



Report 23: 2022-23 | 14 June 2023

FORENSIC AUDIT

Contractor Procurement – Data Led Learnings



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.

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WESTERN AUSTRALIAN AUDITOR GENERAL'S REPORT

Contractor Procurement – Data Led Learnings

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14 June 2023

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**THE PRESIDENT
LEGISLATIVE COUNCIL**

**THE SPEAKER
LEGISLATIVE ASSEMBLY**

CONTRACTOR PROCUREMENT – DATA LED LEARNINGS

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

This forensic audit was an exercise to develop our forensic data analytics methodology, using contractor procurement data from the Public Transport Authority to seek to identify red flags that could indicate undisclosed relationships or corrupt procurement practices.

I wish to acknowledge the entity's staff for their cooperation with this audit work.

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

CAROLINE SPENCER
AUDITOR GENERAL
14 June 2023

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Auditor General's overview

Significant amounts are invested annually across the Western Australian public sector to deliver core services to our community, and we expect the procurement of goods and services to be based on the relationship between value for money, timeliness and quality. The risk of public funds being diverted by fraud or corruption increases when we add influence to this equation, especially when the decision on what to buy, how much and who from can be at the discretion of one individual. There is a constant vulnerability to bias and favouritism when engaging third party contractors and independence, actual or perceived, can be difficult to navigate where suppliers are:



- limited (providing specialist services)
- proven to deliver as a result of prior engagement by the entity
- consulted in advance to ensure the procurement request seeks the appropriate goods and services.

Mitigating this vulnerability requires a well-structured, sustained approach by all State government entities, particularly those engaging in high volume procurement of contractors. Robust policies, controls and well targeted analytics is important.

The Public Transport Authority (PTA) has previously identified and reviewed anomalies within its contractor data and focused attention over recent years on improving the probity of its procurement activities. This work led to the removal of a qualified controls audit opinion for the PTA for the 2021-22 financial year.

The PTA informing us of these anomalies allowed us to assess the data analytic capability of our forensic audit function and test a key model intended for regular deployment in future audits, searching for contractor fraud and corruption red flag indicators. I am pleased to note, in addition to anomalies identified by the PTA, our tools and techniques identified additional red flags and contracts for review.

Any data analytic red flag represents unexpected or unusual results which may have legitimate reasons for sitting outside the curve. A flag does not, of itself, indicate fraud or corruption. Deeper review of 'red flags' is required. In this audit, we noted historical vulnerabilities in conflict-of-interest processes, due diligence and contract management. Our review did not give rise to a suspicion of fraud or corruption, but did highlight procedural, mathematical and documentary gaps that could have been exploited by those dishonestly inclined.

We recognise and thank the PTA for open, honest and frank dialogue during the audit, without which our capability could not be tested and these lessons could not be shared.

While corrective steps have been taken within the PTA to resolve the historical vulnerabilities we identified, the Western Australian public sector can benefit by us sharing those experiences.

Executive summary

Introduction

This audit was an exercise to develop our forensic data analytics methodology, using contractor procurement data from the Public Transport Authority (PTA) within the Network and Infrastructure division (N&I) and Office of Major Transport Infrastructure Delivery (OMTID), to seek to identify red flags that could indicate undisclosed relationships or corrupt procurement practices.

We are encouraged by the PTA's self-identification and detailed review of various irregularities in the procurement process.

Our review covered a five-year period from 1 July 2016 to 30 June 2021. We note that, in addition to legislatively driven change including in the *Procurement Act 2020*, the PTA has advised of other internal reforms to policy, process and control.

Background

The State Government currently has a multi-billion dollar road and rail transport infrastructure investment program, which includes new works and maintenance on existing assets.

Transport portfolio entities engage with an extensive network of contractors. In 2021-22, the PTA spent \$367 million on contractors.¹ This level of spending, coupled with the portfolio's broad and diverse procurement, creates potential risks and vulnerabilities to fraud and corruption.

The OMTID was established in May 2020 as a centre of excellence between the PTA and Main Roads Western Australia for major project delivery.

