Western Australian Auditor General’s Report

Local Government Procurement

Report 5: October 2018-19
Local Government Procurement
LOCAL GOVERNMENT PROCUREMENT

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

This was a narrow scope performance audit, conducted under section 18 of the Auditor General Act 2006 and in accordance with Australian Auditing and Assurance Standards. Narrow scope performance audits have a tight focus and generally target compliance with legislation, public sector policies and accepted good practice.

The audit objective was to determine if local governments have effective procurement arrangements in place.

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

CAROLINE SPENCER
AUDITOR GENERAL
11 October 2018
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Auditor General’s overview

I am pleased to present this performance audit on aspects of local government procurement that require close attention.

Local governments in Western Australia manage more than $40 billion in community assets and spend over $4 billion annually on community infrastructure and services such as roads and footpaths, public halls, recreation facilities and rubbish collection.

Good procurement practices centred around the principles of probity, accountability and transparency are key to managing procurement risks and the delivery of good outcomes for ratepayers. When procurement processes are not followed, or local governments are seen not to be acting in the best interests of their communities, they face reputational damage and expose themselves to the risk of fraud and misconduct. Unfortunately, there are numerous recent reports from integrity agencies which highlight the very real consequences when procurement activities in the public sector are not managed effectively.

My report highlights weaknesses in procurement controls, processes and documentation across the 8 local governments we audited, as well as the need for them to build procurement capability to give staff the knowledge and skills to effectively carry out their jobs. These generally reflect areas for improvement identified in our previous audit reports about State Government entities as well as other public reports.

Some local governments disagreed with the significance of a number of control weaknesses identified. Local governments considered that a finding was not worthy of a ‘significant’ rating if the control weakness did not result in a breach of regulations or the audit did not find evidence of wrongdoing. While legislation places minimum specific requirements on local governments, they still need to ensure they have strong internal controls and good governance. Controls prevent things going wrong and are particularly important in financial management processes, where there is an inherent risk of financial misappropriation. I welcome discussion on this matter and am pleased all local governments have committed to amending their policies and procedures and improving internal controls over purchases, where required.

The findings from this audit have helped me identify areas worthy of future audit attention. Fostering enhanced understanding in the local government sector about the importance of strong internal control frameworks, around not only procurement, but over a wide range of areas, including information system security and regulatory functions, will be prioritised in our future work. I encourage all local governments to review their procurement practices against the focus areas of this audit.
Executive summary

Introduction

The objective of this audit was to assess the effectiveness of procurement arrangements at 8 local government entities (LGs) of varying sizes in both metropolitan and regional Western Australia.

Background

There are currently 148\(^1\) LGs in WA. The population and geographical spread of each LG varies significantly, from small regional LGs like the Shire of Sandstone with a population of around 90, to large metropolitan LGs like the City of Stirling with a population of around 220,000.

LGs in WA employ around 15,000 people and manage more than $40 billion in community assets. In 2016-17, the total expenditure across all Western Australian LGs was over $4 billion.

Procurement activities in LGs are primarily governed by the Local Government (Functions and General) Regulations 1996 (the Regulations). The Regulations require LGs to have policies for purchases that are expected to be less than $150,000. LGs develop their own policies, which are required to cover things like the form (verbal or written) and minimum number of quotes that must be obtained, and how procurement information will be recorded and retained.

For purchases over $150,000, the Regulations set specific requirements for public tender. These include advertising, acceptance and rejection of tender applications, notification of outcomes, and maintaining a tenders’ register.

The Regulations also allow for exemptions from the public tender process, these include, but are not limited to:

- certain emergency situations
- if a contract is to be awarded through auction (with Council approval)
- if goods and services are obtained through the WA Local Government Association’s (WALGA) Preferred Supplier Program – a program of suppliers that have been pre-qualified to supply certain goods and services. WALGA members, of which most LGs are, can access the program.

LGs that are members of WALGA can also access a procurement toolkit that includes purchasing and contract management templates. LGs that use WALGA services are still required to meet their own policy and probity requirements and comply with the Regulations.

