

General's Office

SPECIAL REPORT NO. 31

*Purchasing  
Practices*

MAY 1994

VICTORIA

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Auditor-General  
of Victoria

**SPECIAL REPORT No. 31**

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**PURCHASING  
PRACTICES**

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*Ordered by the Legislative Assembly to be printed*

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May 1994

The Honourable the Speaker  
Legislative Assembly  
Parliament House  
Melbourne Vic. 3002

Sir

Under the provisions of section 48A of the *Audit Act* 1958, I transmit the Auditor-General's Special Report No. 31 on Purchasing Practices

Yours faithfully

  
C.A. BARAGWANATH  
*Auditor-General*

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2	▪ Works Contracts Overview - Second Report	June 1983
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# Foreword

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The purchasing function in the Victorian budget sector involves significant annual outlays. Traditionally, this function has been assigned a low priority and various fiascos such as the purchase of some 3 000 kilometres of toilet paper which could not be used in Victorian public sector toilets have attracted parliamentary and public criticism.

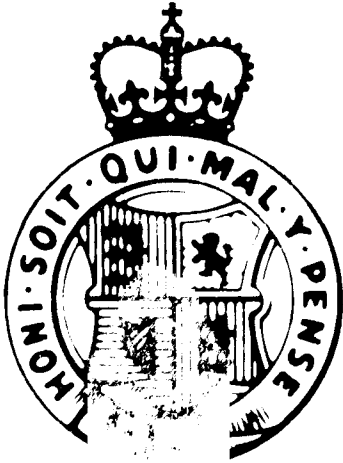
As part of its reform agenda, the Government proposes substantial changes to purchasing arrangements which will address many of the issues raised in this Report. The changes will provide managers with greater autonomy in the day-to-day conduct of their business and the proposed establishment of a Government Purchasing Board should ensure that, in the exercise of such autonomy, the principles of equity and open competition will be maintained.

These are important principles in the public sector where the key factors influencing the supply of goods and services should be value-for-money and a capacity to deliver the required goods and services in a timely manner, and for the contracted price. In the private sector, many large organisations have deregulated the purchasing process thereby permitting employees to arrange purchases with suppliers without the need to consider the claims of other potential suppliers. Such an approach has considerable advantages, particularly in the timeliness of supply and reduction in administrative costs. However, the adoption of these practices in the public sector could leave the Government open to allegations that factors, other than value-for-money and capacity to deliver, have been influential in the selection of suppliers.

The various checks and balances in the public accountability process may be costly to administer and may, as some would argue, be a bureaucratic hindrance in the effective management of a function such as purchasing, but they are designed to protect a Government's reputation and the interests of the public at large.



C.A. BARAGWANATH  
*Auditor-General*



# Part 1

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# Executive Summary



# Part 1.1

## Overall audit conclusion

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**1.1.1** The purchase of goods and services within the Victorian budget sector, valued at \$3.5 billion in 1992-93, represents the second largest cost to government after salaries. This factor, in addition to the significant input goods and services have in the delivery of programs, make it an area where sound management is of key importance to the efficient achievement of government objectives. It is also an area which can be open to public criticism in terms of providing open and fair competition to suppliers. Consequently, aspects of probity, equity and accountability are key considerations for personnel involved in public sector purchasing activities.

**1.1.2** Against this background, it was surprising to find that the purchasing function has traditionally been assigned a low priority in most areas of the budget sector with little attention given to developing a strategic focus for purchasing or to implementing co-ordinating and monitoring procedures at a central level.

**1.1.3** The central framework set in place for purchasing has primarily been limited to requirements to comply with regulations under the *Audit Act* 1958, and ad-hoc policy statements and guidelines issued by agencies with a central role in the purchasing function. While these mechanisms have contributed to the accountability framework, audit is of the view that they have also resulted in undue emphasis on purchasing processes rather than on outcomes such as the achievement of value-for-money objectives. In addition, they have not necessarily created a flexible environment where optimum benefit could be made of innovative developments in purchasing such as co-operative and partnering arrangements.

**1.1.4** As a result of recommendations emanating from a recent consultancy engagement by the Minister for Finance, substantial changes to purchasing arrangements have recently been approved by Cabinet. The proposals will address many of the central management issues discussed in this Report.

**1.1.5** Proposed changes will result in an increase in responsibilities assigned to individual agencies, continuing the trend in recent years towards a devolution of purchasing responsibilities to operational areas. These changes are positive in terms of providing greater autonomy to managers in the day-to-day conduct of their business. However, for the changes to achieve improved efficiency while retaining a sound accountability framework they need to be implemented gradually, on the basis of risk, and within an environment supported by a strengthened central overview function. In this regard, audit strongly supports the proposed creation of a Government Purchasing Board to provide a central focus for this important area of activity.

**1.1.6** Based on the findings in 3 individual agencies, which audit considers are likely to be representative of the budget sector generally, there is also a need for considerable improvement in practices and accountability procedures at an agency level before devolution can be successfully implemented. The areas which will need to be given particular attention are:

- training and development of staff with a view to improving knowledge and expertise in the area;
- greater emphasis on researching the market and adopting the purchasing method which achieves the best value-for-money;
- improving selection processes and contractual arrangements;
- significantly strengthening the accountability framework including compliance with regulations and internal procedures, internal controls, tendering mechanisms and documentation standards; and
- establishing improved information systems, communication processes and monitoring procedures.

**1.1.7** Unless attention is given to addressing these issues, there is considerable doubt as to whether agencies can achieve the best value for the substantial funds utilised in the procurement of goods and services. In addition, if existing weaknesses continue, managers will not be in a position to ensure the risk of erroneous or fraudulent transactions are minimised or to refute any criticisms of inequitable treatment of suppliers.

# Part 1.2

## Summary of major audit findings

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### CENTRAL MANAGEMENT PERSPECTIVE

Page 23

- Failure to take decisive action to address weaknesses in the purchasing area disclosed in internal reviews over a number of years reflects the low priority assigned to this function at a central level. *Paras 4.4 to 4.9*
- The central framework has not been conducive to maximising efficiency and effectiveness in the purchasing function across the budget sector. *Paras 4.21 to 4.24*
- The proposed creation of a Government Purchasing Board is expected to address the current absence of a co-ordinated and strategic focus to budget-sector purchasing. *Paras 4.21 to 4.25*
- Further devolution of purchasing responsibilities to individual agencies needs to be implemented gradually, on the basis of risk, and within an environment supported by a sound central overview of the function. *Paras 4.16 to 4.20*
- Criteria reflecting good purchasing practice need to be promulgated by central agencies to assist in assessing systems and practices of those individual agencies provided with increased purchasing autonomy. *Paras 4.16 to 4.20*
- Basic information on purchasing within the budget sector is not currently available. Information systems will need to be substantially updated if they are to be used by the proposed Government Purchasing Board to effectively monitor purchasing activities. *Paras 4.46 to 4.50*
- Only limited use has been made within the budget sector of electronic data interchange facilities. Given the large volume of transactions generated by purchasing activities, such facilities could achieve substantial savings in administrative effort, time and resources. *Paras 4.51 to 4.55*

## VALUE-FOR-MONEY

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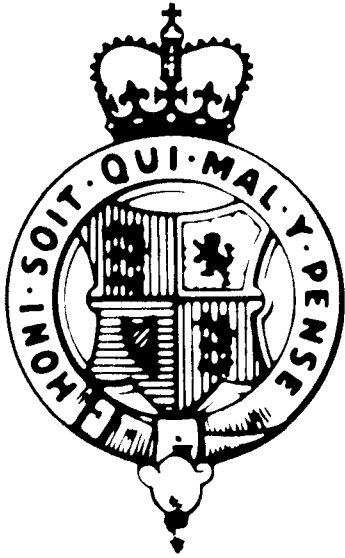
- While some large purchases, such as those arranged by the State Tender Board through period contracts, were supported by well developed specifications, in other instances specifications were not prepared at all or lacked sufficient detail. *Paras 5.5 to 5.17*
- The integration of purchasing into the overall planning for agency activities was found to be deficient. *Paras 5.5 to 5.25*
- Agencies had not given sufficient attention to selecting the method of purchase which best suited requirements or to thoroughly investigating the market to identify the supplier offering the best value-for-money. *Paras 5.26 to 5.63*
- Agencies demonstrated an inclination to use selective rather than open tendering which may have diminished the effectiveness of competition by excluding potential suppliers. *Paras 5.26 to 5.63*
- An absence of clear, relevant selection criteria, poor quality tender evaluation reports, an over-emphasis on price as a selection criteria, coupled with inadequate analysis of whole-of-life costing, were indicative of a poorly managed tender evaluation and selection process. *Paras 5.64 to 5.88*
- Contracts arranged by the State Tender Board provided adequate legal protection to the Government in terms of defining the rights and obligations of the parties to the agreements. *Paras 5.89 to 5.91*
- The quality of contractual arrangements between individual agencies and suppliers varied considerably with instances noted where contractual arrangements were either non-existent or failed to provide adequate legal protection to the agency. *Paras 5.91 to 5.107*
- Poor monitoring of contractual arrangements can lead to payments for goods or services not received. *Paras 5.108 to 5.141*
- The general absence of post-purchase monitoring and assessments of supplier performance resulted in the loss of opportunities to improve supplier products through the identification of poor performance and communication of such information throughout the budget sector for future reference. *Paras 5.108 to 5.141*
- Period contracts arranged by the State Tender Board had not been directed to areas where the greatest savings could be achieved. *Paras 5.113 to 5.120*

**PROBITY AND ACCOUNTABILITY****Page 73**

- State Tender Board approval of purchases with a value in excess of \$50 000 was timely with an average turnaround time of 7 days. The isolated instances where significant delays occurred were generally due to the poor quality of agency documentation submitted to the Board.  
*Paras 6.11 to 6.12*
- Audit questions whether the current State Tender Board approval process adds value to accountability arrangements or whether it merely absolves agency managers from their responsibilities to ensure that value-for-money, probity and accountability have been achieved.  
*Paras 6.13 to 6.20*
- A number of large purchases made by agencies, with a total value of \$1.9 million, had not been submitted to the State Tender Board for approval prior to the engagement of suppliers or, in some cases, making payments.  
*Paras 6.21 to 6.22*
- Tender documentation available in central locations, such as the State Tender Board and the Supply Division of the Office of the Chief Commissioner of Police, was of a high standard reflecting the sound management of purchases arranged by those areas.  
*Paras 6.24 to 6.26*
- Instances of internal control weaknesses and a poor standard of documentation emphasised a need for the accountability framework within agencies to be significantly improved.  
*Paras 6.41 to 6.58*
- Procedures relating to the receipt and evaluation of tenders need to be strengthened with a view to ensuring all suppliers are treated equitably in the tender process.  
*Paras 6.26 to 6.40*

**ADMINISTRATIVE ARRANGEMENTS****Page 89**

- The downsizing of the public sector, together with decentralisation and devolution processes, have contributed to a decrease in the purchasing skill base within agencies.  
*Paras 7.8 to 7.9*
- In many cases, the purchasing function has been given a low priority with responsibilities assigned to relatively junior staff.  
*Paras 7.10 to 7.13*
- There is a lack of a comprehensive training structure at both a central level and within individual agencies. This has contributed to a lack of expertise among staff responsible for purchasing activities.  
*Paras 7.14 to 7.19*
- An absence of relevant information systems, monitoring procedures and communication mechanisms has prevented senior management of agencies from effectively assessing purchasing performance and ensuring that resource allocations and administrative practices adopted are appropriate.  
*Paras 7.20 to 7.31*



# Part 2

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# Background

**2.1** The Victorian budget sector is a major purchaser of goods and services. The goods vary from motor vehicles, office equipment and accommodation to more complex items such as computer software and hardware and goods used in the construction and operation of freeways and hospitals. Government agencies also hire a considerable range of services from the private sector in the nature of consultancy advice and technical support. In more recent times there has been a move towards acquiring certain services from the private sector through contracting-out arrangements.

**2.2** The primary role of the Government's purchasing function is to support a variety of programs managed by agencies. **The procurement of goods and services in the necessary quantities, in the required form, at the right time and at the best price are prerequisites to the cost-effective delivery of services.** As the public sector purchasing function is an area which can be sensitive in terms of providing open and fair competition to suppliers, aspects of probity, equity and accountability are also key considerations for managers of purchasing activities.

## EXPENDITURE ON GOODS AND SERVICES

**2.3** While the consolidated cost of goods and services purchased by all Victorian public sector agencies cannot be readily identified, audit analysis indicates that it represents the second largest public sector cost after salaries. As indicated in Table 2A, the Victorian budget sector alone spends around \$3.5 billion annually on goods and services. The data included in the table is based on budget sector estimated outlays detailed in the document entitled *Restoring Victoria's Finances, Stage 2*, presented by the Treasurer in April 1993, and information contained in the most recent financial statements of large statutory authorities.

**TABLE 2A**  
**ESTIMATED EXPENDITURE, 1992-93**  
((\$billion))

<i>Item</i>	<i>Budget sector</i>	<i>Non-budget sector</i>	<i>Total</i>
Goods and services	3.5	3.0	6.5
Salaries (a)	7.2	4.1	11.3
<b>Total</b>	<b>10.7</b>	<b>7.1</b>	<b>17.8</b>

(a) Includes salaries and salary-related costs

**2.4** It has been estimated in a Commonwealth House of Representatives Standing Committee on Industry, Science and Technology report, *Australian Government Purchasing Policies: Buying our future, March 1994*, that when the costs of goods and services purchased by the Commonwealth and all State and Territory Governments are amalgamated, the annual cost amounts to approximately \$30 billion.

**2.5** In view of the magnitude of these costs, the purchasing power of the public sector can have a material market impact. Consequently, policy decisions and strategies adopted by purchasing managers can influence the achievement of broader government policy directions in the areas of industry development, environmental management and social justice objectives.

## LEGISLATIVE FRAMEWORK

**2.6** Individual Victorian public sector agencies are responsible for decisions regarding the nature and timing of purchases, developing specifications, evaluating tenders and selecting successful tenderers. However, the procedures to be followed and the methods to be used in the purchasing process within the budget sector, which is the focus of this Report, are defined within regulations made under the *Audit Act* 1958. The regulations specify requirements in areas such as public tendering, the seeking of quotations and the payment of accounts. They also require that large purchases, exceeding a specified dollar value, be approved by the State Tender Board.

**2.7** The regulations have been subject to a number of amendments since they were developed over 30 years ago. A major change occurred in July 1993 with the replacement of the then Treasury Regulations 1992 with the Audit (Supply Management) Regulations 1993 and the Audit (Financial Management) Regulations 1993. These new regulations have a planned life of only 12 months, due to the enactment of financial management and audit legislation passed in the current parliamentary session.

**2.8** The requirements of both the current and former regulations provide a framework aimed at ensuring agencies remain accountable for their expenditure, that the need for goods and services is adequately assessed and that procedures promote economy.

## CENTRAL ROLE IN PURCHASING FUNCTION

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**2.9** A number of agencies have a central role in the budget sector purchasing function. Specific details of the roles of these agencies are set out in the following paragraphs.

### Department of Finance

**2.10** The Minister for Finance, in conjunction with the Treasurer, has been assigned responsibility for the administration of those provisions of the *Audit Act* 1958 relating to the payment of public moneys and the development of regulations under the Act. This role, together with the Department of Finance's overall objective of ensuring that government policies relating to financial management are incorporated into agency programs and implemented in a fair and cost-effective manner, impacts on purchasing within the budget sector. The specific objectives of the Department in this regard are to:

- Establish a legislative and operational framework;
- Set in place accountability arrangements; and
- Oversee and monitor purchasing activities. This role includes the issue of guidelines and policies relating to sound financial management practice, for example, those relating to the outsourcing of information technology services and the use of the Victorian Government's Corporate Card.

**2.11** The Commercial Services Group of the Department plays a key role in purchasing activities. The Group, which includes the State Tender Board and the State Supply Service, provides a range of support services to public sector clients on a commercial basis through the application of user-pays principles.



**2.12** The State Tender Board, established under regulations to the *Audit Act* 1958, comprises a Chairman and 4 other members appointed by the Minister for Finance for a period of up to 3 years. The Board has a dual function in relation to purchasing. Firstly, it considers and approves large budget sector agency requisitions for goods and services. Secondly, it determines budget sector agency requirements for certain common-use items, invites tenders for such items and, on behalf of the State, enters into central contracts for the supply of the items to agencies over a specified period.

**2.13** The main role of the State Supply Service is to manage a contract for public sector warehousing and distribution services and to supply a large range of products including equipment, stores and stationery to government agencies and schools.

**2.14** The Information Technology and Telecommunications Division of the Department is responsible for the co-ordination and implementation of cost-effective information technology and telecommunication requirements within agencies. A key function of the Division is to develop appropriate policies, strategies and guidelines on information technology for the public sector.