The PTA's N&I manages, maintains and upgrades the metropolitan railway infrastructure.

The PTA has a sound level of awareness of risks in its operations, including many procurement risks. The PTA informed our Financial Audit team that it had previously considered its procurement process in the N&I, reviewed the issues identified in Table 1 and made changes to their process to mitigate these risks. This information aided the scope of our forensic audit work.

Issue	Description
Suppression of bids	Contractors collude with one another to determine who will not bid or will withdraw from the process.
Shadow bidding	Contractors collude with one another and agree to submit inadequate bids.
Rotation of bidding among vendors	Contractors collude with one another to alternate the business among themselves and subcontract to the unsuccessful contractors.

Source: OAG based on PTA information

Table 1: Procurement risks identified by the PTA

Our initial data testing and review of procurement systems identified high risk PTA contractors within OMTID and N&I.

¹ Public Transport Authority, [Annual Report 2021-2022](#), PTA, Perth, 2022, p 99.

Entities use many types of contracting arrangements to perform a number and range of services and functions. Contractors may be at true arms-length or embedded in the operations of an entity in a role akin to an employee, or any range in between. The Corruption and Crime Commission commented on the nature of embedded contractors:

There is a serious misconduct risk in the wider public sector where there is insufficient oversight of contractors embedded in public agencies on rolling short term contracts.

Embedded contractors typically work within public agencies for an extended period alongside public officers, and in some instances, performing the same role as a public officer.

There is a risk embedded contractors may act in their own self-interest and not for the public benefit. A contractor may 'drag' projects out to ensure they have ongoing work, or favour other external parties by influencing referrals of work from public agencies. The insecurity of a contractor's position might, perhaps, be felt increasingly keenly with the passage of time.

The fees paid to embedded contractors are public monies, and as such, there should be appropriate mechanisms in place to ensure the work performed and the conduct of the contractors adheres to the same standards of propriety required of all public officers. The Commission considers the community would expect this level of accountability when public monies are expended, and especially when contractors are performing what would otherwise be a public officer function.²

Our examination of the PTA was focused on the risks associated with contractor procurement and contract management.

Data analytics within our forensic audit function assessed contractors within N&I and OMTID and identified 127 awarded contracts for further interrogation, of which we only examined contractors not already reviewed by the PTA.

Conclusion

It is pleasing to see the identification of risk and response by the PTA. While not indicative of wrongdoing, we found fraud and corruption vulnerabilities that could have been exploited in the PTA's previous procurement practices through instances of undeclared conflicts of interest, unmanaged conflicts of interest, inadequate supplier due diligence and contract management issues.

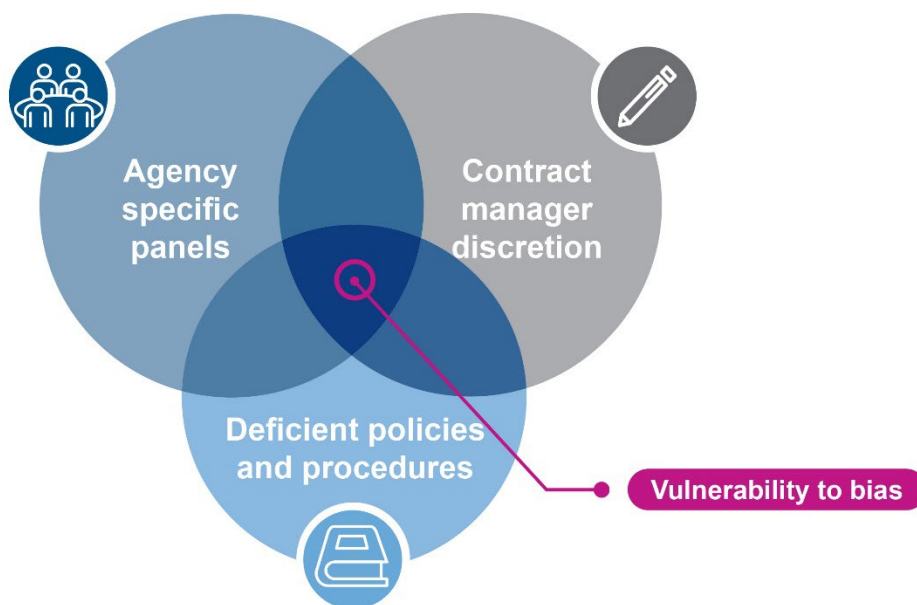
² Corruption and Crime Commission, *A report on corrupt procurement practices and conduct in the Department of Communities*, CCC, Perth, 2022, p. 53.