There are a number of procurement processes and controls that help reduce broader procurement risks and support value for money (Figure 1). Some of these are covered in Regulations, others are based on sound practice.

Due to a variety of factors affecting the way that LGs procure, we did not expect to find identical procurement practices across the LGs included in our audit. The audit therefore required significant judgement when assessing proper procurement practices. However, we did expect them to meet the principles of the Local Government Act 1995 which places obligations on councils to oversee the allocation of the LG’s finances and resources, and for determining the LG’s policies, as well as for LGs to keep proper accounts and records.

\(^1\) This includes 137 LGs, 2 Indian Ocean territories and 9 regional councils.
Furthermore, LGs are required to establish efficient systems and procedures for financial management which includes procurement.

Our audit focus areas are set out in Appendix 1. We reviewed the processes and controls used by LGs, but we did not review if procurement decisions attained the best value for money or outcomes for LG communities.

![Figure 1: Procurement framework](source: OAG, with blue shading showing areas within audit scope)

**Audit conclusion**

All 8 local governments we reviewed had shortcomings in their procurement practices, most related to weak procurement controls, processes and documentation for tendering, purchase orders and approvals, and reviewing invoices and payment. However, we did not identify any evidence of misconduct.

Local governments varied in how well they complied with legislation and their own procurement policies. While local government’s policies broadly met regulatory requirements, they need to do more to monitor procurement controls and the effectiveness of processes. We saw no notable difference in the effectiveness of controls between the regional and metropolitan, and the small and large local governments we examined.

Having policies and controls that are appropriate, and monitoring their effectiveness is essential if local governments, and the ratepayers that they serve, are to have confidence in local government procurement activities. Procurement practices that focus solely on minimum compliance with legislation are unlikely to provide local governments with the oversight and control they need to address risks and ensure value for money in their procurement.

The issues identified in this audit are relatively simple to fix. By addressing them, governance of this important local government function can be strengthened.
**Summary**

We reported 86 detailed findings across the 8 LGs. This included 11 significant findings across 5 LGs, and 41 moderate and 34 minor across all 8 LGs. Figure 2 shows the findings against all our audit focus areas.

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**Figure 2: Summary of key findings**

Source: OAG
Findings per local government

The issues we identified represent weaknesses in key policy and control principles. Figure 3 shows the breakdown of findings for each of the 8 LGs we reviewed, and shows no specific trends across size or location of the LG.

![Figure 3: Key findings by LG](source: OAG)
Recommendations

All LGs, including those not sampled in this audit, should review their policies, processes and controls against the focus areas of our audit in Appendix 1.

Each LG we audited should provide an action plan to address this recommendation, table it with their Council, and make it available on their website, as per the Local Government Act 1995.
Response from local governments

Local governments in our sample generally accepted our recommendations and confirmed that, where relevant, they have either amended their policies, procedures or administrative systems or will improve controls for monitoring and managing procurement activities.
Audit focus and scope

The audit objective was to determine if LGs have effective procurement arrangements in place.

The specific lines of inquiry were:

- Have LGs established policies and procedures for procurement of goods and services?
- Is there effective oversight and control of procurement activities?

We visited and reviewed the following LGs:

- Town of Bassendean
- Shire of Dalwallinu
- City of Fremantle
- City of Greater Geraldton
- Shire of Harvey
- City of Kalgoorlie Boulder
- City of Karratha
- City of Karratha
- City of Stirling.

We assessed LGs against the policy, training, and sourcing audit focus areas shown in Appendix 1. This audit did not review if procurement decisions attained the best value for money or outcomes for LG communities.

At each LG we selected 20 transactions with a value under $150,000. For these items we reviewed recordkeeping of procurement activities, segregation of duties, quote processes, decision and approval delegations, LG policy and compliance with the Regulations. We also reviewed LGs use of WALGA’s Preferred Suppliers as a procurement route, but did not review the arrangements in place at WALGA.