### **Department of Business and Employment**

**2.15** Within a broad industry policy framework and the context of utilising government purchasing leverage as an industry development tool, the Department of Business and Employment has lead responsibility for the development and administration of a number of government purchasing policies. The approach of the Department is in line with the Commonwealth Government's present approach to industrial development, which has as its central objective the creation of internationally competitive manufacturing and service industries able to survive and grow within a global economy.

### **Department of the Premier and Cabinet**

**2.16** The Department of the Premier and Cabinet issued guidelines in September 1993 for the engagement of consultants. The guidelines are aimed at ensuring engagements are based on consistent standards in relation to fair competition, value-for-money, effective service and the ability to satisfy public scrutiny.

**2.17** In the budget sector these guidelines require that:

- the Premier, or relevant Minister, may undertake random reviews of agency adherence to the guidelines;
- agencies are to provide the Department with 6-monthly summaries of internal evaluations of consultancy arrangements; and
- agencies provide details in Annual Reports of consultants engaged during the reporting period.

### **Department of the Treasury**

**2.18** In May 1993, the Office of State Owned Enterprises of the Department of the Treasury issued guidelines aimed at assisting all agencies in achieving, where possible, a consistent approach to the contracting-out of services. The guidelines address areas relating to the identification of contracting-out opportunities, the evaluation of proposals in terms of costs, benefits and risks, and the management of the tender implementation and monitoring processes.

## RELATIONSHIP WITH NATIONAL PURCHASING BODIES

**2.19** Victorian government agencies are involved in addressing purchasing issues on a national or Australasian basis through representation on the following bodies:

- The *National Supply Group*, formed in the mid-1980s, comprises supply managers from various government contracting agencies throughout Australia and New Zealand. Its principal role is the promotion of purchasing policies and supply expertise. The Group aims to address issues relating to improving and developing the procurement process to achieve uniformity in policies, practices and procedures;
- The *Government Information Technology Conditions Working Party* comprises legal, purchasing and information technology professionals from Commonwealth, State and local governments. Its principal task is to establish national standardised terms and conditions of contracts for government information technology procurement. Other matters which have been considered by the Working Party are opportunities for a joint approach to period contracts, standardisation of specifications for common-use products or services and other co-operative arrangements; and
- The *Standing Committee on Industry and Procurement* includes representatives from the industry development agency of each of the State, Territory and Commonwealth Governments. It is concerned with the use of government procurement to encourage industry development.

## RECENT DEVELOPMENTS IN PURCHASING

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**2.20** The environment in which purchasing managers operate has been subject to a number of developments in recent years including changes in administrative arrangements and increased complexity in the techniques used for the procurement of goods and services.

### Devolution of responsibilities

**2.21** Purchases by budget sector agencies have traditionally been made within a regulated framework characterised by centralised approval processes and the need to comply with centrally developed regulations and policies.

**2.22** Administrative reform in recent years, and continued by the present Government, has resulted in the regionalisation of many agencies and increased devolution of responsibilities to agencies with the aim of enabling them to conduct their business with minimal intervention by central agencies.

**2.23** Within the purchasing area, this devolution process has been reflected in the 1993 changes to regulations which provide greater autonomy to budget sector agencies in the purchase of goods and services.

## Increased complexity

**2.24** The mechanisms used and the technology available to assist in the management of the purchasing function within both the private and public sectors have become more complex in recent times. Reforms have included:

- Use of electronic data interchange (EDI) and electronic funds transfer (EFT);
- Use of innovative purchasing arrangements including co-operative tendering by a number of agencies, with a view to maximising purchasing power, and partnering arrangements or strategic alliances involving long-term teaming agreements between 2 or more parties (suppliers and purchasers) with mutually agreed objectives. Such agreements, aimed at enhancing quality, flexibility and customer service, generally result in dealings with fewer suppliers;
- Contracting-out of functions traditionally performed in-house by public sector agencies; and
- Increased emphasis on quality with the ability of suppliers to satisfy quality assurance requirements becoming a major factor in awarding government contracts.

**2.25** As the purchasing area has become more complex and suppliers more sophisticated in negotiating contracts, there has been an increased need for managers to develop specialist knowledge and skills. In addition, the need to maintain sound purchasing information systems has become critical in achieving the efficient and effective use of resources.

## Developments in other public sector areas

**2.26** Government purchasing in all public sector areas is in the process of major reform. At the Commonwealth level, developments have included:

- the establishment of a Department of Administrative Services Purchasing Task Force;
- the initiation of an inquiry into Australian Government Purchasing Policies by the Commonwealth House of Representatives Standing Committee on Industry, Science and Technology (the Bevis Inquiry); and
- the Prime Minister's Statement, *Working Nation, Policies and Programs, May 1994*.

**2.27** Each of these developments has focused on critical issues in relation to government purchasing policies within a broader economic framework. Commonwealth procurement and supply policies are under review and innovative supply arrangements have been negotiated with suppliers within a less regulated and controlled purchasing environment.

**2.28** Change and reform is also occurring at a State level, particularly in New South Wales, South Australia and Western Australia. Modern purchasing techniques have been introduced, as in the case of New South Wales where EDI has been operating for some time, and central bodies have been established with overall responsibility for purchasing policies, training and monitoring.

**2.29** There have also been recent developments aimed at improving local government purchasing. In Victoria, compulsory competitive tendering has been introduced requiring the use of the public tender process in the supply of goods and services to councils. This development is part of the State Government's overall policy agenda for improving local government efficiency and effectiveness.

## REFORM WITHIN THE VICTORIAN BUDGET SECTOR

**2.30** Various aspects of the Victorian budget sector purchasing function have been the subject of a number of internal and external reviews over the past 10 years.

**2.31** The *Report of the Auditor-General, Government Stores Operations, 1984*, identified a need for a significant upgrading in stores management procedures. In summary, the Report concluded that organisations had failed to pay sufficient attention to monitoring and reviewing their stores operations and had not applied modern resource management techniques.

**2.32** An audit of the State Supply Service, included in the *Report on Ministerial Portfolios, May 1993*, found that there was scope for agencies to achieve further savings through greater use of the Service. The Report also highlighted a need for improved strategic planning, marketing and monitoring of stock levels, with a view to increasing usage and meeting customer requirements in a more timely manner.

**2.33** Between 1986 and 1992, several reports were prepared by central agencies addressing particular aspects of the government purchasing function. The reports identified deficiencies in purchasing arrangements and made significant recommendations to address these deficiencies.

**2.34** Although the ongoing review mechanisms have resulted in several changes in the regulatory framework and the management of stores operations, **most aspects of the accountability structures and purchasing methods used by public sector agencies have remained relatively unchanged for many years.**

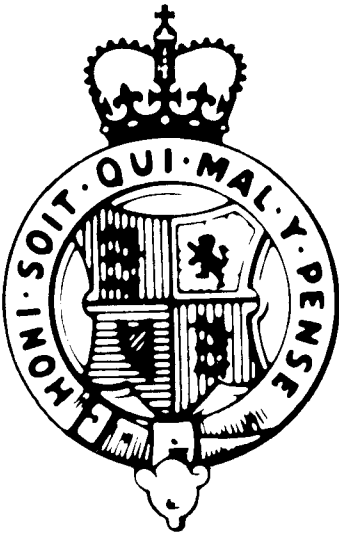
**2.35** In October 1993, the Department of Finance engaged consultants to "*... identify an appropriate range of mechanisms for the acquisition of goods and services by Government Departments and agencies in a cost efficient manner which best meets the needs of the individual Department or agency and withstand public scrutiny*". The objectives of the review were to:

- provide an operating framework for the future acquisition of goods and services by government;
- identify the most appropriate contractual or other supply arrangements for particular classifications of goods and services; and
- evaluate and report on the function and effectiveness of the State Supply Service and its future role in the acquisition of supplies.

**2.36** In April 1994, a submission was made to Cabinet by the Department of Finance recommending significant changes in the purchasing accountability framework, substantially reflecting the findings of the consultancy. The proposed reforms, to be progressively implemented over an 18 month period, include:

- establishment of a new Government Purchasing Board;
- further devolution of responsibilities to agencies; and
- review and amendment of relevant legislation.

**2.37** The implementation of these changes is expected to address a number of the issues raised in this Report. Although the Report primarily discusses the systems and practices in place during 1992-93, the proposed changes recommended by the Department, and their impact, have been taken into account where relevant. Suggestions have also been made in relation to weaknesses disclosed during the current audit which still need to be addressed or will require particular attention under the proposed changed structure.



# Part 3

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# Conduct of the Audit

## AUDIT OBJECTIVE

- 3.1** The overall objective of the audit was to assess the extent to which:
- budget sector agencies achieve value-for-money in their purchasing arrangements, with due regard to probity and equity; and
  - the current budget sector accountability framework is conducive to the effective management of the purchasing function.

## AUDIT SCOPE

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### Examinations in individual agencies

**3.2** The audit focused on purchasing within the budget sector with emphasis on the 1992-93 financial year. To obtain a representative cross section of practices within the sector, examinations were conducted within 3 agencies, namely, the Office of the Chief Commissioner of Police (the Force), the Directorate of School Education and the Department of Arts, Sport and Tourism.

**3.3** The audit concentrated on the purchase of goods and services. Items associated with capital works, with the exception of certain maintenance and repair purchases by the Directorate of School Education, were excluded as this area has been under review by the Parliamentary Economic Development Committee in its inquiry into the Victorian building and construction industry. The Committee tabled its *Third Report* in Parliament in April 1994. Expenditure on grants, electricity, telephone and water charges was also excluded from audit examinations.

**3.4** The following specific areas were subject to audit within the 3 selected agencies:

- accountability arrangements including policy formulation and internal controls;
- planning of purchases and the development of specifications;
- purchasing methods used;
- tendering procedures;
- contractual arrangements;
- post-purchase monitoring procedures;
- compliance with relevant regulations and policies;
- information systems;
- staff training and expertise; and
- administrative arrangements.

**3.5** The audit involved detailed examination of a randomly selected sample of purchases valued in excess of \$50 000. For the purpose of assessing issues of accountability and compliance, a sample of purchases within the \$1 000 to \$50 000 range was also reviewed. Purchases made through agency credit card or petty cash facilities were not selected for examination.

**3.6** Purchases examined were selected from payments made in 1992-93 which included a number of contracts entered into in prior years. The payments were examined for compliance with the Treasury Regulations 1992 which were applicable at the time. Audit acknowledges that changes to these accountability requirements have occurred in recent times with the issue of amended regulations applying during the 1993-94 financial year and the development of new regulations to operate from 1 July 1994. Nevertheless, the audit findings contained in the Report in relation to compliance issues are equally applicable to the revised regulatory framework.

### **Review of central framework**

**3.7** The audit investigations at a central level concentrated on the agencies with key policy responsibility for purchasing, namely the Departments of Finance, and Business and Employment.

**3.8** The audit within the Department of Finance was conducted in 2 parts. The first covered the operations of the State Tender Board and the second, the overview functions of the Department from the viewpoint of the effectiveness of:

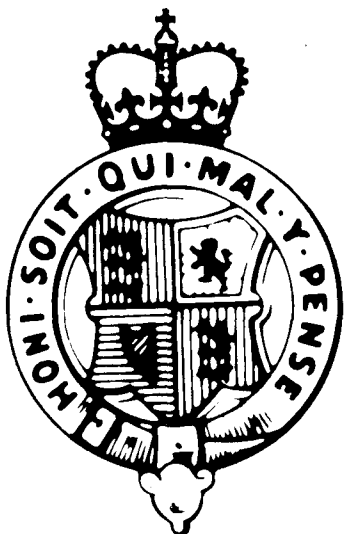
- strategic planning;
- administrative structures and the allocation of responsibilities;
- central monitoring arrangements; and
- management information systems.

**3.9** The roles and activities of the State Tender Board were reviewed in relation to the approval of requisitions submitted by individual agencies, the management of period contracts for common items used across the budget sector and the administration of the Government's Approved Supplier Policy for computer hardware.

**3.10** As the State Supply Service was the subject of a recent performance audit by my Office, detailed examinations of that area were not included in the current audit. For the purpose of assessing the overall role of the State Supply Service, reliance was placed on the findings of the previous audit and on information provided in discussions with representatives of the Department of Finance.

**3.11** The audit within the Department of Business and Employment focused on:

- the effectiveness of the systems to monitor compliance by budget sector agencies with government purchasing policies administered by the Department; and
- the extent of research and analysis undertaken by the Department to measure the effectiveness of purchasing policies within the context of market creation and industry development.



# Part 4

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# Central Management Perspective



## OVERVIEW

**4.1** The absence of a co-ordinated approach and strategic focus for budget-sector purchasing reflects the low priority which has been assigned to this area in the past.

**4.2** As little attention has been given to establishing sound information systems and monitoring procedures, agencies with responsibility for overall purchasing policies have not been in a position to adequately evaluate the effectiveness of their policies or to identify areas where further cost savings could be made.

**4.3** The proposed establishment of a Government Purchasing Board is aimed at addressing a number of the weaknesses which currently exist at a central level. The Board will need to take a key role in developing criteria which can be used in evaluating the purchasing activities of individual agencies and in improving the skill level of staff assigned purchasing responsibilities in those agencies.

## LACK OF STRATEGIC FOCUS

**4.4** As indicated previously in this Report, the budget sector purchasing area has been the subject of a number of reviews in recent years undertaken by the Department of Finance, its predecessors, other relevant central agencies as well as by my Office. The internal reviews identified a range of deficiencies including:

- the need for a revision of Treasury Regulations;
- inadequate data on government purchasing;
- the absence of a co-ordinated policy and procedural manual;
- the need to establish a central procurement agency;
- duplication of procurement and warehousing processes; and
- a need for the State Tender Board to take a more pro-active role in the purchasing function.

**4.5** A report issued by the Commercial Services Group of the Department of Finance in July 1992 referred to a supply reform strategy to be implemented through the State Tender Board and the State Supply Service, aimed at achieving probity, accountability, value-for-money and the maximisation of government buying power within a devolved purchasing environment. The essential elements of the strategy were stated as:

- service delivery on a commercial basis;
- strengthening of centralised contracting;
- private sector facilities management in place of central warehousing;
- introduction of EDI to modernise the buying environment and reduce the time and cost of purchasing; and
- updated regulations to provide flexible guidelines to purchasing agencies.

**4.6** Audit was advised that the strategy was formalised in a submission to Cabinet and subsequently approved. However, a document setting out the specific strategy aims and targets had not been prepared.

**4.7** Action taken to address identified deficiencies and to implement the directions of the strategy have included the consolidation of a number of separately managed stores operations within the State Supply Service, several revisions of the Treasury Regulations, to allow more flexibility in procedures, and the implementation of EDI in some non-budget sector agencies and, in part, within the State Supply Service.

**4.8** Nevertheless, from audit analysis of the current situation, compared with the aims of the strategy and the findings of past reviews, it was evident that many issues, some of which have been identified on several occasions over the past 10 years, have remained unaddressed.

**4.9** Audit concluded that **the failure to undertake more decisive action in this area has reflected the low priority assigned to the purchasing function at a central level. Progress in the area has also been hindered by the absence of a clearly defined strategic focus for purchasing, supported by a plan setting out objectives and future directions together with targets and time frames to rectify deficiencies.**

*□ RESPONSE provided by Acting Secretary, Department of Finance*

*Reform of current purchasing arrangements places emphasis upon the development and dissemination of guidelines within a clearly articulated strategic framework. A key priority of the new Government Purchasing Board will be to undertake this task and to regularly review its effectiveness and ongoing relevance as changes may arise*

## THE DEVOLUTION PROCESS

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**4.10** The development of regulations and guidelines has been traditionally used by central agencies to facilitate the purchase of goods and services in line with policy objectives and within an overall accountability framework.

**4.11** Amendments to the regulatory framework in 1993 represented a significant change in that they increased the responsibilities devolved to agencies. Specific provisions of the Audit (Supply Management) Regulations 1993 have:

- increased the value of purchases requiring State Tender Board approval from \$50 000 to \$100 000;
- increased discretionary powers to agencies to by-pass period contracts arranged centrally by the State Tender Board, on the condition that Board approval for such departures is obtained in advance; and
- provided Departmental Heads with all the powers of the State Tender Board, subject to approval being obtained from the Minister for Finance.

**4.12** Audit analysis of purchases made in selected agencies during 1992-93 indicated that a substantial proportion fell within the range of \$50 000 to \$100 000. Consequently, the change in the value of purchases requiring State Tender Board approval has already resulted in a significant increase in the number of transactions which can now be approved solely at an agency level.

**4.13** Further devolution will result from a proposal recently approved by Cabinet to limit the number of period contracts arranged by the State Tender Board. This action will provide individual agencies with greater responsibility for making arrangements for the purchase of commonly used items.