Learnings

Procurement processes vulnerable to favouritism or bias

State government entities are able to establish agency specific panels and these are supported by State procurement guidelines.³ Panels are established for consistent, large volumes of goods or services. All suppliers appointed to the panel can deliver the required good or service. An example of an agency specific panel being manipulated was identified by the Corruption and Crime Commission in a 2022 report on individuals within the Department of Communities.⁴

Guidance should be provided, and decisions clearly documented, when work allocation is left to the discretion of an individual. Without these, there is a risk that bias or personal relationships may influence the allocation of work. This increases the risk of fraud or corruption occurring.



Source: OAG

Figure 1: Agency specific panel's bias risk

Case study 1: Agency specific panels

At the PTA during the period examined, direct quotations were only needed from one supplier on the agency specific panel if the value of work was estimated to be below \$150,000. The contract manager had the discretion to select which supplier to approach for a direct quote. We were unable to find documented policies or procedure, or case-based records, outlining relevant considerations when exercising this discretion.

The PTA advised that its policy is contractors listed on the panel are not guaranteed work and it has implemented:

³ Department of Finance, [Agency Specific Panels](#), Government of Western Australia website, n.d., accessed 16 May 2023.

⁴Corruption and Crime Commission, *A report on corrupt procurement practices and conduct in the Department of Communities*, CCC, Perth, 2022, pp 8-10.

- updates to its procurement rules and guidelines with the introduction of the *Procurement Act 2020*
- a requirement for reviews by senior procurement staff to ensure that the appropriate levels of due diligence are undertaken
- panel buying transferred to a specialist branch
- regular contract reviews (end of contract or during variation consideration).

Conflict of interest management

If conflicts of interest, including perceived conflicts, are not declared and appropriately managed, there is a risk that procurement is influenced in such a way that fraud or corruption occurs or value for money is not achieved.

The risk of influence in the procurement environment increases when there are only a handful of companies providing specialised services.

Case study 2: Conflict of interest declarations

During some of the period examined by our review the PTA could not provide conflict of interest forms for a number of staff on evaluation panels. There were no forms for 16 of the contracts we examined and for three evaluation panels we found the declarations lacked disclosure of perceived conflicts.

The three perceived conflicts related to panel members also being listed as a referee on a supplier's submission. The PTA advised it identified these conflicts and managed them by using an alternative referee. Whether a genuine conflict of interest exists or not, it could be perceived that the evaluation panel member could improperly or unduly influence the evaluation of suppliers for the contract so extra care must be taken to ensure unbiased procurement.

The PTA advised that the specialised nature of the work meant there was:

- a limited pool of suitable panel members
- most panel members would have an existing relationship with the tendering businesses.

The PTA also advised that, in September 2021, it launched an online conflict of interest form and portal and all declarations, management plans and review of management plans are now stored in an online repository.

Due diligence on suppliers

Good due diligence includes not just checking the Australian Business Number exists⁵, but also assessing other information sources to ascertain the financial stability, ability to perform and any reputational history of a supplier. This includes maintaining records justifying why new companies have been approached or reputational concerns need not be an issue. This increases transparency across an entity.

⁵ Checking for an Australian Company Number is not an indicator of a business registration – Australian Business Names and the Australian Business Register (which includes Australian Business Numbers and further details of holders) should be primary sources used in due diligence processes in conjunction with company searches.