We reviewed a separate sample of 5 tenders from each LG. We assessed them against the requirements in the Regulations, including where and how long they were advertised, how submissions were recorded, if assessments were completed and recorded and if tenderers were notified of outcomes. We also reviewed how LGs recorded and assessed declarations of interests for tender evaluation panels and where applicable, council agendas, minutes and reports.

This was a narrow scope performance audit, conducted under section 18 of the Auditor General Act 2006 and in accordance with Australian Assurance Standards ASAE 3500 Performance Engagements. We complied with the independence and other relevant ethical requirements related to assurance engagements. Performance audits primarily focus on the effective management of agency and LG programs and activities. The approximate cost of undertaking and tabling of this audit was $470,000.
Findings

While all LGs had procurement policies and procedures, they are not always effectively and consistently used

All LGs had policies and training in place to support staff in the procurement process. However, we found examples where LG procurement activity did not comply with their own policies, either because staff did not understand the policy requirements, or the policy did not meet the LG’s needs. This included instances where the purchasing method used did not comply with the LG’s own policies:

- 5 of the 8 LGs had instances of staff not seeking and recording quotes in line with their own policies
- 2 LGs had purchases that should have gone to tender, but did not.

LGs do not always purchase in line with their own policies

We found 23 purchases across 5 LGs, one of which had 8 instances where staff did not obtain quotes or failed to record them in accordance with their policies. Seeking and recording quotes promotes open and effective purchasing. When LGs do not comply with their own policies it reduces the likelihood they will get value for money and increases the potential for misappropriation of funds.

We also identified 2 purchases at 2 LGs that should have gone to tender, but did not. One LG sought quotes for the purchase from a number of suppliers, but did not tender. The other accepted a quote from a single supplier. Neither process met the tender, or exemption requirements under the Regulations. Tendering for high value purchases supports LGs in understanding the market and encourages open and effective competition for suppliers.

All LGs had procurement policies but there is opportunity to improve

All 8 LGs we reviewed had purchasing policies. At the time of our audit, 1 LG had a high level policy which did not meet the requirements of the Regulations. The LG has since updated its policy to meet requirements.

LGs should review their policies to ensure things like purchasing thresholds and quote requirements reflect current needs. In doing this LGs demonstrate they meet regulatory requirements and are fit for their purpose. The issues identified above, around non-compliance with policy, also highlight an opportunity for LGs to review the appropriateness of their policies. Non-compliance can indicate a lack of understanding by staff, or that policies no longer meet the needs of the LG.

LGs provided staff with procurement training

All 8 LGs provided procurement training to staff. Three LGs delivered procurement training programs that included both induction and set refresher sessions. We found the training content to be sound as it not only covered policy and legislative requirements, process and procedures, but also provided essential context around procurement compliance and probity.

The other 5 LGs provided training at induction, through on-the-job activities or as a result of policy updates. We found this training covered policy requirements, but provided less context around procurement risks and individual accountability. These LGs also lacked a clear approach to providing refresher training.
The Corruption and Crime Commission’s 2015 *Report on Misconduct Risk in Local Government Procurement*\(^2\) (CCC report) identified inadequate training as one of the risks common to procurement related misconduct in LGs. Structured training and regular refresher training helps LGs manage this risk and reduce the number of instances of non-compliance with LG policies.

**LGs need better procurement oversight and controls**

We found weaknesses in key controls around approvals, segregation of duties, and checking of invoices at the 8 LGs. This exposes LGs to unnecessary procurement risks, such as improper use of funds or paying for goods and services not received.

**Controls over raising and approving purchase orders could be improved**

We saw a range of control weaknesses over purchase orders across all LGs, these included:

- 5 purchase orders across 4 LGs that were approved by staff without the appropriate authority to do so. All LGs maintained lists of the role, position and dollar value limits of staff that are authorised to approve purchase orders. However, these approval limits were not always complied with, which increases the risk that goods or services are procured by someone without the proper experience or authority to determine the best value purchase for the LG.

- 13 instances across 5 LGs where purchase orders were raised after invoices were received. Purchase orders act as an internal approval and control mechanism to proceed with a purchase. These controls are ineffective if purchase orders are raised after goods and services have been received. It is not possible for the LG to determine who approved the initial request for the goods or services, and if they had the proper authority to do so.