**4.14** The increase in devolution is positive in terms of allowing increased autonomy to Departmental Heads and less restrictions, at a central level, on the day-to-day conduct of agency business. However, for the changes to achieve economic purchasing while retaining the necessary public sector requirements of accountability, probity and equity, **audit considers that the devolution process needs to be implemented gradually, on the basis of risk, and within an environment supported by a sound central overview of the purchasing function.**

**4.15** This approach is in line with the Government's *Management Improvement Initiative for Victoria* announced in October 1993. Under the Initiative, individual Ministers and agencies have clear responsibility and authority to implement the Government's policies and programs without unnecessary detailed central control. However, the Government has acknowledged in the Initiative that the effectiveness of such measures will depend, in part, on the development of improved monitoring and accountability mechanisms by central agencies.

## ASSESSMENT OF RISK

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**4.16** Devolution of purchasing in the past has primarily been based on the dollar value of individual transactions with the value of those requiring State Tender Board approval increasing from \$10 000 in 1981 to the current level of \$100 000.

**4.17** However, the risks associated with the purchasing function in terms of the failure by individual agencies to achieve value-for-money or to comply with regulations, are not only dependent on the dollar value of transactions but are also impacted by:

- the level of knowledge and expertise of agency staff involved in the purchasing function;
- the internal control framework of the agency including the strength of the internal audit function;
- the size of the organisation and resources available to establish a specialist purchasing function; and
- the type of purchases made by the agency

**4.18** In the light of the above, there is a need for the Government to develop a structured approach to devolution based on the extent to which individual agencies, or transactions, represent a risk in terms of each of these factors.

**4.19** As disclosed in the following Parts of this Report, many agencies have moved in recent years to decentralised structures with significant devolution of responsibilities. In line with this approach, there has been a move away from centralised specialist purchasing areas. This factor, together with the many deficiencies in purchasing practices and basic control weaknesses highlighted throughout this Report, will need to be addressed if the devolved purchasing structure is to operate effectively.

**4.20** To assist in the process, **criteria for determining sound purchasing practices will need to be developed at a central level. In addition, a process to review and evaluate the systems and procedures of individual agencies to be provided with increased responsibility will need to be established.** Such an approach would be in line with that adopted in a number of other States, such as South Australia and Western Australia, which have established an accreditation system or have developed degrees of devolution depending on the competence of the agency. Under the accreditation system, agencies can move from partial devolution to full devolution as their expertise increases. Unlike Victoria, where the requirements to comply with regulations is limited to budget sector agencies, the accreditation and devolution process in some States has extended to all agencies including statutory authorities.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*It is proposed that the new Government Purchasing Board will have responsibility for this function, including the establishment of agency purchasing management performance criteria which will need to be demonstrated prior to the devolution of purchasing to agencies. Similarly, agencies will be responsible for ensuring that appropriate internal control mechanisms are in place and that reports are provided to the Board as required. It is the Department's view that the Victorian Auditor-General's Office has an important role to play in the conduct of audits relevant to agency performance and compliance.*

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## NEED FOR CO-ORDINATION OF CENTRAL FUNCTIONS

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**4.21** Audit considers that within a devolved framework certain responsibilities relating to the purchasing function should remain at a central level, namely:

- policy development;
- strategic planning;
- centralised procurement of common-use items where volume purchases will result in savings;
- providing specialist advice, where needed, including training; and
- monitoring of purchasing activities of the budget sector as a whole and within individual agencies.

**4.22** Unlike a number of other States, such as Western Australia and South Australia, where a central body has been established for several years to perform all of these roles, Victoria has had a number of agencies, or sections of agencies, which have been assigned components of these responsibilities.

**4.23** Audit found that under the current Victorian arrangements:

- responsibility for overall strategic planning and monitoring of purchasing activities has not been clearly assigned;
- specialist skills and knowledge in the purchasing area have been spread across a number of central areas;
- responsibility for the provision of advice to agencies, including training and development of staff, has not been performed or co-ordinated centrally;
- while the 2 Departments with key responsibilities in the area, namely the Departments of Finance, and Business and Employment, communicate on an informal basis on specific purchasing issues, formal co-ordination mechanisms have not existed between the Departments; and
- the role of maximising government purchasing power through identifying common-use items has, in some regards, been shared between the State Tender Board and the State Supply Service.

**4.24** For these reasons, **the central framework has not been conducive to maximising efficiency and effectiveness in the purchasing function across the budget sector.** In addition, the absence of a co-ordinated and strategic approach to purchasing has not reflected the importance of this area of activity in terms of the value of expenditure and its importance in meeting government and agency objectives.

**4.25** Audit strongly supports the proposal recently approved by Cabinet to establish a Government Purchasing Board with overall responsibility for policy development, training, providing advice to agencies and maximising the purchasing power of government.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*The new Government Purchasing Board will have the following functions:*

- *to develop, issue and maintain policies and practices and to provide advice and assistance to departments in supply management risk, purchasing practice and contract management.*
- *to promote improved supply management practices within departments through development of standards and performance measures and provide consultancy services for outsourcing and contracting of services, advice, staff training and accreditation;*
- *to maximise savings to government where appropriate, in purchasing goods and services through value-for-money practices, and open and effective competition;*
- *to promote probity and public accountability in departmental procurement;*
- *to monitor and review the implementation of supply policies and directions and to provide for the audit of departmental acquisition, management and disposal practices and report irregularities to relevant Ministers and the Minister;*
- *to arbitrate on grievances regarding government purchasing;*
- *to foster improvements in the use and application of purchasing systems and standards-based electronic messaging;*
- *to establish and maintain a comprehensive database of purchasing data of departments and supply markets for access by departments; and*
- *to provide an annual report of its operations to the Minister for Finance.*

*The residual functions of the current State Tender Board will be incorporated into the operations of the new Board. Inter-departmental liaison between the Department of Finance and the Department of Business and Employment will continue and the latter agency's role in respect of industry policy development matters is supported by the Finance portfolio.*

**□ RESPONSE** provided by Secretary, Department of Business and Employment

*There is a formal arrangement between departments through joint membership of the Government Supply Advisory Committee (GSAC) and the Inter-departmental Committee on Information Technology. The GSAC is the primary formal mechanism for co-ordinating purchasing activities in the budget and non-budget sectors in Victoria.*

*The creation of the Government Purchasing Board should enhance the relationship because there will be a single point of total responsibility in the budget sector.*

## CENTRAL MONITORING ARRANGEMENTS

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### Department of Finance

**4.26** Although the responsibility for decisions relating to the purchase of goods and services primarily rests with individual agencies, appropriate and relevant monitoring mechanisms should be established both within the agency and at a central level. Monitoring should be aimed at evaluating the extent of adherence with regulations and policies, evaluating outcomes against policy objectives and identifying scope to improve practices. While the internal, and to a lesser extent, external audit functions have a role in this regard, central agencies also have a key responsibility in performing an overview function. Audit considers that such a role should encompass:

- A process of reporting, by agencies, of key data to enable the purchasing activities in the budget sector to be assessed;
- Development of measures to assess performance. Such measures could include the amount of savings made through centralised contract arrangements and the extent of usage of such contracts; and

- Regular evaluation of the effectiveness of purchasing policies and guidelines in achieving overall government objectives

**4.27** From audit analysis and discussions with staff within the Department of Finance, it was evident that such **centralised monitoring arrangements have not been established and as a result the Department has not been in a position to evaluate whether current practices are achieving maximum benefit to the State.**

**4.28** Audit has been advised that the proposed Government Purchasing Board will have responsibility for addressing this issue.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*The new Government Purchasing Board will be responsible for development of purchasing policy and guidelines for agencies, monitoring compliance and reporting to portfolio Ministers and the Minister for Finance. Its role will also include provision of consultancy services to agencies, development of related policy and procedures for the establishment and management of service contracts and for monitoring agency compliance. The guidelines to be provided by the new Board aim to ensure best practice in purchasing activities by agencies and consistency with the Government's objectives in relation to value-for-money, equity and accountability.*

## Department of Business and Employment

### *Policies and guidelines*

**4.29** The Department of Business and Employment is responsible for the administration of a number of government policies relating to purchasing. The following policies, primarily developed at a Commonwealth level in conjunction with the States, are viewed by the Department as mandatory:

- *Government Procurement Agreement.* In line with this Agreement, agencies are required to give consideration to the benefits of purchasing goods and services of local origin and to maximise local content in purchasing wherever possible. The Agreement provides that when evaluating tenders, the goods of New Zealand suppliers are to compete on an equal footing with those available within Australian States, in the expectation that competition will be increased,
- *Industry Support Policies.* Under these policies, overseas suppliers of computer hardware, software and services to Commonwealth, State and Territory Governments are encouraged to enter into activities to foster industry development within Australia. For example, suppliers with annual government sales of between \$10 and \$40 million are to be invited to enter into Fixed-Term Arrangements, usually over 4 years. Suppliers selling over \$40 million annually to government are expected to enter into longer-term arrangements under the Partnerships for Development Program. Both policies are principally aimed at initiating activities which will be of benefit to Australia from an industry development perspective;
- *Victorian Government Offsets Program.* This Program is relevant for all other goods and services not covered by Fixed-Term Arrangements and the Partnerships for Development Program. Under the Program, suppliers of goods with significant imported content are required to enter into an agreement, prior to the awarding of tenders, setting out activities the supplier agrees to perform which will be of benefit to Victorian industry. The Department advised that it is at present exploring alternatives to this Program, such as the development of Industry Impact Statements. Such Statements would be aimed at identifying industry sectors, other than information technology, telecommunications and the vehicle industry, where significant economic benefits could be gained; and

- *Women's Employment Policy.* The Victorian Government, through its agencies, is not to provide industry assistance or let contracts to any firm named in Federal Parliament as failing to comply with provisions of the Commonwealth's *Affirmative Action Act 1986*.

**4.30** A number of other policies administered by the Department are not considered mandatory but are issued in the form of guidelines. These include:

- *Paper Conservation and Recycling Policy.* This policy was developed to promote the purchase and use by agencies of recycled paper and paper products; and
- *Dumped Goods.* Under these guidelines agencies are not to purchase goods which are strongly suspected of being dumped by overseas suppliers. The guidelines are aimed at protecting local industry against unfairly priced imports.

**4.31** The Department is also in the process of developing a policy relating to quality assurance for government procurement. A recommendation relating to this policy is to be presented to Cabinet later in 1994.

### *Supply Policy Manual*

**4.32** As a means of communicating purchasing policies to agencies and assisting in their implementation, the Department issued a Supply Policy Manual to budget sector agencies and statutory authorities in 1986. The manual, which contains details of each policy, has been updated on a number of occasions and contains guidance on several purchasing functions such as the preparation of tender documentation and contractual arrangements.

**4.33** Since January 1993, the Manual has been undergoing further revision with a view to incorporating relevant Commonwealth policy changes. It is also to be updated to provide guidelines reflecting Victorian Government policies on industry development and the economy. Although expected to be completed by mid-1993, the revision was yet to be finalised at the completion of the audit in early 1994.

**4.34** As a result of the delay, the Manual currently utilised by agencies does not reflect certain changes in policy impacting on purchasing. For example, it has not been updated to include information on additions or deletions to the listing of those companies which do not comply with the *Affirmative Action Act 1986*.

**4.35** **For agencies to achieve compliance with the Government's purchasing policies and guidelines, it is important that they are provided with relevant, current, practical information to assist staff responsible for the purchasing function.** The role of this Manual, in particular the appropriateness of the inclusion of general purchasing guidance statements, will need to be clarified within the proposed new structure.

#### **□ RESPONSE** *provided by Secretary, Department of Business and Employment*

*The update of the Supply Policy Manual will occur following formal Cabinet consideration of the industry policy issues of government purchasing.*

*Practical guidance on policies which require some explanation will be included. As well, seminars and training sessions, as previously carried out, will be conducted in association with the Government Purchasing Board.*

### Monitoring compliance with policies

**4.36** For a number of years, the Industry Sectors and Government Supply Unit of the Department have engaged an auditor with responsibility for monitoring compliance by agencies with policies and guidelines. However, from discussions with departmental personnel, it was evident that the scope of examinations in this area has been extremely limited in recent years with no formal audit program carried out in 1992-93.

**4.37** Audit was advised that since the change in government in October 1992, there has been a re-arrangement of priorities within the Unit with increased emphasis placed on the creation of market development through using purchasing leverage in sectors such as telecommunications, defence and information technology. The Unit also promotes the application of advanced supply systems such as Electronic Data Interchange and strategic partnerships.

**4.38** The Unit considers that under these changed priorities a comprehensive audit program is no longer appropriate. Audit also found that the internal audit programs of the agencies examined did not include evaluations of compliance with the policies.

**4.39** In the absence of a comprehensive audit program, **the Department is not in a position to identify areas of non-compliance or areas where guidance and training are needed within agencies in the application of particular policies.**

*□ RESPONSE provided by Secretary, Department of Business and Employment*

*An audit program was in place and regular reports made prior to the period of this audit (1992-93). However, this practice was discontinued due to the need to maximise benefits from reduced resources by focusing on those purchases at Commonwealth and State level that have major strategic benefits for Victorian industry.*

### Evaluation of effectiveness

**4.40** The Department indicated that the leverage available through budget sector purchasing is limited, compared with the non-budget sector, and therefore forms a small part of its industry development activities.

**4.41** Although purchasing policies issued by the Department are not industry specific, audit was advised by the Department that budget sector purchasing decisions can only impact on industry development in the following fields:

- *Motor vehicles.* A recent consultancy arranged by the Department of Finance estimated that budget sector purchasing in this area amounts to \$165 million a year.
- *Information technology.* Budget sector purchases were estimated by the consultant to amount to \$108 million annually, and
- *Stationery and office requisites.* Purchasing in this area involved an estimated expenditure of \$161 million a year.

**4.42** The application of policies or guidelines may, in some instances, result in higher costs to individual agencies, for example, in cases where contracts are awarded to local companies in favour of overseas companies offering cheaper prices. Consequently, it is important that the effectiveness of the policies in achieving their intended objectives are regularly evaluated and their continued application justified.



**4.43** It was evident that limited attention has been given by the Department to such evaluations since the Supply Policy Manual was issued over 8 years ago. Audit was advised that research has concentrated on evaluating the impact of a number of individual purchasing arrangements by non-budget sector agencies. For example, a consultant engaged by the Department reported in January 1994 on the extent of local content achieved by Tattersalls and the Totalizator Agency Board of Victoria in their respective gaming system networks.

**4.44** In the late 1980s, the Department also evaluated the extent of local and imported content of government contracts. While the results of that research led to the establishment of an import replacement initiative aimed at improving local business enterprises and enabling them to compete effectively with overseas suppliers, analysis has not subsequently been undertaken to assess the effectiveness of this initiative

**4.45** Under current arrangements, the Department does not have a comprehensive knowledge of the impact of its purchasing policies or agency practices on Victorian industry.

**□ RESPONSE** provided by Secretary, Department of Business and Employment

*This will be the primary responsibility of the Government Purchasing Board. However, as the Department has a clear interest in the impact of purchasing policies on Victorian industry it expects to play a role in this activity.*

*The major policies contained in the Supply Policy Manual have been reviewed in whole or part, that is the preference policies and the offsets policies.*

*The Government Procurement Agreement (an agreement between all Australian and New Zealand Governments) was introduced in 1986 for an initial 5 year period and contained a monetary reference clause (in Victoria's case, 20 per cent). In 1989 the Bureau of Industry Economics reviewed the impact of monetary preferences and concluded they served no worthwhile purpose. As a result, Victoria and the Commonwealth abolished the 20 per cent preference. Other parties still apply a preference.*

*The Government Procurement Agreement was renewed for a further 5 years without a formal evaluation based on research because it was the view, based on prima facie evidence (a low rate of complaints to the "Designated Bodies"), that the anti-discrimination provisions were working.*

*The Victorian Decentralised Industry Preference introduced in the early 1980s was evaluated and, on departmental advice, abandoned in 1986. (This purchasing policy reimbursed purchasing agencies which were required to give country manufacturers a 5 per cent monetary preference, over metropolitan and interstate suppliers.)*

*At a national level in respect of offsets, the 1984 Inglis Committee of Inquiry made certain recommendations on the value of the policy. These ultimately were reflected in the Australian Civil Offset Agreement which provided the Guidelines under which all offsets schemes were to operate. Due to political pressure connected with GATT, the Agreement has been abandoned. Alternative policies such as the Partnership for Development Program which replaced the Offset Scheme for information technology purchases has been introduced. Although the Partnership for Development Program has never been evaluated in its entirety, the performance of individual partners is evaluated annually.*

*The Victorian Government Offsets Scheme was independently evaluated in 1990. An analysis of purchases revealed that with the removal of the offset policy there would be some one-off purchases where the employment benefits, not necessarily industry development, would be considerable. Thus, 2 years ago, Victoria pushed nationally for the introduction of Industry Impact Statements and Victoria has trialled this concept. (The recent Federal Industry Statement formally establishes this concept on the national level.)*

*The statement that "Under current arrangements, the Department does not have a comprehensive knowledge of the impact of purchasing policies or agency practices on Victoria industry", when coupled with the earlier statement that the State purchases goods and services worth \$3.5 billion gives a false impression of the potential impact of Victorian budget sector purchases on industry development. The amount of purchasing leverage which is not already covered by effective policies, e.g. cars and information technology, is a relatively small percentage of the total.*

*There are no industry sectors where Victorian budget sector purchasing by itself can readily play a significant role in the development of that sector. However, there are instances where Victorian Government purchases can be significant to individual companies, but these tend to occur in the non-budget sector.*

*As stated earlier, the budget sector's information technology purchases are only significant because aggregation under the Partnership Program gives Victorian industry access to Commonwealth leverage in particular.*

*In the medical equipment area, our purchases could have a limited role to play. This role was investigated in the 1989 Health Products Study but a concerted action by all governments was rejected on the grounds that the expected benefits would not justify the costs. In Pharmaceuticals, the driving influence is not our purchases but the Commonwealth police, e.g. Factor F. Our role is therefore one of advocacy to the Commonwealth on behalf of local industry.*

## MANAGEMENT INFORMATION SYSTEMS

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### Monitoring systems

**4.46** In order to undertake their role of assessing risk and setting guidelines and policies, those agencies with government-wide purchasing responsibilities need to have sufficient information for monitoring purchases. Such information should enable the identification of overall trends and purchasing patterns and areas for further savings to government in addition to facilitating strategic planning and measurement of achievements.