Source: OAG

Figure 2: Supplier due diligence checklist

In the absence of appropriate due diligence there is the risk that an entity can be exposed to risks including the engagement of illegitimate or poor performing suppliers, non-delivery of services, overcharging for services and false invoicing. Not knowing your staff, customers and suppliers creates risks for any entity.

Australian Standard 8001:2021 *Fraud and Corruption Control* includes a number of points on managing the fraud and corruption risk by business associates⁶. Due diligence is a critical aspect of managing this risk.

Case study 3: Supplier due diligence

Our analysis identified one contract awarded to a supplier affiliated with an individual with drug trafficking convictions. The individual was a director of the supplier for one year, during which time it was engaged by the PTA. We identified this through open-source intelligence⁷. There is no record of the conviction being identified by the PTA.

The contract was originally awarded for \$90,200 and was procured by direct sourcing under the Aboriginal procurement exemptions. A subsequent variation took this total to \$282,700.

In another instance, a contractor was invited to quote only four days after it was registered on the Australian Securities and Investments Commission. There is no record justifying why a four-day old company was asked to quote or how it was deemed capable of providing the services given its infancy. Our examination identified that the supplier's director was a previous PTA contractor who had established a new business. While not documented, the PTA was of the view the contractor was capable of providing the services required.

The PTA advised that it conducts due diligence taking into account a variety of factors including the financial and operational risk presented by the suppliers. The PTA is satisfied with the level of due diligence being driven by the risk to the procurement, the entity or broader State Government.

⁶ Business associates includes, at section 1.4.4, suppliers, vendors, sub-contractors, joint venture partners and a number of other parties.

⁷ Open source intelligence is the practice of collecting information from published or otherwise publicly available sources.

The PTA regularly reviews its risk profile and this is taken into account when reviewing due diligence requirements.

The PTA also relies on the new debarment regime put in place by the Department of Finance as part the *Procurement Act 2020* to dictate which suppliers cannot be used by entities.

Contract costs and contract splitting

Excessive variations may be driven by market factors however may also indicate poor budgeting. Contracts requiring regular and repeated variations should be reviewed with remediation steps documented. Excessive variations may obscure the transparency of procurement but also increases the risk of fraudulent claims arising.

Accidental errors in procurement should be properly recorded, identifying the root cause for the error and lead to appropriate process improvement to prevent it happening again. Approving variations that do not reflect on the true cause of the error increase the risk of fraudulent variation claims being approved.

The Department of Finance notes a red flag or warning sign of procurement fraud is tender threshold avoidance, including contract splitting.⁸

Contract splitting is where one contract is divided into smaller quantities, amounts, phases or sub-contracts for the purpose of evading or circumventing competitive bidding and the requirements for alternative methods of procurement.

