:

(6) The Alliance Agreement is a commercial contract arrangement between the Water Corporation and Programmed Facilities Management.

Legislative Assembly Question on Notice 5873

I refer to the decision by Water Corporation to insource the services currently provided under the Aroona Alliance, and ask:

(c) Can the Minister table the Aroona Alliance contract;

On 10 March 2020, the Minister replied:

(c) The Alliance Agreement is a commercial contract arrangement between the Water Corporation and the Alliance partners.

The Minister's notices advised that the Perth Regional Alliance Agreement and the Aroona Alliance Contract could not be provided to Parliament, as their release would disclose commercially confidential and sensitive information.

We determined that the 2 notices were not required in this instance, as the information does not concern the conduct or operation of an agency as required by the FMA. Section 85 of the *Water Corporations Act 1995* outlines the limited application of the FMA and the *Auditor General Act 2006* to the Water Corporation, but this does not cover section 82 of the FMA.

The Audit Practice Statement on our website (www.audit.wa.gov.au) outlines the circumstances when a notice is unlikely to be required. These include when the requested information does not concern the conduct or operation of an agency as required by the FMA.

Auditor General's reports

Report number	2019-20 reports	Date tabled
19	Control of Monies Held for Specific Purposes	30 April 2020
18	Information Systems Audit Report 2020 – State Government Entities	6 April 2020
17	Controls Over Purchasing Cards	27 March 2020
16	Audit Results Report – Annual 2018-19 Financial Audit of Local Government Entities	11 March 2020
15	Opinion on Ministerial Notification	28 February 2020
14	Opinion on Ministerial Notification	31 January 2020
13	Fee-setting by the Department of Primary Industries and Regional Development and Western Australia Police Force	4 December 2019
12	Audit Results Report – Annual 2018-19 Financial Audits of State Government Entities	14 November 2019
11	Opinion on Ministerial Notification	30 October 2019
10	Working with Children Checks – Follow-up	23 October 2019
9	An Analysis of the Department of Health's Data Relating to State-Managed Adult Mental Health Services from 2013 to 2017	9 October 2019
8	Opinions on Ministerial Notifications	8 October 2019
7	Opinion on Ministerial Notification	26 September 2019
6	Opinions on Ministerial Notifications	18 September 2019
5	Fraud Prevention in Local Government	15 August 2019
4	Access to State-Managed Adult Mental Health Services	14 August 2019
3	Delivering Western Australia's Ambulance Services – Follow-up Audit	31 July 2019
2	Opinion on Ministerial Notification	26 July 2019
1	Opinions on Ministerial Notifications	19 July 2019

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