**4.47** It was apparent during the audit that even basic consolidated information on purchasing within the budget sector is not currently available. For example, audit could not establish the total annual cost of all goods and services purchased.

**4.48** Information systems at a central level are currently limited to those in place within the State Tender Board. The Board has 11 personal computers connected through a local area network to record data on period contracts and the requisition approval process.

**4.49** Audit was advised that the computer system was intended to be the foundation of the Board's operations. However, due to a lack of systems development since 1990, it is unable to meet a number of the Board's current needs. In particular, the system does not permit prompt access to details of period contracts managed by the Board, the analysis of information provided by computer suppliers under the Approved Supplier Policy or details of agency purchases

**4.50** Audit concluded that the information systems will need to be substantially updated if they are to be used by the new Government Purchasing Board to effectively monitor purchasing activities across the budget sector.

□ *RESPONSE provided by Acting Secretary, Department of Finance*

*A key function of the Government Purchasing Board will be to construct and categorise a comprehensive database of purchasing expenditure across the budget sector to facilitate improved financial management and performance monitoring. Such data will enable monitoring and analysis of trends and commercial opportunities arising in the supply market.*

□ *RESPONSE provided by Secretary, Department of Business and Employment*

*This recommendation will be addressed through the Government Purchasing Board.*

## Electronic trading

**4.51** The Electronic Trading Strategy, issued by the Department of Finance in May 1993, defines electronic trading as the automated exchange or interchange of documents, files and messages in an electronic form between the computers of various organisations. The use of the electronic data interchange (EDI) component of electronic trading, which involves the interchange of standardised documents between the computer applications of 2 parties, is of particular relevance in the purchasing function.

**4.52** The benefits of adopting electronic trading in conducting government business, as defined in the Strategy, include:

- efficiency and other savings through reducing the large volume of paperwork in the form of purchase orders, quotations and account payment documents;
- enhancement of customer service; and
- remaining competitive on a regional, national and international basis

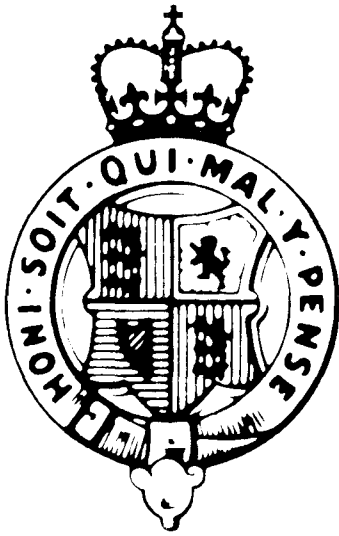
**4.53** Electronic trading has been implemented for some time in the supply function of a number of private sector organisations and in areas of the New South Wales and Commonwealth public sectors. However, **Victoria has been slow to implement such facilities across all areas of the budget sector**

**4.54** The budget sector focus of work in this area has largely been on electronic mail and data interchange to the public ledger. The State Supply Service has also partially implemented EDI for the receipt of orders into its store. Audit was advised that the implementation of EDI within the budget sector has been difficult due to the progressive devolution of responsibilities within many agencies over a number of years.

**4.55** In October 1993, the Government entered into a contract with Telecom Plus for the development and marketing of appropriate software for the implementation of EDI within the Victorian public sector.

□ *RESPONSE provided by Acting Secretary, Department of Finance*

*The role of the new Government Purchasing Board will be to further investigate advantages and administrative savings associated with the development and implementation of electronic trading facilities such as EDI EFT. It is recognised that full benefits are more likely to be generated on a whole-of-government basis. Significant progress is now being achieved in identifying opportunities in the implementation of EDI.*



# Part 5

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# Value-for-money

## OVERVIEW

**5.1** To assist in achieving various program objectives, government purchasing managers need to focus on obtaining value-for-money in the acquisition of goods and services. **Value-for-money not only involves consideration of costs but also relates to issues of quality and timeliness.**

**5.2** Within this context, it is important that sound management operates in all phases of the purchasing process, namely:

- planning the purchase, including developing specifications;
- researching the market;
- selecting the method of purchase;
- evaluating tenders;
- negotiating contractual conditions; and
- monitoring purchasing arrangements.

**5.3** From examinations within individual agencies audit formed the view that there is significant scope for improvement in each of these aspects of budget sector purchasing. In particular, **insufficient attention has been given to ensuring the best value is achieved by selecting the purchasing method which is most appropriate to the size, timing and nature of the goods or services sought.** Greater attention also needs to be given to integrating purchasing into agencies' overall planning processes, taking all relevant factors into consideration in the selection process, improving negotiations with suppliers and strengthening the processes for monitoring purchasing arrangements both during and after the contract period.

**5.4** Specific findings in relation to value-for-money issues disclosed during the audit are detailed in the following paragraphs. Examples arising from the review of selected agencies have been included, where appropriate, as a means of illustrating the deficiencies highlighted in each aspect of the purchasing function. **The use of these examples should not be seen as simply a criticism of the agencies involved in the review, but as indicative of some of the deficiencies in the purchasing function of the whole budget sector.**

## PROCUREMENT PLANNING

**5.5** Effective procurement planning should be aimed at ensuring that the goods or services acquired meet specific requirements, the timing of the purchase supports the organisation's operational needs and, within these parameters, the best available price is obtained.

**5.6** The accurate estimation of the quantity and quality of requirements, or the length of the service provision, is an important aspect of planning. Where requirements are under-specified, the operational needs of the agency will not be met. Conversely, the over-specification of requirements results in unnecessary costs to the agency. Significant extensions to contracts, where under-estimation occurs in the first instance or needs are not soundly planned, may also result in agencies forgoing the opportunity to obtain the best price through maximising their bargaining position.

**5.7** Communication with suppliers at an early stage can assist in the development of specifications and enable suppliers to meet the needs of the government purchasing environment. As the availability of funds to enable the purchase at the right time is critical, the input of the estimated cost of the purchase into the organisation's budgetary process is also an important aspect of effective planning.

**5.8** Audit found that **the standard of specifications developed by the agencies examined varied greatly**. While some purchases, including those arranged by the State Tender Board through period contracts, were supported by well-developed specifications, in other cases specifications were either:

- non-existent;
- prepared by the supplier; or
- not sufficiently detailed to reflect actual requirements.

**5.9** **The integration of purchasing into the overall planning for agency activities was also found to be deficient**. This situation, in some instances, placed managers in a position where they were not able to achieve the most economic outcome as they were required to purchase items in urgent circumstances or arrange significant extensions to existing contracts. Purchases were also noted which were in conflict with the overall strategic directions of agencies.

**5.10** Specific planning issues relating to several of the agencies examined follow

### State Tender Board

#### *Requirements not accurately estimated*

**5.11** Period contracts are agreements between commercial suppliers and the State Tender Board for the supply of goods or services to budget sector agencies at tendered prices. In 1992-93, there were 270 period contracts between the Board and suppliers covering approximately 2 700 items including motor vehicles, motor spirits, office requisites, food and items of computer software and consumables. In addition, there were 180 contracts for the supply of computer hardware under the Government's Approved Supplier Policy.



*Items supplied under State Tender Board period contracts.*

**5.12** The Treasury Regulations 1992 set out procedures to be used by the Board in determining whether common-use goods or services should be covered by period contracts. Under these procedures agencies are required to provide information on their needs for particular items at the beginning of each contract cycle. For maximum savings to be achieved by the Government in its purchasing arrangements, it is important that requirements for common-use items are accurately identified.

**5.13** However, the audit disclosed that the framework in place within the Board was not conducive to effective planning for period contract requirements in that

- Board members indicated that little confidence could be placed on the accuracy of the estimates provided by agencies due to the rapidly changing administrative arrangements and supply needs of agencies;
- Although provisions are contained in all period contracts for suppliers to provide data on the use by agencies of period contracts, the recording and monitoring systems within the Board do not permit any consolidation and analysis of the information provided;
- The data provided by suppliers is in some cases unreliable, incomplete and misleading. For example, statements from suppliers have contained details of purchases made by non-government organisations or have not contained sufficient details of the actual items purchased; and
- Requests for estimates of supply requirements made by the Board to agencies are restricted to categories of goods and services which have been developed and well-established over a long period of time. A mechanism is not in place to regularly determine new areas of supply where period contracts could provide a cost-effective means of procuring the items.

**5.14** A 1991 report of a Working Party on the Co-ordination of Budget Sector Supply Activities identified the need for the standard cataloguing of items purchased throughout the budget sector to assist in identifying common-use items. As such a system has not yet been introduced, the Board does not have accurate data on the requirements for particular items on period contracts or on the use by agencies of available items.

*□ RESPONSE provided by Acting Secretary, Department of Finance*

*The new Government Purchasing Board has a principal role in the identification of competitive pricing opportunities for the purchase of common-use items which agencies can access. This will include accessing other contracts, as appropriate.*

## Department of Arts, Sport and Tourism

### *Inadequate specifications*

**5.15** Owing to the relatively small size of the Department of Arts, Sport and Tourism, purchases requiring a tender process were very limited with only 2 tenders sought during 1992-93, both by the Public Record Office for shelving requirements. While specifications were established for the purchase of approximately \$100 000 worth of shelving, delays occurred while 2 tenderers made offers and counter-offers. These offers resulted from a lack of clarity within the specifications. Audit was advised that action has subsequently been taken to ensure that future shelving requirements are adequately specified prior to tender.

**5.16** Major consultancies during the year were limited to an engagement to prepare an economic impact study associated with the possibility of Melbourne hosting the 2002 Commonwealth Games and one relating to a financial evaluation of, and strategic plan for, the Victorian State Opera. Although briefs were prepared for each engagement, extensions to the contracts, involving additional costs totalling \$20 000, raised doubts as to the quality of the briefs prepared.

**□ RESPONSE** provided by Secretary, Department of Arts, Sport and Tourism

*The need for clear and detailed specifications is acknowledged. The Public Record Office has, since the review, revised its specification for shelving to provide greater detail and ensure tenderers are provided with a clear and precise specification.*

*Appropriate approvals were obtained for the extensions to the 2 consultancies mentioned. In each case, the need for the additional work could not be foreseen. For example, in the case of the economic impact study associated with the possibility of Melbourne hosting the 2002 Commonwealth Games, additional data was requested, due, in part at least, to the success of the Sydney Olympic bid. It was considered more expedient and cost-effective to vary the existing consultancy than to initiate a new engagement.*

## Office of the Chief Commissioner of Police

### Absence of specifications

**5.17** Although the Force has purchased disposable plastic mouthpieces for breathalyser equipment since 1985, it was not until May 1993 that specifications were developed and a contract entered into for the supply of the items. When the specifications were finally prepared and tenders invited for a 2 year period contract, the successful tender was 23 per cent cheaper than the supplier used by the Force for the previous 7 years. As a result, an estimated \$133 000 will be saved over the current 2 year contract, in addition to savings in administrative costs resulting from the elimination of the need to raise regular orders for various quantities of mouthpieces.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*The history of purchasing disposable mouthpieces for use in preliminary breath testing devices dated from 1982. From 1982 to the present time, mouthpiece requirements have risen from an initial 60 000 a year to 2 million a year. The Traffic Alcohol Section has been advised that this volume, plus a 2 year contract, has made it viable for companies to consider the tooling and sterilisation costs.*

### Under-estimation of requirements

**5.18** In August 1991, the Traffic Camera Office prepared specifications and invited tenders for the supply and processing of film for speed and red light cameras. The specifications were based on processing requirements up until early 1992 when an imaging system was expected to become fully operational. Contracts totalling \$842 000 were subsequently awarded to 2 suppliers, based on an estimated requirement of approximately 1.5 million film frames over 2 years.



**5.19** In July 1992, the responsibility for the management of the Traffic Camera Office was transferred to the Force from the Ministry for Police and Emergency Services. As the imaging system had not been implemented by September of that year, the Force requested approval from the State Tender Board for additional photographic services. It was estimated that an additional 1 million frames would be taken before the expiry of the contracts. As a result of the 67 per cent under-estimation in the initial specification, the Force requested an increase of \$2.2 million in the original contract (a 265 per cent increase).

**5.20** In a further case involving the engagement of a supplier to provide a payroll data entry system for a period of 12 months at a cost of \$150 000, the contract was extended on several occasions over a 2 year period at an additional cost of \$367 000. The extensions resulted from a change in priorities in relation to developments associated with the Force's mainframe computer.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*During the period subject to audit, the Victoria Police responsibility at the Traffic Camera Office was limited to the prosecution and enforcement functions of the Office. The Force had no responsibility nor input into the administration of contracts, including tender process.*

*The specification utilised was prepared by the Ministry for Police and Emergency Services and the contract entered into by that body. The deficiencies in the specification were identified by the Supply Division after the Force took over the Administration of the Traffic Camera Office.*

*The Tender advertised in August 1991, stated:*

*"Tenders are hereby invited for the provision of either or all of the following:*

- supply of unexposed film;*
- loading and unloading of film;*
- development of exposed film;*
- printing of photographs (various sizes); and*
- mounting of reversal film.*

*"The period of supply of these services is anticipated to be from 1 October 1991 up to 30 September 1993.*

*"While it is expected that the [imaging] system will be fully operational within 6 months, photographic prints are currently being used.*

*"It is anticipated that following the advent of the imaging system there will be an ongoing photograph printing requirement, but at a lower volume."*

*Tender specifications reflected the Force's obligation to ensure potential tenderers were not misled in terms of expected throughput through the life of the contract. The image-based system, when delivered, would have reduced the work under the contract by over 90 per cent. Contractor set-up costs are amortised over the duration of contracts based on throughput estimates.*

*The expectations of the Victoria Police were not met, rather than the specifications were poorly compiled. Speed camera film demand is totally proportionate to the rate of transgression of speeding motorists. While enforcement hours can be programmed, speeding cannot. Estimates are exactly that.*

*It was envisaged that the payroll data entry system would only reside on the Force's Bureau for up to 12 months while the Force sought additional mainframe capacity. While an annual cost of \$150 000 has been incurred, the benefits of the system have been:*

- *reduction of 10 staff in the Pay Branch with annual savings of \$250 000;*
- *removal of the existing payroll service with annual savings of \$18 000;*
- *reduction in timelines for members allowances from 6 to 2 weeks;*
- *facilitated evolution of the payroll function;*
- *reduction in industrial relations' problems; and*
- *reduction in head office overtime.*

### *Purchases not linked to overall operational plans*

**5.21** During 1990, the Force invited tenders for the supply, installation and implementation of an integrated transport information and workshop management system. Tenders received ranged between \$900 000 and \$1.5 million. However, these offers were considered unacceptable on the basis of cost.

**5.22** In March 1991, it was decided to recall tenders and redraft the tender specifications with the aim of reducing costs. The tender was re-advertised in May 1991 and in September the State Tender Board approved the supply and installation of a fleet management system at a cost of around \$310 000.