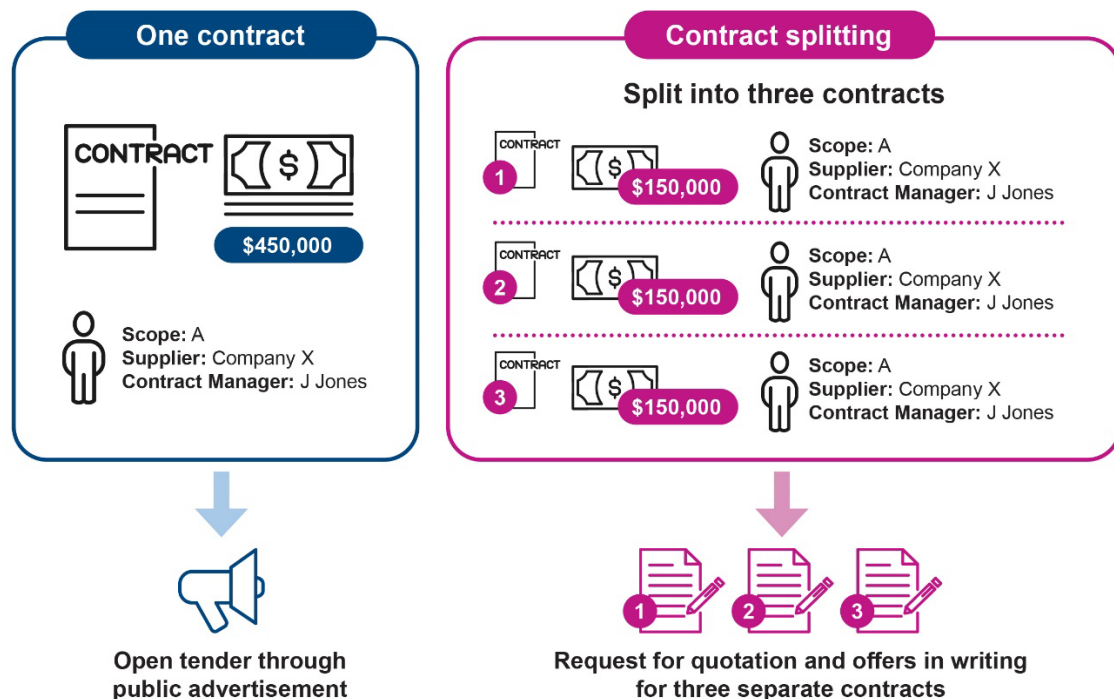


Figure 3: Contract splitting

Source: OAG

⁸ Department of Finance, [Red flags during pre-tender](#), Government of Western Australia website, 11 November 2020, accessed 16 May 2023.

Splitting contracts may sacrifice a fair and equitable procurement process for large value contracts and create additional costs where economies of scale could be achieved. Without a fair and equitable procurement process, there is a risk that value for money is not achieved, procurement is not competitive, preferred suppliers are being selected or fraud or corruption is occurring.

Case study 4: Contract costs and contract splitting

Our sample identified one contract in the PTA's records with 19 price variations over a five-year period, increasing the cost from approximately \$1.5 million to just over \$2.1 million (41% increase).

An error in the budget for another contract (one day per week instead of five) meant the contract cost was underestimated by 80% (\$84,480 instead of \$422,400) and the wrong procurement method was used. This error meant a significant variation was required only 11 weeks into what was meant to be an initial 46-week contract.

The variation stated that 'the contract was based on a budget of 505 hours' however:

- contract submissions provided hourly rates, not total cost or hours required
- the budget (which was 80% understated) showed 384 hours
- the request for quote estimated 1,840 hours.⁹

We also noted instances where contract managers created multiple separate contracts for similar goods or services. For example, similar services were required at three different locations. The PTA established three standalone contracts with consecutive contract numbers, awarded to the same supplier by the same contract manager on the same date.

The PTA advised that it has implemented a rigorous review approach to all contract variations to ensure that extending the contract reflects the best decision for the entity and will still result in value for money being received for the State Government.

The PTA also advised that it provides continued education and training with respect to the cost estimation in order to award contracts for the appropriate value the first time. More prescriptive information is being asked in the development of contract management plans which should also assist contract managers identify where the risk of variations might need to be considered in the procurement.

To encourage greater accuracy, the PTA is also implementing a process for pre-procurement estimates to encourage greater accuracy in understanding potential costs of services.

⁹ The calculation of 505 hours is arrived at by dividing the incorrect budget / contract award amount of \$84,480 by the winning hourly rate. This equates to around 10.97 hours per week where the request for quote required 'full time' for 46 weeks.

Recommendations

All State government entities should review their procurement and contract management arrangements and the fraud and corruption risks they present, this includes:

1. ensuring that conflicts of interest, including perceived conflicts, are declared, independently reviewed and recorded. Develop and document management plans that mitigate the risks associated with any perceived or actual conflicts identified
2. conducting due diligence on all suppliers that are awarded a contract and embed a practice of further enquiry where results conflict with standard expectations
3. reviewing contract management processes including contract variations and contract costing
4. developing controls that mitigate the risk of corruption occurring such as the regular rotation of contract managers and independent review of contract awards.