- We found a small number of purchase orders at 3 LGs that were raised for $0 or for a nominal value (e.g. $0.91) that did not reflect the expected spend. This was despite there being a known budget, quote or existing contracts for many of these items. Purchase orders should be raised for the full, expected amount prior to the purchase being made and approved by someone with appropriate delegation. This increases the likelihood that expenditure will be capped or monitored.

**LGs should strengthen processes for checking goods and services when receiving them**

We identified 36 invoices across 8 LGs that could not be verified against purchase orders, quotes or contracts. The invoices contained insufficient detail to reconcile them against agreed contract milestones and price schedules, but had still been approved for payment by the LG. The invoices included instances of LGs being overcharged and undercharged. Verifying invoices for payment is an important control to ensure that LGs have received the expected goods and services and that they have been correctly charged.

It is important that even small variances are checked as these are more likely to go undetected for long periods of time. The CCC Report identified supervisors not checking payment processes and work actually done on contracts as common risks to procurement related misconduct.

Sound practice is to ensure that there is evidence to support all transactions and that a clear audit trail exists. This includes documentation for contract payments, any variations, and reviewing supplier invoices for accuracy.

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LGs had weaknesses in their segregation of duties

Five of 8 LGs had not effectively segregated key steps in the procurement process or had insufficient records to show controls had been followed. For example:

- In 9 of the 20 purchases we reviewed at 1 LG, the same person had approved purchase orders, checked that goods and services had been received, and approved invoices to progress for payment. The 9 purchases totalled less than $150,000.

Four LGs captured insufficient information for us to independently verify who was receiving goods and services and approving invoices to progress to payment. Without clear records the risk of inappropriate payments is increased and the effectiveness of monitoring controls is reduced.

Stronger controls would include, where possible, the implementation of automated systems that require segregation across the different procurement functions.

Segregation of duties is a key internal control which assumes the risk of two or more people making the same error or colluding to defraud is less than an individual acting alone. The CCC Report identified failure to separate duties as a risk common to procurement related misconduct. The report cited the example of one person being able to be involved in various stages of organising contracts and authorising payments. Segregating duties is one key way LGs can reduce this risk.

In smaller LGs, where resources are limited and full segregation is more difficult, the increased involvement of other senior staff in checking purchases and controls can mitigate this risk.

While we identified weaknesses in individual segregations, we did not identify any purchases where one person was the sole approver for all steps in the process, including payment.

Procurement decisions and conflict of interest considerations need to be better documented

To ensure accountable and transparent procurement activities LGs need to document key processes. This includes justifying the use of sole supplier exemptions, tendering decisions and potential conflicts of interests.

Exemptions from seeking quotes are regularly used, but are poorly documented and not always justified

All 8 LGs claimed exemptions from procurement policies for purchases we reviewed. Exemptions can improve efficiency in procurement activities, but need to be properly managed and sufficiently justified. They should not be used to avoid testing the market. Of the 8 LGs:

- 5 LGs did not have sufficient records to support sole supplier exemptions, 3 LGs did.
- 1 LG used the sole supplier provisions 5 times for purchases totalling nearly $150,000 but did not keep records to support these exemptions in line with its own policy. In 1 instance, when we requested support for the use of the sole supplier provision the LG advised that the supplier was an authorised distributor of a product, not that they were a sole supplier.

There are opportunities for LGs to be more transparent and efficient around when exemptions can be applied. For example, 1 LG achieved this by including a list of purchase types that were exempt from policy requirements (e.g. legal fees, utilities). Ideally this list

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3 Western Australian Local Government Accounting Manual, Section 7 – Internal Control Framework, p 27.
would be approved by Council. Reporting higher value exemptions to Council, or a committee of Council (such as the Audit Committee) would also improve transparency and accountability. One LG already included this reporting mechanism in its policy.