**5.23** Audit found that the substantially cheaper system is not compatible with the Force's Information Management Strategy and as such cannot currently be integrated with the Force's network. Consequently, the system, which was originally intended to provide State-wide coverage and access, is only accessible to officers stationed at the Force's Transport Division in Brunswick. District Commanders are, therefore, unable to manage local vehicle fleets through the system.

**5.24** In another instance, a decision was made in June 1992 to operate the Police Workshop in Collingwood on a charge-out basis with a view to assessing its ongoing commercial viability. Although audit was advised that it is normal practice within the Force to halt major purchases in circumstances where an area has been placed under such a review, discussions with personnel at the Workshop and a review of available documentation, indicated a lack of any communication or directive of this nature.

**5.25** In August 1992, shortly after the decision to review the area was made, a Workshop Management and Inventory Software package was purchased for the Workshop at a cost of \$51 300. The State Tender Board subsequently approved a 12 month contract commencing 1 July 1993 for the contracting-out of the Workshop's functions. As a result, the software package has not been used since July 1993.

**□ RESPONSE** *provided by Chief Commissioner, Office of the Chief Commissioner of Police*

*The Fleet Management System purchased by the Force is compatible with the Force's existing EDP network, but requires additional expenditure to implement same. The system is considered to be among the best fleet management systems available and is superior in many respects to the best tender lodged in 1990, i.e. speed of data retrieval, flexibility of report generation and ease of system support. The system has automated many routine functions of managing the Victoria Police fleet, supports the management decision-making process, facilitates data exchange with the Force's Financial Management and Asset Management Systems, and provides accurate recording and control of vehicle and equipment assets valued in excess of \$45 million.*

*Having taken the decision to operate the workshops on a fully commercial basis, it is inconceivable that a test of commercial viability be undertaken without giving managers proper supporting systems common in any modern workshop. It must be noted that the workshops were subject to major organisational changes at the time in question and to deny the provision of computerised support systems would have been to impose unfair limitations on the potential for success of the project. The Force has plans to utilise the Workshop Management and Inventory Software in the management of the privatised fit-out processes. It is proposed to automate existing manual systems in order for generation and tracking of specialised fit-out data, equipment and components used in the fit-out and repair of each police vehicle.*

## **DETERMINING THE METHOD OF PURCHASE**

**5.26** There is a variety of purchasing methods available to government agencies for the acquisition of goods and services, including:

- open or public tendering;
- selective tendering;
- the use of a sole supplier;
- purchases from period contracts arranged by the State Tender Board;
- agency-specific period contracts; and
- lease, hire or rental arrangements

**5.27** In more recent times there has also been a trend towards the use of co-operative tendering, partnering arrangements or strategic alliances. The current Government's policy to contract-out certain functions, with a view to achieving cost savings, has also impacted on decisions relating to the procurement of goods and services

**5.28** With the aim of achieving the best value-for-money, while maintaining principles of probity and equity, it is important that the most appropriate purchasing method is chosen by agencies. Decisions should be determined by the nature and value of the purchase including when, where and how often the goods and services are required, the range of suppliers available in the market together with the costs and benefits of alternative purchasing methods under consideration.

**5.29** Decisions can also be influenced by externally imposed requirements such as the Treasury Regulations 1992 which required purchases in excess of \$50 000 to be subject to tender and approved by the State Tender Board. Purchases valued between \$1 000 and \$50 000 were to be supported by 3 quotations. Tendering was defined in the Regulations as "... a written offer to undertake works or to supply services or stores under contract".

**5.30** Overall, audit found that insufficient attention had been given by agencies to selecting the method of purchase which best suits requirements or to thoroughly investigating the market to identify the supplier providing the best value-for-money. In particular:

- Emphasis was placed on selective rather than public tendering for large purchases over \$50 000;
- There was a tendency to seek offers from a small number of firms in cases where a selective tender process was adopted;
- In many instances the required 3 quotations were not obtained for purchases in the range of \$1 000 to \$50 000; and

- Little attention was given by agencies to investigating alternative purchasing methods such as co-operative tendering and strategic alliances. Similarly, action had not been taken at a central level to foster the use of such arrangements or to fully investigate the possibility of co-operative tendering arrangements with other public sector bodies at a local, State or Commonwealth level.

**5.31** Audit concluded that **an increase in competition for government purchasing would provide greater assurance that the best value is achieved for the substantial funds utilised in the purchase of goods and services.**

**5.32** Specific details of the selection methods used by the agencies reviewed follow. Further comment on issues of accountability and probity in the tender process are contained in Part 6 of this Report.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*Opportunities to access contracts arranged by the Commonwealth will be investigated by the new Government Purchasing Board. In this context, consideration will need to be given to the benefits accruing to Victorian agencies through such an approach.*

## Department of Arts, Sport and Tourism

### Selective tendering

**5.33** A selective, rather than public, tender process was used by the Department for the 2 major shelving acquisitions for the Public Record Office. Although the Department indicated that the shelving requirements could only be met by a limited number of organisations, audit examination of documentation supporting the purchase disclosed that even the selective tender process conducted for one of the purchases revealed a supplier not previously considered by the Department as able to meet the requirements. In the case of a major consultancy engaged by the Department involving costs of \$40 000, the appointment was also made without seeking tenders from alternative organisations.

**□ RESPONSE** provided by Secretary, Department of Arts, Sport and Tourism

*While it is correct that tenders from alternative organisations were not sought by Arts for the financial evaluation of, and strategic plan for, the Victorian State Opera (VSO), there were extenuating circumstances for not doing so. The nature of the VSO's situation was such that the choice of consultant was not made by Arts alone but in conjunction with the VSO's bankers. The sensitivity of the issue also precluded a "public" tendering process.*

### Camp requirements

**5.34** Tenders were sought individually by the managers of 5 recreational camps, operated by the Department throughout Victoria, for the yearly supply of food such as meat, fruit, vegetables and groceries. However, camp management was not compelled to use the selected suppliers if cheaper sources were available from time-to-time.

**5.35** Audit found that camp purchases made outside these contractual arrangements were not always adequately supported by details of the required quotations. Documentation supporting payments often contained a notation that the recommended supplier was the *sole supplier*. Audit was advised by the Department that the absence of quotations and a poor response to tenders was due to the remoteness of the camp sites, especially the one located at Howman's Gap in north-eastern Victoria and to the fact that some potential suppliers could not meet particular criteria set for supply, such as regular delivery of the goods and services to the camp sites.



*Recreational camp located at Werribee.*

**5.36** While recognising the supply difficulties, audit considers that increased competition, and consequently greater cost savings, may be achieved if

- consideration is given to undertaking a collective tender on behalf of all the camps or in conjunction with other government organisations such as hospitals;
- less restrictive conditions are placed on the tenders; or
- tenders are sought for a period of more than 12 months.

**□ RESPONSE** *provided by Secretary, Department of Arts, Sport and Tourism*

*Audit raised the issue of competitive quotations not always being obtained for goods provided to the Department's 5 rural recreation camps. It appears that this comment relates almost exclusively to purchase contracts for the supply of perishables such as meat, vegetables, frozen foods etc.*

*Quotations are sought as widely as is practicable and suppliers are often having to be prompted and cajoled into providing tenders or quotations. There are difficulties, however, associated with supplying remotely located camps. Furthermore, it is impracticable to expect a local food supplier to submit a detailed tender for goods when a regional food wholesaler, who also supplies that local supplier, is tendering for the same contract. Local suppliers are fully aware of this and are not prepared to waste time and effort in submitting formal tenders.*

*Action has been taken to strengthen internal procedures and from 1 January 1994, purchase orders have not been issued without appropriate details of quotes, or reasons for their absence, being documented on the requisition.*

### *Use of State Tender Board contracts*

**5.37** Budget sector agencies are required to purchase from suppliers contracted to the Government under period contracts arranged by the State Tender Board unless they receive specific exemptions from the Board. Audit found that during 1992-93 the Department of Arts, Sport and Tourism did not fully comply with these requirements. A review of purchases revealed that at least half of the food purchased by the 2 metropolitan recreational camps, which are bound by State Tender Board arrangements, were not made from approved suppliers. Audit found that some purchases of office requisites and equipment were also made from non-approved suppliers.

**5.38** As State Tender Board contracts are arranged for the long-term benefit of the Government, deviations by agencies on individual purchases may impact on the Government's ability to negotiate favourable extensions to such contracts.

### **Directorate of School Education**

**5.39** Audit was advised by senior management of the Directorate that the selective tender process was more commonly used than public tender through advertisement. This was supported by the audit sample of 21 purchases over \$50 000, of which 12 were by a selective tender, 5 from sole suppliers and 4 purchased through tender by advertisement.

**5.40** While the use of a selective tender process was, in some cases, justified on the basis of the urgency of the services required, in the examples discussed below, evidence was not available to substantiate that the selective method of purchase was the most cost-effective or that the small number of quotations sought was sufficient to adequately test the market.

### *Legal services*

**5.41** In April 1993, a private legal firm was engaged by the Directorate to provide legal services and representation related to the closure of the Richmond and Northland Secondary Colleges. The firm, selected from a number of organisations recommended by the Victorian Government Solicitor, was not subject to tender due to urgent circumstances imposed by an impending Equal Opportunity Board hearing.

**5.42** Audit considers that if a competitive tender process had been undertaken, a lower hourly rate may have been achieved for this service than the actual rate paid of \$305.

**5.43** The arrangement for the supply of services was open-ended and did not include agreed terms and conditions of the service engagements. While the initial cost quoted for the services was \$118 000, by the end of the engagement, the costs had escalated to \$649 000 due to an increase in the hours of service required.

**5.44** In audit opinion, the tender and negotiation of a standing offer for future legal services to the Directorate, may not only minimise the overall cost of legal services but also contain the cost of emergency advice which, as stated above, can be extremely expensive.

**□ RESPONSE** provided by Director, Directorate of School Education

*In October 1993, the Directorate called tenders to enable the appointment of a panel of legal firms at competitively determined rates to provide ongoing and emergency services for a defined period. Of the 80 firms who tendered, the Directorate was able to confirm that the rate paid in April 1993 was competitive having regard to the quality of the service offered. The only firm with the ability to undertake the work at a significantly lower cost was the Victorian Government Solicitor (VGS) yet the VGS did not have the resources required to defend this matter and in turn recommended the selected firm to the Directorate.*

*A comparison of only the hourly solicitor rate fails to take account of the expertise and efficiency of the solicitor selected, the likelihood of the matter going to an appeal to the Supreme Court or High Court, the general importance of the matter to the overall interests of the State of Victoria, the need for high quality legal advice and the need for a solicitor to dedicate him/herself to a file to the virtual exclusion of other clients.*

*Audit mentions the fact that the legal costs escalated to \$649 000. This is a misleading statement given that the large proportion, if not the majority, of those costs are for barrister fees, which would have been payable irrespective of which solicitor was used.*

*It is also critical to note that the Directorate and the State of Victoria were defending this action and were not initiating any action. Furthermore, a government assets sales program of some \$200 million was being put at risk as a result of this action.*

### Insurance broker services

**5.45** In response to losses on a number of school council works projects resulting from the financial collapse of building contractors, the Directorate decided early in 1992 to take out *principal-controlled* works insurance to cover all school council contracts.

**5.46** In July 1992, the Directorate paid an insurance broker an amount of \$252 000 (including a broker's fee of \$44 000) representing the premium for the insurance cover for the period April 1992 to June 1993.

**5.47** Audit was advised that the insurance broker had built up a good reputation with the Directorate over a number of years and was selected on the basis of this prior relationship. However, the cost-effectiveness of using the particular broker, rather than other brokers within the market, was not supported by:

- a tender or selective quotation process,
- criteria to assess suitability, apart from past experience; and
- a formal evaluation process.

**5.48** The arrangement was subsequently extended with the particular broker for the 1993-94 year. Audit was advised that as a result of the decision to renew the arrangement with the same broker, an additional deposit premium of around \$20 000 was avoided and the Directorate was only required to pay 85 per cent of the total premium. Nevertheless, other offers available within the market were not tested at the time of the renewal.

**5.49** Audit discussions with the insurance section within the Department of Finance indicated that insurance broker engagements should be competitively tendered and, in such cases, the Victorian Government's preferred broker should be included as one of the tenderers.

□ **RESPONSE** provided by Director, Directorate of School Education

*The Directorate selected the insurance broker for a number of reasons in addition to those to do with the fact that it had a good reputation and that the Directorate had worked with it on previous occasions. The Directorate was required to resolve an urgent situation relating to the non-insurance of a number of failed school council works projects in 1991. During their previous dealing with the Directorate, the broker had demonstrated a detailed understanding of the needs of the Directorate, and in particular, a technical knowledge of the proposed principal controlled works insurance scheme. This, together with an apparent lack of expertise by other brokers including the Government's preferred broker, made it necessary to utilise the services of the broker so that the problems identified with the school council projects could be rectified without delay. The Directorate, while seeking to maintain continuity of service through its involvement with the broker, was confident that the arrangements were cost-effective given all of the circumstances.*

*It should be noted that following a public tender in March 1994, the Directorate appointed a subsidiary of the firm as its broker.*

### Jobskills training

**5.50** In October 1992, the Directorate received accreditation from the Commonwealth Department of Employment, Education and Training under the Commonwealth Jobskills Program. Commonwealth funding of \$1.5 million enabled the Directorate to accept 750 trainees who were placed in schools for 26 weeks and given 40 days of structured formal training.

**5.51** The Directorate decided to contract-out the provision of the training. As a result of a selective tender process, 2 universities were chosen to supply training in communication and office skills, and in teacher aide and computing areas at a total cost of approximately \$1.4 million. The balance of the funds provided amounting to around \$66 000, was returned to the Commonwealth.

**5.52** Audit questions whether the restrictive selection process which involved submissions from only 4 organisations produced the best value or whether submissions should have been sought from a wider selection of training bodies.

□ **RESPONSE** provided by Director, Directorate of School Education

*The Report claims that the restrictive selection process involving submissions from only 4 organisations to conduct a Commonwealth Jobskills training program did not necessarily result in the best value for the funds available. The Directorate considered that after investigation, and given the right time-lines which applied to the setting-up of the programs, that the 4 organisations concerned were the only ones able to provide programs of the required quality and quantity.*

*It should be noted that the organisations covered a range of type and functions. (for example, inner urban TAFE college and university; outer urban TAFE college and university). Furthermore, State Tender Board approval for the scheme was sought and granted.*



## Office of the Chief Commissioner of Police

**5.53** The Manager of the Force's Supply Division issued guidelines in late 1991 indicating that, unless alternative arrangements are agreed, public tenders are to be sought where the estimated cost of the purchase exceeds \$50 000. All public tenders are to be arranged by the Division which is also responsible for ensuring that due tendering processes are followed and the necessary tender documentation is in order before it is submitted to the State Tender Board for approval. During 1992-93, the Supply Division administered around 47 purchase submissions to the Board amounting to \$13 million. Of these, 20 were publicly advertised.

**5.54** Although the proportion of tenders advertised publicly was relatively high, audit testing of large purchases revealed a number of examples where the effectiveness of competition was diminished by the limitations of a selective tendering process.

### *Sole supplier*

**5.55** Audit found that there were 2 situations where the argument of a *sole supplier* had been used by the Force to justify the absence of a competitive quotation or tender process, namely:

- *convenience* - where this rationale was used due to custom, preference, time constraints or lack of market knowledge; and
- *bona fide sole supplier*- where the requirement could only be satisfied by one supplier.

**5.56** Where the *sole supplier* rationale is used as a convenience, the benefits which can be obtained from competition are lost. Such circumstances also represent a breach of the Treasury Regulations and may leave the Force open to criticism of inequitable treatment of potential suppliers. Audit noted instances where:

- Maintenance contracts had been awarded to 2 suppliers of computer equipment, without tendering, on the false assumption that the supplier was the only organisation capable of maintaining the equipment. In one case, the State Tender Board has since recommended that the Force seek competitive offers for the service in 1994-95; and
- In the case of the purchase of disposable plastic mouthpieces for breathalyser equipment, items were purchased from the same supplier for 7 years without investigation of other possible suppliers. The documentation supporting the purchases constantly referred to *sole supplier* as the basis of supplier selection. However, as indicated previously, the eventual issue of a tender in 1992 for the period 1993-95 disclosed a new supplier who now provides the items at a price 23 per cent lower than the previous supplier.

**5.57** Where the selection is based on a *bona fide sole supplier* situation, the purchaser is competitively disadvantaged as the supplier has exclusive control or possession of the product or service. This is the case in the purchase by the Force of particular software products where licensing fees must continue to be paid to the supplier for as long as the software is used. Similarly, the purchase of certain specialised equipment has restricted the Force to arranging maintenance contracts with the supplier of the equipment. As such, the Force has become locked into a continuing service contract with the particular supplier.