Response from the Public Transport Authority

The PTA would like to thank the Office of the Auditor General (OAG) for the opportunity to participate in one of the first of its type forensic data audit. The PTA is acutely aware of the risks and vulnerabilities that can exist within procurement processes within all agencies but especially within an agency with the volume and magnitude of spending of the PTA.

The PTA has taken the opportunity to review its procurement practices with the introduction of the *Procurement Act 2020* and was pleased that the recommendations identified by the OAG have already been implemented by the PTA.

While no process can be infallible, through continuous education and vigilance the PTA is working towards ensuring that the risks associated with procurement have been mitigated to as low as reasonably practicable.

The PTA acknowledges and appreciates the time spent by the staff from the OAG in getting to know and understand the PTA's business and operations, which ultimately led to this report – which is hopefully a constructive and beneficial report for all agencies.

The PTA looks forward to working with the OAG in a similar fashion in the future.

Audit focus and scope

Our objective was to develop our forensic data analytics capability, using contractor procurement data. Our focus was to:

- Identify undisclosed conflicts of interest between entity employees and vendors that had been awarded contracts.
- Identify links between vendors engaged in competitive quote submissions that may have compromised procurement processes.

This audit focused on procurement within the Public Transport Authority Network and Infrastructure division (for the period 1 July 2016 to 30 June 2021) and the Office of Major Transport Infrastructure Delivery division (for the period 1 May 2020 to 30 June 2021) jointly operated by PTA and MRWA.

Selecting areas for a forensic audit does not mean we suspect fraud or corruption is occurring; however, our audits are targeted by the combination of various fraud risk factors. Our intent is, preferably, to identify vulnerabilities that can be eliminated before fraud has occurred.

Profiling of procurement patterns and spend was used to identify high risk vendors and commissioning staff. Highly probable exceptions were identified for further investigation.

Forensic testing methods included but were not limited to:

- detailed data analytics on contract metrics
- data matching across data sets to uncover conflicts of interests
- examination of documents including requests for quote, tenders, supplier responses, contracts, variations documentation and payments data
- reviewing panel selection and make up of panel members.

This was an independent forensic audit, conducted under section 18 of the *Auditor General Act 2006*. The approximate cost of undertaking the audit and reporting was \$510,000.

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Auditor General's 2022-23 reports

Number	Title	Date tabled
22	Effectiveness of Public School Reviews	24 May 2023
21	Financial Audit Results – State Government 2021-22 – Part 2: COVID-19 Impacts	3 May 2023
20	Regulation of Air-handling and Water Systems	21 April 2023
19	Information Systems Audit – Local Government 2021-22	29 March 2023
18	Opinions on Ministerial Notifications – Tourism WA's Campaign Expenditure	27 March 2023
17	Information Systems Audit – State Government 2021-22	22 March 2023
16	Opinions on Ministerial Notifications – Triennial Reports for Griffin Coal and Premier Coal	22 March 2023
15	Opinion on Ministerial Notification – Stamp Duty on the Landgate Building, Midland	8 March 2023
14	Administration of the Perth Parking Levy	16 February 2023
13	Funding of Volunteer Emergency and Fire Services	22 December 2022
12	Financial Audit Results – State Government 2021-22	22 December 2022
11	Compliance with Mining Environmental Conditions	20 December 2022
10	Regulation of Commercial Fishing	7 December 2022
9	Management of Long Stay Patients in Public Hospitals	16 November 2022
8	Forensic Audit Results 2022	16 November 2022
7	Opinion on Ministerial Notification – Tom Price Hospital Redevelopment and Meekatharra Health Centre Business Cases	2 November 2022
6	Compliance Frameworks for Anti-Money Laundering and Counter-Terrorism Financing Obligations	19 October 2022
5	Financial Audit Results – Local Government 2020-21	17 August 2022
4	Payments to Subcontractors Working on State Government Construction Projects	11 August 2022
3	Public Trustee's Administration of Trusts and Deceased Estates	10 August 2022
2	Financial Audit Results – Universities and TAFEs 2021	21 July 2022
1	Opinion on Ministerial Notification – Wooroloo Bushfire Inquiry	18 July 2022

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