**Recording of tender processes and conflict of interests could be improved**

Under the Regulations tenders have a number of specific requirements. We found 7 LGs could improve the information they captured on tender processes, for example:

- proof of when and where tenders have been advertised
- individual tender panel assessments
- sufficient detail in individual panel member workbooks to support awarding of scores.

Complete records provide transparency that tenders are handled and assessed in line with regulatory requirements and the LG’s policy. All LGs are required to maintain a Tenders Register and make it available for public inspection. All LGs maintained a public register but only 1 had the information available on its website. Making the register available online can reduce barriers to how the public accesses the information and increase confidence in tender processes.

We found 1 LG did not have a clear record to support why Council did not accept the tender evaluation panel’s recommendation. Evaluation panels only make a recommendation to Council, who are not obliged to accept the recommendation. However, keeping a record of Council’s reasons for not following a tender panel’s recommendation supports the principle of transparent and accountable decision making and the requirement to keep proper records of the affairs of the LG.

We also identified weaknesses in how 5 LGs recorded declarations of interest for tender evaluation panel members. Declaring an interest doesn’t automatically exclude someone from taking part in the evaluation process. However, there should be a clear record that a declaration has been made and signed, reviewed by someone with appropriate authority, and assessed as to whether it results in an actual, potential or perceived conflict of interest. The decision made on how to remove or manage the conflict should be clearly recorded.

Weaknesses we identified are shown in Figure 4.

**Declarations of interest and management of conflicts – Tender panels**

Four of the 8 LGs we reviewed had weak processes:

- 2 LGs required panel member declarations of interest, but for some samples none were recorded and for other samples some panel member declarations were retained, but others were missing
- 1 LG had instances of incomplete and unsigned panel member declarations
- 1 LG had 3 instances where panel members had declared interests and they were appropriately recorded. However, it was not clear how the interests were addressed. In all but 1 instance the panel member remained on the evaluation panel.

One LG only required panel members to complete a declaration if a conflict existed. Providing positive assurance by requiring declarations from all panel members is a sound approach that encourages all staff to engage with the process and consider if any real or perceived conflicts of interest exist.

**Figure 4: Weaknesses in the management of conflict of interest declarations**
## Appendix 1: Audit focus areas

The following table shows our audit focus areas. They cover a number of sound procurement practices and controls, and are not intended as an exhaustive list.

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<th>Procurement Framework</th>
<th>Focus Area</th>
<th>What we expected to see:</th>
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| Policy                | Policy             | • LGs regularly review policy to assess if value thresholds and quote requirements reflect current needs  
• policies are clear about when and how to apply exemptions  |
| Training              | Training           | • LGs provide all staff involved in the procurement process with training in relevant policy and processes  
• training emphasises personal accountability and how probity and transparency relate to procurement  
• LGs provide staff with refresher training  |
| Seeking quotes        | Seeking quotes     | • that business requirements were determined prior to engaging suppliers  
• LG staff used the right purchasing method, as required by their own policies and the Regulations  
• that the use of exemptions was justified and documented  |
| Tendering             | Tendering          | • that tenders were advertised, opened, assessed and recorded in line with the Regulations  
• documentation was retained to support open, fair and transparent decisions, and show that processes have been followed  
• that a Tenders Register was maintained in line with Regulations  |
| Conflict of interest  | Conflict of interest | • that tender evaluation panel members provide positive assurance declarations  
• that declarations were retained and there was a record of how they were assessed and how any conflicts were addressed  |
| Sourcing              | Purchase orders and approvals | • that purchase orders were raised for the full expected amount of the procurement  
• purchase orders were approved by staff with appropriate authority  
• internal approvals were obtained before goods and services were purchased  |
|                       | Segregation of duties | • appropriate segregation of duties across the procurement process  |
|                       | Reviewing invoices and payments | • any differences between invoice charges and quoted or contracted rates had been reviewed and appropriately justified  
• goods and services were received and approved by staff with appropriate authority  
• that there were strong controls around payment of suppliers and access to bank accounts  
• documentation was retained to support open, fair and transparent decisions, and show that processes have been followed  |
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