**5.58** Such circumstances place a greater onus on the Force to clearly specify requirements within contractual arrangements and to maintain a vigilant approach to monitoring the performance of the supplier in terms of its maintenance service and the justification of any changes or enhancements made to the system. In addition, the Force needs to monitor the market for any changes in the sources of supply.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Specifications are currently being prepared for public tenders to cover maintenance of mainframe equipment as requested by the State Tender Board.*

*The supplier of mouthpieces was the only known supplier until another supplier entered the market, coincidentally at the time a tender was advertised. Until recently, this supplier would not have entered the market as they would have had to get the mouthpieces from the UK, and that was not considered a viable business proposition.*

*Force Supply Policy developed on the issue of "Certificates of Impracticability or Expediency" under the Audit (Supply Management) Regulations 1993 provides instruction to staff on the use of "sole supplier" circumstances.*

**Selective tendering**

**5.59** A number of instances were identified during the audit where the Force had not sought sufficient tenders or quotations, namely:

- While documentation associated with the provision of a payroll data entry system in 1991 refers to other possible suppliers, no competitive quotation process was employed. The final selection was based on prior dealings with the supplier, particularly in relation to the provision of existing services on a major computer system and the offer of a price linked to an existing agreement relating to another computer system; and
- The purchase of 2 000 pairs of handcuffs in June 1992, at a cost of \$265 000, was based on the receipt of only 4 quotations. Audit found that the extent of competition available in the market had not been adequately investigated by the Force and as a result, other suppliers who may have been capable of providing the goods were not given the opportunity to make an offer.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Generally, the finding of audit in respect to the supply of handcuffs is acknowledged. The Force recognises that there are other suppliers of this product. The 4 quotations were sought from suppliers with whom other Australian Police Forces had had dealings. Future supply will be achieved through the tender process.*

*As existing software had already been outsourced to the supplier and State-wide communications linking the supplier with Police District Centres was already established, it was not appropriate to duplicate another communications network with another vendor.*

**Co-operative tendering**

**5.60** In 1991, the Supply Division of the Force commenced the development of a co-operative tender for a 5 year contract for the supply of shirts on a rate per shirt basis. Co-operative tenders enable purchasing agencies with a common requirement to achieve economies of scale in terms of reducing the administrative costs of purchase and maximising purchasing power. The tender, issued in September 1993, was aimed at purchasing common-use goods for the Force, the Office of Corrections (Victoria), the South Australia Police and the Sheriff's Office (Victoria). **The Force should be commended on the initiation of this particular form of tender as a method of purchase.**

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Audit commendation in respect of Supply Division's co-operative tender activities is appreciated. The concept of the Co-operative Tender Process was developed/pioneered by the Supply Division and has been in use since 1991 with an increase in the number of inquiries from other agencies to participate in the process.*

### Rental or leasing options

**5.61** In 1985 and 1989, the Force purchased 2 mainframe computers through State Leasing Facilities provided by the Department of Finance. The cost of the equipment, including leasing costs, was around \$11 million. The final lease payments are due in June 1994.

**5.62** In May 1992, the Force purchased a new mainframe computer to meet increased requirements in capacity and the original equipment was placed into storage in June of that year with the balance of the leases, amounting to \$3.8 million, still to be paid. Although the Department of Finance has advertised the surplus equipment throughout the public sector, another user of the equipment is yet to be identified. Consequently, the Force has had to continue paying substantial amounts for equipment no longer used.

**5.63** This situation illustrates the need to adequately identify future needs at the time of purchasing major equipment and to select a method of purchase which best suits the nature of the equipment and the period over which the equipment will be used.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*The Force was faced with dramatic changes in technology and increased demand on Police services after the purchase of the mainframe. The Force had no other alternative but to quickly respond to these demands. Some of the imperatives were to significantly expand its mainframe resource base to cater for a significantly increased criminal information database. The development of the computerised Law Enforcement Assistance Program (LEAP) was the catalyst which triggered the need for a larger and more powerful mainframe. The Force was conscious that to some degree it had been overtaken by events. As a result it created a Division within its Information Technology Department with the role of long and short-term planning.*

## TENDER EVALUATION AND SELECTION

**5.64** The importance of many purchases in terms of their value or length of contract puts a heavy onus on decision makers to arrive at the right choice of supplier. As such, the evaluation and selection phases of the purchasing process are critical in ensuring the selected supplier offers the best value-for-money and that the selection is free of bias arising from past custom.

**5.65** The initial purchase price should not be the only factor used in evaluating tenders. Other considerations are performance and quality standards, delivery times, price variations, product support and replacement arrangements. All costs associated with the purchase need to be evaluated over the entire life of the item to be purchased.

**5.66** Audit analysis revealed that the tender evaluation phase of the purchasing function was generally poorly managed. In summary, the following deficiencies were noted:

- a lack of clearly articulated selection criteria which had been communicated to tenderers;
- absence of selection panel reports detailing procedures and criteria used by the panel in the selection process;
- very brief tender evaluation reports which did not contain sufficient evidence to justify the decision;
- inadequate consideration given to assessing all costs associated with the purchase including the impact of factors such as ongoing maintenance charges and foreign exchange fluctuations; and
- many instances where price alone was the main criterion used in the selection of suppliers for maintenance and repairs.

**5.67** Examples which illustrate these deficiencies in 2 of the agencies examined follow.

## **Directorate of School Education**

### *Security services*

**5.68** The Directorate indicated that following the October 1992 State election, the Minister for Education and some staff received threats. Consequently, additional security was deemed necessary at the Directorate's head office building. A security firm was subsequently engaged between November 1992 and February 1993 with the co-operation and endorsement of the Victoria Police.

**5.69** In February 1993, it was decided that there was a need to maintain these additional security arrangements until May 1993. On the basis of 3 quotations, a recommendation was made that the firm already engaged be re-appointed on the basis of performance, qualifications and price. The total payments made for the services provided between February and May 1993, in addition to a 2 week extension of the appointment to early June, amounted to \$156 000. After the 6 month period of the engagement, the company was not re-appointed as misconduct allegations against one of the guards provided by the company was confirmed.

**5.70** Audit considers that there were a number of weaknesses relating to the selection process for this engagement, namely:

- The evaluation was undertaken by one officer rather than a panel;
- As one of the firms requested to provide a quotation declined, the selection was based on only 2 quotations;
- The selection process did not include a thorough assessment of the security officers to be provided, including character references; and
- Documentation was not available to indicate the basis on which the firm was selected and engaged prior to February 1993. Audit was advised that the engagement was by verbal agreement.

### *Consultancy relating to Changes for Quality Education Project*

**5.71** In March 1993, the Directorate engaged an international management consultant for a period of 16 weeks to undertake a major consultancy relating to the *Changes for Quality Education Project, Phase 2*, involving an organisational development and redesign of the Directorate. Tenders were sought from 6 organisations including the firm previously engaged for Phase 1 of the Project. Three of the tenderers were interviewed by the Directorate. The remainder were not considered suitable on the basis of price and level of expertise of the firms.

**5.72** During the interview process, the firm engaged for Phase 1 was asked to revise its tender documentation to reflect the information that had been orally presented. The selection panel also requested further consideration be given to the inclusion of representatives of the firm participating in Phase 1 of the Project. The revised offer, reflecting the above changes, was made at a reduced price of \$560 000 compared with an original offer of \$674 000. The other 2 short-listed firms had made original offers of \$558 200 and \$612 000, respectively.

**5.73** The firm was approved by the Minister and the State Tender Board as the successful tenderer in March 1993. The documentation detailing the basis of selection indicated that the criteria used by the panel in arriving at the decision were personnel, experience and qualifications, costs, familiarity with issues and understanding of project aims.

**5.74** Audit review of the tender selection process revealed the following unsatisfactory matters:

- Documentation indicated that the successful tenderer was provided with the opportunity to revise the original offer. The same opportunity was not provided to the other tenderers;
- A submission to the State Tender Board advised that the successful firm was selected as the best tenderer at the original offer of \$674 000. However, a panel report to that effect was not prepared. The documentation supporting the selection was based on the reduced offer of \$560 000; and
- Although 2 of the tenderers (including the successful tenderer) were assessed as providing the best offers on the basis of the personnel provided and the price quoted, the successful tenderer was selected on the basis of the other 2 criteria. The evaluation made a number of references to the previous knowledge of the successful tenderer gained during Phase 1 and the need for the unsuccessful tenderer to become familiar with the project. Audit concluded that the engagement of the firm to undertake Phase 1 of the Project (involving an engagement of only 10 days at a cost of \$10 000) gave it a significant advantage in tendering for the Phase 2 component.

#### **□ RESPONSE** provided by Director, Directorate of School Education

*The Directorate strongly believes that the process used for the appointment was properly conducted. Negotiations which resulted in a reduced contract price were undertaken only after the successful firm had been selected on the basis of their original tendered price as was detailed in the documentation provided to the State Tender Board. The Directorate acknowledges that had the revised price been a factor in determining the successful tenderer then the same opportunity should have been offered to other tenderers. However, this was not the case and to the extent that the panel report examined by audit does not show this, it is incorrect.*

*The terms of the consultancy were of key importance to the Schools of the Future Program. The evaluation of the tenders considered above all the need for a quality product to equate with the importance that the Schools of the Future Program and the restructure of the Directorate had in the context of government policy. The firm was selected because it was judged to have the best credentials to deliver the required quality outputs.*

*As part of the process of seeking the State Tender Board's approval, a range of matters including cost were considered. In a letter to the Chairman dated 23 March 1993, it was explained that "... when the decision was made by the interview panel to recommend the firm to undertake the consultancy, the decision was taken on merit on their original quotation (\$674 000) ... and whilst ... recommended on the original cost, it would not be appropriate to reject the improved price (\$560 000)" The State Tender Board approved the tender.*

*The outcome of the process was that the taxpayer was saved \$114 000 through these contract negotiations.*

*The firm was chosen on the basis of the quality of the proposal it put forward and the quality and potential of the staff they offered for the project. The selection of the firm has been vindicated by the quality of the work completed and by the savings it has been able to identify. These include:*

<i>Staff reductions</i>	<i>\$26.4 million</i>
<i>Operating costs</i>	<i>\$7.5 million</i>
<i>Premises</i>	<i>\$29.9 million</i>
<i>Leases</i>	<i>\$7.5 million</i>

*These recommendations are now well on the way to being implemented and the savings of \$71.3 million in the process of being realised.*

## **Office of the Chief Commissioner of Police**

### *Purchase of automated fingerprint computer equipment*

**5.75** In July 1985, the New South Wales Contracts and Control Board approved a contract between the New South Wales Police Department and a Japanese supplier for the purchase of an Automated Fingerprint Processing System and Image Retrieval System for the Central Fingerprint Bureau of Australia. The New South Wales Police Department was nominated in the contract as the major representative of the Bureau which serves as a State and National repository for fingerprint records and provides services to all State, Federal and Territory Police Forces, government and semi-government bodies within Australia and international police organisations.

**5.76** The aim of the contract was to provide an Australia-wide integrated network for use by all nominated agencies. As such, a financial contribution for usage and maintenance of the main installation in Sydney was to be paid in specified proportions by each State.

**5.77** Audit review of the documentation relating to this purchase indicated that it was implied in the tender documentation, and in the acceptance of the contract with the supplier, that access to the main installation would be provided by the supplier to other users through the provision of remote location equipment.

**5.78** In January 1986, the Force reviewed the following options available from the supplier for such equipment:

- purchase of a system which could also operate independently in Victoria;
- purchase of a remote input system which would be linked through input and inquiry facilities to Sydney; and
- a leasing option.



*Fingerprint Bureau.*

**5.79** In May 1986, the State Tender Board approved the purchase of the remote input system at a cost of \$772 000. Audit found that the Force had not undertaken an adequate evaluation of the costs of each option prior to the decision to purchase the equipment. In particular:

- While the price quoted to the Force by the supplier was a separate transaction to the contract with the New South Wales Police Department for the main installation, the supplier referred in the quotation to conditions accepted by New South Wales which stated that the full cost of the equipment was subject to exchange rate variations. In December 1986, the supplier submitted a claim for a price variation, due to fluctuations in the exchange rate, increasing the price to \$1.6 million (an increase of 110 per cent). As the possible impact of exchange rate fluctuations was not recognised at the time of purchase, there was no action taken by the Force to hedge against any such fluctuations;
- Maintenance costs associated with the equipment purchase were not taken into account at the time of purchasing the equipment as the Force considered those costs would be more appropriately addressed during the annual budget cycle. The New South Wales contract did not provide for any warranty period and as such the maintenance agreement became operative after installation and systems testing. The supplier provides maintenance services to the Force according to the terms and conditions of the New South Wales contract. Maintenance charges are calculated on a percentage of the equipment value and the value of the Australian dollar and Japanese yen at the time of settlement of the account. While the annual maintenance charge is advised each year, it is subject to rate increases from time-to-time. Any increases in maintenance fees requested by the supplier are accepted or rejected by the New South Wales State Contracts and Control Board and referred on to Victoria as a matter of course;

- The supplier would not provide a firm quotation of costs associated with the leasing option until a definite order was placed. This condition prevented any detailed financial analysis of this option, and
- Costs associated with training, site preparation and conversion were not adequately considered.

**5.80** While the original decision to purchase the equipment was based on a cost of \$772 000 in mid-1986, the actual cost to 30 June 1993, including the annual maintenance charges and the impact of exchange rate fluctuations, had risen to \$2.3 million.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Audit findings are accepted. Because of the number of issues relating to the purchase and continued maintenance of this equipment, the Force is currently examining the contractual arrangements with the supplier of the Automated Fingerprint Equipment and will advise the Crime Department in due course.*

*The major issue that has been raised out of the Automated Fingerprint Computer Equipment 1985 purchase has been the need for adequate documentation management.*

*It is obvious that all papers relating to the initial stages of the specifications, calling for tenders and the evaluation of offers were not retained on one major file and it has now become impossible to accurately evaluate the various steps and decisions that were taken (or omitted).*

### Laboratory equipment

**5.81** The Force purchased laboratory equipment in 1988, which has since been covered by an annual support service agreement. Although the maintenance costs associated with this agreement have amounted to around \$300 000, there was no evidence to indicate that such costs had been considered at the time the equipment was purchased.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Audit's finding is accepted, however, ongoing maintenance costs of service agreements are now included in any assessment of significant equipment purchases at the State Forensic Science Laboratory.*

### Keyboard operators

**5.82** In June 1992, the Force contracted with 2 suppliers for the provision of skilled keyboard operators within its Fixed Penalty Payments Office for a 12 month period at a cost of \$227 000. A review of documentation indicated that the evaluation of offers was made against price, experience, referees, level of contact and knowledge of work requirements. The criteria were not weighted in terms of their relative importance.

**5.83** Subsequent problems with the performance of the suppliers, mainly due to the use of poorly trained staff, a lack of staff continuity and the inability to replace staff on short periods of leave, commenced around November 1992, peaking in March 1993. The poor performance led to delays in the recording of infringement notices and payments. The Force was also required to engage 2 operators outside of the existing contract to address the problems.



**5.84** Audit concluded that the poor selection of the suppliers stemmed from the inadequacy of the evaluation process in that it did not sufficiently assess:

- accreditation of the suppliers within the industry;
- service support arrangements;
- replacement arrangements; and
- suitability and experience of staff to the Force's requirements, e.g. whether long-term continuity could be provided.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Audit assertions that the evaluation process was inadequate is a comment in hindsight after the suppliers failed. It needs to be considered that one of the key suppliers was at that time probably second only to the largest data entry bureau or service provider of data entry personnel.*

### *Selection of handcuffs*

**5.85** In May 1992, in response to a number of breakages in a particular brand of handcuff, the Force requested quotations from 4 suppliers for 2 000 pairs of "standard chain linked nickel finished metallic handcuffs together with spare keys".

**5.86** A submission made to the State Tender Board in May 1992, requesting approval of the most expensive quotation received, amounting to \$265 000, was returned to the Force for further consideration. The Board requested more detailed explanation justifying the selection of the highest quotation, stating

*"... there has been no evaluation report included which supports superior operational efficiency of the recommended product to justify additional expenditure in the range of 230 to 400 per cent."*

**5.87** Although the purchase was subsequently approved by the Board, audit review of documentation relating to the use of handcuffs by the Force since 1986 revealed that:

- As the Force has not developed detailed specifications for handcuffs against which suppliers can be assessed, such as an acceptable rate of failure, evaluations in this area have been, to some extent, subjective;
- Of the 4 suppliers who provided quotations in 1992, 3 had been recommended as suitable for Force needs at various times over the previous 6 years; and
- While one particular brand of handcuff was viewed as having a significant failure rate, details had not been documented. Other brands used had not been monitored in terms of their performance or failure rate.

**5.88** In these circumstances, the Force was not in a position to adequately assess the operational suitability of handcuffs available within the market or to justify the continued use of the most expensive brand.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Generally the finding of audit is acknowledged. The Force is developing a functional specification based on operational and training requirements and is implementing a reporting system to highlight reported failures. The purchase was eventually approved by the State Tender Board after it was physically demonstrated that the alternatives presented difficulties in operational use.*

*While it is acknowledged that the selection criteria was not addressed in the Request for Quotation and there is no documentation on file justifying the final decision, the approval by the State Tender Board was made subsequent to a physical demonstration of all handcuffs tendered. The Board accepted that the lower offers did not satisfy operational requirements. Consequently, the accepted offer was made on the basis of "why non-recommended offers were unacceptable".*

## CONTRACTUAL ARRANGEMENTS

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**5.89** Following the evaluation of offers, selection of the successful supplier and negotiation of contractual arrangements, a formal contract or legal agreement setting out the rights and obligations of each party should be prepared by staff with appropriate skills including legal expertise, where necessary. General terms and conditions for contracts can be obtained from the Victorian Government Solicitor and are also detailed in the Government Supply Policy Manual issued by the Department of Business and Employment.

**5.90** It is important that contracts provide adequate legal protection to the Government in terms of:

- defining who bears certain risks and liabilities;
- guarantees, performance bonds or other security;
- methods and enforcement of quality assurance;
- acceptance testing;
- requirements in relation to inspection and rejection;
- insurance liabilities in various circumstances;
- rights to any intellectual property; and
- confidentiality provisions.

**5.91** While audit found that period contracts arranged by the State Tender Board provided adequate protection to the Government in each of these aspects, instances were evident in other areas where contractual arrangements between the agencies and suppliers were less than satisfactory. Deficiencies ranged from the absence of any form of contractual arrangement to cases where terms and conditions of contracts did not provide adequate protection to the agency.

### Department of Arts, Sport and Tourism

**5.92** Formal contractual arrangements were not established for one of the consultancy arrangements entered into by the Department during 1992-93. In the case of the consultancy relating to a review of the Victorian State Opera, contractual arrangements took the form of a letter of engagement. Audit considers that these arrangements could have been further strengthened if the letter had made provision for termination of the engagement and had established the basis for fee or work variations.

**5.93** Although the engagements were expected to cost between \$35 000 and \$40 000, respectively, each involved an extension of approximately 25 per cent. In both cases the extra costs were linked to additional work performed after the consultant's initial advice had been provided. Audit considers that the use of more comprehensive contracts for these consultancies would have assisted in clearly defining the scope of the arrangement, the rights and obligations of each party and identifying any necessary changes to the engagement at an early stage.

## Directorate of School Education

**5.94** Audit found a lack of Directorate policies regarding the preparation of contractual arrangements. Detailed testing also revealed inconsistencies in the quality of contractual arrangements entered into by the Directorate in relation to the acquisition of goods and services and in a number of cases a formal contract did not exist.

**5.95** In the case of the printing and distribution of the *Victorian School Education News*, a 12 month contract was in place. However, the extent of protection for the Directorate, could have been strengthened by including clauses relating to compensation to the Directorate and penalty payments by the supplier in the event of non-performance in relation to agreed terms and conditions, bankruptcy and liquidation.

**□ RESPONSE** provided by Director, Directorate of School Education

*The contract for the Victorian School Education News was drawn up with the Directorate Legal Office and allows the Directorate to terminate the agreement at anytime for no reason. Directorate Legal Office advice is that default clauses were not deemed necessary in the contract.*

**5.96** In November 1993, the Directorate selected a computer supplier as the prime contractor for a period of 2 years for the provision of administrative computing equipment, installation, support and training services for schools participating in the Schools of the Future Program. The installation has, to date, been completed in around 320 schools and is expected to be completed in all schools by the start of the 1996 school year. The total price for the equipment, including 3300 work stations, was \$12.6 million as a result of a public tender process.

**5.97** **Audit found that a comprehensive selection and evaluation process was followed for this purchase.** A number of criteria were considered in the selection process including the financial viability of the supplier in addition to warranty and maintenance conditions included in the offers. However, given the large number of computers required and the high incidence of computer firms ceasing business in recent years, audit considers it would have been more prudent to have spread the contract over a number of suppliers. Such an approach could have achieved the necessary standard equipment and consistent support while minimising the risk to the Directorate associated with enforcing warranty conditions in the event of a supplier ceasing trading.

**□ RESPONSE** provided by Director, Directorate of School Education

*The Directorate accepts that appropriate contractual arrangements should be in place in the knowledge that its current policies and practices are clearly in accordance with this approach. Formal contractual arrangements are now established by the Directorate for all large purchases and the advice of appropriate legal experts is sought where appropriate in the preparation of tender and contractual documents.*

*The Directorate disagrees with the observation relating to the purchase of computer equipment. As part of the tender evaluation, financial viability of the tenderers was examined in significant detail. Having regard to the extremely tight time scale and tight project management required to achieve this, the need to have standard equipment and consistent support in all schools and to gain maximum advantage from economies of scale, the Directorate was of the firm opinion that this was best achieved by a single large and stable manufacturer.*

## Office of the Chief Commissioner of Police

### Absence of contracts

**5.98** The Force purchased computer equipment in May 1986 in connection with the automation of the Central Fingerprint Bureau of Australia. The State Tender Board approved the purchase of the equipment on the condition that a formal legal agreement be executed between the Force and the supplier. However, audit found that no such agreement was formalised. Furthermore, the purchase order issued by the Force contained no detailed requirements or conditions relating to the supply.

**5.99** The Force relied totally on the provisions of the contract between the New South Wales Police Department and the supplier covering the main installation of the system in Sydney. However, personnel at the Fingerprint Bureau had no record of the contract covering the supply of equipment and maintenance arrangements. As a result, the Force has paid an annual maintenance fee to the supplier for the past 7 years, without any record of the conditions of the maintenance service.

**5.100** In the absence of a contract between the Force and the supplier, some doubt exists as to the ability of the Force to legally enforce any of the contractual terms and conditions against the supplier in the event of a dispute or unsatisfactory performance. In addition, the Force is unable to negotiate with the supplier over any increases in maintenance charges.

**5.101** Similarly, the purchase of a payroll data entry bureau service by the Force in May 1991 was not subject to any formal agreement or contract specifying the terms and conditions of the supply arrangement which has amounted to around \$517 000 over 3 years.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*A copy of original/conditions signed between the supplier of the fingerprint computer and New South Wales "Contracts and Control Board" is being forwarded to the Supply Division. There is no contract currently in place.*

*It is agreed that contracts should be prepared by staff with relevant expertise and where appropriate, legal consideration. The Force has improved dramatically its performance in this area, and in furtherance of this concept it is suggested that an appropriately staffed area of the Supply Division should oversee all significant contracts.*

*The Force is in the process of obtaining specific details of the rights and obligations of each party to the purchase and use of the Automated Fingerprint Computer Equipment. It is then intended that appropriate legal advice will be sought. Likewise, full details are being obtained regarding the maintenance conditions of the equipment.*

*As the Payroll Data Entry System was not purchased by the Force in May 1991, but rather bureau services to run the system required, the issue over the protection of the system is not in question. However, it is acknowledged that a contract for running the in-house developed system for payroll data entry has not been exercised as was done with the Financial Management Information System. While there has been no problem for the last 3 years, it is intended to formalise a sound working arrangement with a contract.*

## Terms and conditions

**5.102** Audit found 2 cases where the terms and conditions detailed in the supply contract signed by the Force were biased in favour of the supplier, namely.

- An agreement between the Force and the agent of an international computer company, valued at \$377 000, contained the following clauses:
  - the company would not be under any liability for loss or damage however caused (negligent or otherwise) which may be suffered directly or indirectly in respect of the agreement,
  - the liability of the company for any breach of legislation affecting the agreement would be limited to the replacement or repair of the goods or services involved,
  - the Force warrants that it has not relied on any representation made by the company,
  - the Force must indemnify the company against all liability which may be incurred if actions taken by the company result in the infringement of any intellectual property rights of a third party or cause the company to suffer loss or damages; and
  - if a person not directly licensed by the company uses the product, the Force must pay the company liquidated damages equal to the amount prescribed in a formula contained in the agreement; and
- An agreement in place between the Force and a supplier for the provision of a number of software products at an annual cost of around \$160 000 refers to payments expressed in United States dollars. It also contains:
  - an absolute disclaimer for any loss or damages arising out of the agreement in the event of breach or supplier negligence; and
  - a limitation on the liability of the company to the amount paid by the Force or the cost of replacing goods and services.

In addition, the agreement did not detail any performance measures or standards which the supplier must meet or the circumstances under which the Force can terminate the agreement.

**5.103** The terms and conditions contained in these contracts put the Force at the mercy of the supplier particularly in the event of poor performance, bankruptcy, dispute, price variations, defects, poor product quality or product failures. Given the significant amounts of money involved, such considerations should be covered in the contract to adequately safeguard the purchaser's interest.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*In reference to the purchase valued at \$377 000, it must be emphasised that the contract was reviewed and vetted by the Government Solicitor's Office. It must also be understood that despite hard negotiating, when dealing with large multi-national companies, the Force is often at a significant disadvantage and must accept unpalatable purchase conditions stipulated by the company or forgo the benefits of their product or service.*

*In reference to the second example, the supplier is the sole supplier of the software which was critical to the Force. Furthermore, it is standard in the computer industry that warranty for a product does not exceed the price of the product. The contracting procedures of the Force have been strengthened since 1986 (approximate date of the contract). Substantial contracts are now reviewed either by the Government Solicitor or the Legal Adviser to the Force.*

*The Computer Information Technology Division (CITD) has developed a "Generic Contract" which now forms the basis of all CITD agreements/contracts. It is submitted that the exception rule should apply where departures from the generic form prompt the seeking of legal advice.*

**Penalty clauses for non-performance**

**5.104** Adequate protection of the Force's rights in terms of receiving the required product or service to the standards specified are an essential component of any contract or agreement for supply.

**5.105** In the case of the previously mentioned keyboard operator services acquired by the Force, the agreement included requirements for the supply of well-trained and qualified staff for the duration of the agreement. However, contractual arrangements did not make provision for compensation or penalties for poor performance.

**5.106** As a result of the poor performance and lack of continuity of the operators, the Force suffered administrative inconveniences and costs associated with:

- Severe backlogs in processing of infringement notices and unprocessed revenue for the period March to May 1993. Audit was advised by the Force that the backlog totalled approximately 21 000 infringement notices valued at around \$2.6 million;
- The lengthy process of monitoring and negotiation with the suppliers between March and May 1993 with the aim of resolving the difficulties; and
- The administrative costs associated with the engagement of 2 data entry staff to replace those of the suppliers.

**5.107** Despite the costs incurred by the Force, no action was taken to obtain compensation for non-performance.

**□ RESPONSE** *provided by Chief Commissioner, Office of the Chief Commissioner of Police*

*Problems with the approved tenderers resulted in the following action:*

- *an agreement was reached with the contracted supplier that if either did not provide trained personnel able to meet the quote within half a day on location at the Fixed Penalty Payments Office (FPPO) no account would be submitted, and if one was it would not be paid; and*
- *as the contracted suppliers could not maintain continuity of operators, keyboard staff were hired at the contract rate from an alternative agency.*

*During the course of the 1992-93 financial year the backlog never exceeded 21 500 and, considering the peaks and troughs issue, this is manageable.*

*The Force did not incur additional cash cost monitoring the contractors in the period March to May 1993. Regardless, it is the role of managers to monitor all service contracts, and the period March to May is not considered to be a lengthy period of monitoring and re-negotiating.*

*The engagement of the 2 data entry operators was not at additional cost, but in lieu of the approved contractor's inability to supply trained personnel. I would commend the Manager of the FPPO for ensuring the system continued to operate and ensuring the collection of "revenue" was not inhibited.*

*There were problems with the contract in question which resulted in amendments in the "Schedule of Requirements" for the contract for 1993-94. However, I suggest the Force was not disadvantaged nor was the FPPO capacity to record infringement details and collect expiations (revenue).*

## MONITORING AND EVALUATION

**5.108** An essential element in preserving value-for-money in purchasing arrangements is regular monitoring of the effectiveness of supplier performance. Monitoring and reporting of the results can lead to improvements in the service or product provided and ensure that information on suppliers' performance is shared throughout the organisation and other areas of the budget sector. Such information provides valuable background material when inviting quotations and assessing offers, avoids the re-appointment of unsatisfactory suppliers and assists in making decisions relating to the extension of contracts for a further period. This is particularly important in a decentralised environment where large numbers of personnel are involved in the purchasing function.

**5.109** Monitoring of supply arrangements includes verification and validation of charges made by suppliers, monitoring the quality of the service or product provided and ensuring that all the benefits anticipated from a particular purchase decision are realised.

**5.110** In view of the increasing emphasis of the current Government on contracting-out areas of government activity, regular formal monitoring and evaluation will become increasingly important in ensuring that past decisions are in fact cost-effective and that external parties are delivering the required services, in line with agreed conditions.

**5.111** **Audit testing revealed that this phase of the purchasing process was not well managed by agencies.** This is due to a number of factors including:

- lack of knowledge and expertise of staff involved;
- absence of an appropriate system to record project management details;
- absence of clear assignment of responsibility for monitoring functions; and
- a common attitude that the purchase is complete once the purchase order has been issued.

**5.112** Specific audit findings with respect to post-purchase monitoring and performance assessment in specific agencies are detailed in the following paragraphs.

### State Tender Board

**5.113** For the Board to ensure that resources devoted to the arrangement of period contracts are utilised in the most cost-effective manner, it is important that a sound framework is in place to regularly measure and monitor achievements in this area. However, as previously mentioned in this Part of the Report, the Board does not have systems in place to measure the actual use by agencies of various goods and services. As a result, it is not in a position to readily:

- evaluate the cost-effectiveness of various contract arrangements;
- change or terminate contracts that are no longer relevant to agency needs;
- identify contracts which would be more appropriately arranged by individual agencies;
- increase or decrease tender volumes to provide suppliers with a more accurate estimate of agency requirements;
- identify additional areas suitable for the arrangement of period contracts; or
- establish indicators to measure any non-compliance by agencies with requirements to purchase from period contracts.

*Cost-effectiveness of current contract arrangements*

**5.114** Although the Board has arranged period contracts for many years, it was surprising to find that it had not undertaken any analysis over that time of the overall savings achieved for the Government as a result of the arrangements or of savings made on individual contracts.

**5.115** While audit analysis indicated that the savings to the Government from period contracts are likely to be substantial, a large proportion of the savings relate to a small number of contracts. For example, audit analysis indicated that if all agencies had purchased the volume of goods that they estimated as required during 1992-93, the savings on period contracts, as represented by the difference between the contract price and the list price of items, would have amounted to around \$55 million. However, as indicated in Table 5A, 84 per cent of the savings amounting to \$46.2 million would have resulted from only 8 of the 44 categories of items available through period contract arrangements and would have been derived from only 56 per cent of the 450 individual contracts arranged by the Board.

**TABLE 5A  
POTENTIAL SAVINGS DERIVED FROM PERIOD CONTRACTS**

<i>Category</i>	<i>Number of contracts</i>	<i>Savings</i>
	<i>(No.)</i>	<i>(\$million)</i>
Light commercial vehicles	5	12.0
Passenger vehicles	5	14.5
EDP consumables and software	18	5.0
Computer hardware	180	4.0
Motor spirits	3	3.3
Provisions - groceries	26	3.1
Furniture	16	2.6
Advertising placement	1	1.7
<b>Total</b>	<b>254</b>	<b>46.2</b>

**5.116** As many agencies would be able to obtain a discount price, in their own right, or take advantage of price discount offers, the above savings are not entirely attributable to the negotiations of the Board

**5.117** In the absence of more accurate information on actual usage and savings achieved on individual contracts, the Board is not in a position to:

- measure the overall effectiveness of its contracts;
- assess whether the costs of arranging numerous smaller contracts are recouped through savings; or
- ensure contracts are currently focused on those categories of goods which provide maximum savings to the budget sector.





*Period contracts for the supply of motor spirits provide substantial savings to the Government.*

**5.118** Under the terms of many period contract arrangements, commission is due to the Board from suppliers, generally on the basis of the volume of purchases. The information systems and monitoring procedures currently in place do not enable the Board to verify that all commissions due have in fact been received.

*□ RESPONSE provided by Acting Secretary, Department of Finance*

*The new Government Purchasing Board will undertake to review current arrangements for charging commissions, in line with government policy.*

#### *Rationalisation of current period contracts*

**5.119** An examination of period contracts disclosed a number of items which were either:

- No longer used in large volumes throughout the public sector. Items in this category included rubber stamps, dictaphone machines, typewriters, painter's tools and kitchenware. Audit was advised that such items will eventually not be re-tendered; or
- Used primarily by one agency. For example, motor vehicle tyres are used mainly by the Office of the Chief Commissioner of Police. Vehicles used in other areas of the budget sector, such as those provided under Executive Officer arrangements, are generally traded-in before replacement tyres are required.

**5.120** These factors indicate that items currently tendered at a central level may no longer be the most appropriate to achieve the greatest savings to the Government. In this regard there will be a need for the new Government Purchasing Board to evaluate the appropriateness of current period contract arrangements and to regularly identify commonly-used items with a view to providing further opportunities for savings to be made through central contracting arrangements.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*It is envisaged that this function would be undertaken by the new Government Purchasing Board as part of its overall purchasing co-ordination and review role. The Government has supported the progressive untying of the majority of Common Use Contracts and the establishment of a small number of central contracts for price and/or strategic bargaining purposes.*

*The role of the new Government Purchasing Board will be to examine the benefits of these arrangements. There will also be a need to establish procedures and guidelines to assist agencies in this area.*

### Directorate of School Education

**5.121** Audit analysis indicated that post-purchase monitoring and evaluation had generally not been undertaken by the Directorate. Of the major purchases examined, only one instance was found where a formal post-purchase evaluation had been prepared. In some other cases, arrangements had been renewed or extended without assessing whether they had in fact adequately met the Directorate's requirements.

**5.122** Specific examples of inadequate monitoring procedures within the Directorate follow.

#### Insurance services

**5.123** As indicated previously in this Report, a *principal-controlled* insurance policy was arranged by the Directorate in 1992 for all school council works contracts. The advantages of such an arrangement, according to the Directorate, are:

- The use of one annual policy rather than numerous project specific policies with varying covers;
- Standardisation of cover for all projects together with a guaranteed continuity of cover;
- Provisions of a cover designed to suit the Directorate's needs with all works, regardless of value, covered by the policy;
- Reduction in, or elimination of, uninsured losses;
- Cost savings resulting from economies of scale and competitive premiums. For example, premiums for *contractor-controlled* insurance range from 0.4 to 0.6 per cent of the total project cost compared with *principal-controlled* insurance ranging between 0.08 and 0.25 per cent. The Directorate anticipated annual savings of \$120 000 to \$430 000; and
- Savings in administrative costs resulting from the Insurance Unit of the Directorate administering one policy as opposed to 8 regions administering numerous contractor policies.

**5.124** In April 1992, regions were advised by circular that all school council works contracts, including minor, urgent and maintenance works, were covered by the principal contract. As such, any tenders for building projects were to exclude the insurance already covered by the central policy.

**5.125** The Directorate should be commended on the decision to arrange a centralised policy for insurance cover. However, the decision needs to be supported by monitoring procedures to assess whether regions are complying with the circular and whether the expected outcomes have been achieved.

**5.126** An audit review of a sample of building contracts managed by regions in 1992-93 disclosed 2 contracts, with total project costs around \$327 000 and \$235 000, respectively, which contained insurance for public liability and damages already covered by the central policy.

### *Contract cleaning*

**5.127** At the end of 1992, the Directorate decided to contract-out school cleaning services. The contracts, set for 2 years with an option to extend for a further year, became effective from February 1993. An industrial agreement was not in place, which would compel the Directorate to engage the existing school cleaners and, therefore, schools were given the option of awarding the contract to either existing school cleaners (at set rates) or to negotiate more favourable rates with private cleaning firms. However, funding was provided to schools for the cleaning function at the same rate irrespective of the choice of cleaning arrangement. The Directorate has estimated that in approximately 36 per cent of cases, contracts have been awarded to existing school cleaners.

**5.128** In terms of monitoring the performance of the school cleaning contract, audit was advised by Directorate senior management that each school is responsible for the day-to-day operations of the contract and for monitoring service performance. A review undertaken by the Directorate in March 1994, which focused on costs rather than on the quality of service provided, identified that annual savings of around \$40 million had been made, to date, as a result of the introduction of contract cleaning arrangements.

**5.129** Although the responsibility for the engagement of contractors and assessment of performance has been devolved to schools, certain monitoring functions in relation to this area should be conducted centrally on an ongoing basis, including:

- The overall cost-effectiveness of cleaning arrangements;
- Analysis of the proportion of contracts awarded to commercial cleaners together with comparisons of the average costs of these arrangements with the engagement of individual cleaners. Such analysis undertaken by the Directorate, to date, indicates that the costs associated with contracts awarded to existing cleaners were more expensive than private firm cleaners by 8.7 per cent; and
- The quality of the services provided by both commercial and individual cleaners.

**5.130** Such information would enable the Directorate to provide information to schools aimed at assisting them in their decision-making process. It would also assist in the development of central directives and guidelines and in determining the level of funds to be allocated to schools for cleaning activities.

**5.131** Audit was advised that a review mechanism has recently been established at a regional level to monitor the performance of school cleaning arrangements. Consideration will need to be given to alternative monitoring mechanisms in the event that regional offices cease to operate under the proposed devolution process.

□ **RESPONSE** provided by Director, Directorate of School Education

*Responsibility for the effectiveness of cleaning services rests with school councils which have discretion over the mix between contract and volunteer cleaning arrangements. School councils have discretion over the type of cleaning service used, for example commercial or individual. The Directorate provides funding for cleaning based on State-wide parameters. This enables school councils to generate savings through a range of measures including the use of volunteer services.*

*The Directorate acknowledges the importance of undertaking post-purchase monitoring and evaluation of tenders and contracts. This requirement will be written into the consolidated Purchasing Manual being developed and will be supervised by senior management to ensure that the Directorate gains maximum benefit from its expenditure.*

## Office of the Chief Commissioner of Police

### Monitoring supplier service and charges

**5.132** Instances were disclosed during the audit where there was an absence of monitoring services provided against charges made by the supplier. In such instances, the Force is at risk of paying more for the goods or services than the value of products or services received.

**5.133** In most cases, maintenance contracts detail the extent of maintenance services to be provided in addition to the equipment covered by the agreement. However, audit found cases where the details of maintenance conducted by suppliers was not adequately recorded and verified by the Force. For example, the Police Air Wing have a maintenance contract in place for 24 hour maintenance coverage of radios for their helicopters. Discussions with personnel at the Air Wing revealed that a *Radio Maintenance Diary* is kept by the Engineer which the supplier must sign when a visit is made. However, audit review of Diary records indicated that the only notation in the Diary was the name of the supplier's representative and a note about the reason for the visit. Audit was advised that details recorded in the Diary have recently been improved.

**5.134** Further instances were highlighted where services were not adequately monitored, including the following:

- The Force had purchased maintenance services from the supplier of computer equipment based on an annual listing prepared by the supplier of all equipment covered under the agreement. However, as the listing was not regularly reviewed by Force personnel to verify the accuracy of the maintenance charge, the Force could be overcharged or could be paying for equipment no longer owned or no longer requiring maintenance cover; and
- An agreement was in place with a supplier covering the use of a number of software products. Fees are paid annually and cover a licence to use the software and a yearly fee covering updates to the software. A review of available documentation relating to this purchase revealed that a period of at least 12 months had passed before the Force noticed that one of the software packages was no longer utilised. As a result, unnecessary charges, estimated at around \$10 000, had been paid over 12 months for the licence of a package.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*The Air Wing - Radio Maintenance Diary now records the name of the radio engineer, aircraft registration, defect/inspection and time of arrival and departure.*

*The computer equipment referred to in the Report existed. Although some items were not in use at the time, the equipment still had to be maintained in order to keep it in running order for future use and retention of market value. Some equipment was moved from one location to another without CITD being informed. CITD has since surveyed the equipment at the various locations and removed all unserviceable items from maintenance and is still monitoring the situation.*

### Monitoring price variations

**5.135** The Force purchases petrol under a State Tender Board contract. Variations in the price of petrol are published in the *Victorian Government Gazette* together with the effective date of application. Audit found that prices quoted on the invoices paid by the Force were not reconciled to the Gazette as there is a delay in receipt of the Gazette by agencies. In a sample of payments for fuel made by the Force during 1992-93, audit found that an overpayment had occurred in 57 per cent of cases examined.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Any delay in the receipt of the Government Gazette is not justification or reason for any overpayments. Payments should not be made in excess of notified contract rates. Payment of accounts does not form part of the purchasing process.*

### Monitoring supplier performance

**5.136** Following failures in a number of handcuffs, the Force took action through the Victorian Government Solicitor in October 1992 to recover \$14 000 for 500 sets of handcuffs purchased in June 1990 and considered faulty by the Force.

**5.137** The supplier attempted to deal with the complaint by seeking an inspection of the faulty handcuffs. However, this was not possible as the Force had destroyed the handcuffs and did not have any others on hand in the range of serial numbers provided by the supplier.

**5.138** In December 1992, the Victorian Government Solicitor wrote to the Force advising that the success of the action against the supplier was doubtful. The letter stated:

*"Given that there is no information or record on file to indicate any of the handcuffs supplied by [the supplier] were faulty, it is unrealistic to expect such supplier to now compensate the Force. Indeed it is even optimistic to believe it would consider reimbursing the Force when the handcuffs were supplied in excess of 2 years ago and no official complaint was received until now".*

**5.139** In another case, a report was prepared by Force personnel in June 1993, following the completion of the 1992-93 tender for the supply of keyboard operators to the Fixed Penalty Payments Office, detailing the events which had transpired and the nature of the lack of performance by both suppliers.

**5.140** Despite this record of poor performance, the Force issued a letter of thanks to one of the suppliers in June 1993 indicating that the tender was now complete and offering to provide the supplier with a reference for future tenders.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*The findings of audit are supported in the instance of handcuffs. Action has been taken to remedy the situation.*

### Post-contract evaluation

**5.141** The following instances were noted where insufficient attention had been given to post-contract evaluations:

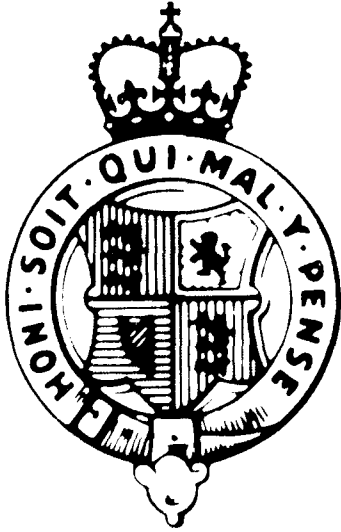
- In 2 cases examined, the Force made a significant extension to a contract and awarded a substantial contract to suppliers who had recently completed a contract with the Force. Despite this previous relationship there was no evidence of any form of post-contract evaluation undertaken by the Force to assess the suitability or performance of the supplier against the requirements of contracts or specifications; and
- The decision to purchase a Fleet Management System in May 1991 was based on an evaluation of the costs and benefits of the selected tender. The tender evaluation report indicated a reduction in vehicle numbers over a short period of time resulting in a saving of over \$4 million. It was also anticipated that the implementation costs of the System would be fully recovered within the 1991-92 financial year. There was no documentation available to validate the accuracy of these estimates and an evaluation of the realised savings against forecasts is yet to be undertaken.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*In one of the extensions noted by audit, it is agreed that no formal report or assessment of supplier performance was logged. However, no adverse reports on service provision had been received at the time of renewal.*

*Savings achieved as a result of the use of the Fleet Management System have already exceeded its purchase cost. Vehicle insurance costs to the Force have been reduced by in excess of \$1 million.*

*Part of the duties of the newly established Contract and Tender officers positions (in their capacity as contract administrators) is to ensure that post-contract evaluations are carried out and that a record of supplier performance is maintained.*



# Part 6

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# Probity and Accountability

## OVERVIEW

**6.1** Accountability in the public sector refers to the obligation of those entrusted with public resources to manage them responsibly and account to the Parliament for their use. Probity is concerned with ensuring honesty and integrity in all aspects of the management process. Within this context, purchasing decisions should be open to public scrutiny and be made within a sound accountability framework.

**6.2** Regulations to the *Audit Act* 1958 have traditionally been the primary mechanism established at a central level to outline the processes to be followed in the purchase of goods and services. The 1993 revision to the Regulations, which increased the value of requisitions requiring State Tender Board approval from \$50 000 to \$100 000, together with proposed changes recently approved by Cabinet, represent a lessening of the centralised controls over purchasing and provide more autonomy to managers within agencies.

**6.3** With the trend towards a devolved budget sector accountability framework, it has become increasingly important that the requirements of centrally developed regulations and guidelines are supplemented by internal policies and procedures, developed by individual agencies, encompassing:

- documented purchasing policies and procedures which are clearly communicated to all relevant personnel;
- up-to-date delegations;
- effective segregation of duties;
- maintenance of appropriate documentation to support decisions; and
- a strong internal audit and review function

**6.4** It was clear from audit examinations of the systems and practices in place prior to the reduction in centralised controls that significant strengthening of the accountability framework within agencies is required. Deficiencies disclosed included non-compliance with regulations and internal policies, weaknesses in internal controls including tendering mechanisms and a poor standard of documentation supporting the decision-making process.

**6.5** The Department of Finance proposes that significant reliance will be placed on internal accountability mechanisms within the revised purchasing structure. With the substantial increase in the number of potential participants in all aspects of the purchasing function due to the trend towards devolution of responsibilities, audit considers that greater attention needs to be given to fraud management by Departmental Heads and more particularly by internal audit units.

**6.6** Urgent attention will need to be given to addressing the above issues if budget sector managers are to be in a position to ensure the risk of erroneous or fraudulent transactions is minimised and to refute any future criticisms of inequitable treatment of suppliers.



## CENTRAL APPROVAL PROCESSES

### Role of the State Tender Board

**6.7** The Treasury Regulations 1992 indicated that the State Tender Board was to approve all requisitions of budget sector agencies for purchases of goods and services with a value in excess of \$50 000.

**6.8** Board minutes for 1992-93 revealed that the total value of requisitions submitted by agencies for approval during that period amounted to around \$90 million. The requisitions were primarily approved under Treasury Regulations which:

- either required agencies to publicly invite tenders before any contract was entered into, subject to certain exemptions; or
- gave agencies the option of purchasing goods on the basis of 3 quotations and with the approval of the appropriate Minister.

**6.9** The Board could also recommend to the Minister for Finance that authority be given for expenditure where agencies had failed to comply with the requirements of the Regulations. In these cases, the Board was to satisfy itself that a legal liability had been incurred by the State, before seeking authorisation for payment from the Minister for Finance.

**6.10** An analysis of approvals given by the Board during 1992-93 revealed that almost half were made using the option of obtaining 3 quotations and the Minister's approval, **reflecting the high proportion of agency requisitions submitted to the Board which were not subject to public tender.** A total of \$6 million, representing only 7 per cent of all requisitions presented to the Board, required authorisation by the Minister for Finance.

### *Timeliness of approvals*

**6.11** During 1992-93, the Board held 37 meetings, averaging 3 per month. The frequency of the meetings was appropriate to enable a timely approval process and contributed to an average turnaround time of 7 days.

**6.12** Nevertheless, it was evident that approvals were significantly delayed in certain individual cases. Audit was advised that these delays resulted from the need to obtain additional information from agencies where documentation contained in submissions presented to the Board by agencies was incomplete.

### *Nature of approval process*

**6.13** While the Regulations specify the need for the Board to approve large purchases made by agencies, they do not clearly define the objective of the Board's approval process or the scope of investigations to be performed by the Board prior to approval. Similarly, the specific objectives of the Board in the approval process have not been clearly defined in policy statements of either the Board or the Department of Finance.

**6.14** Audit was advised by the Secretary of the Board that the examination process is aimed at evaluating whether purchases represent value-for-money, the procurement process used by agencies has treated all suppliers fairly and equally and probity has been achieved.

**6.15** In practice, audit found that the examinations of individual requisitions are primarily concerned with the processes followed by agencies and do not question the validity of the purchase. The Board's procedures include the following:

- Where documentation presented indicates that a required procedure, such as obtaining 3 quotations, has not been followed, agencies are requested by the Board to take action to address the situation or provide information to substantiate the alternative procedure followed. Actual tenders or other documentation supporting the purchase are examined in some cases;
- Agencies failing to comply with correct procedures or supplying inadequate supporting documentation are requested to provide further information prior to approval; and
- When in receipt of requisitions which utilise the option of purchasing goods on the basis of 3 quotations, the Board usually seeks an explanation from agencies of their reasons for not undertaking a public tender process. In some cases, agencies are requested to undertake such a process.

**6.16** In all cases, submissions made to the Board in the past have eventually been approved once queries have been satisfied. In cases where approval was given subject to certain conditions being met, the Board did not take action to ensure that the conditions had been subsequently followed

**6.17** Audit concluded that the approval process is dependent, to a large extent, on the quality of the submissions presented to the Board. While recognising that the overview of the Board may provide a deterrent to agencies seeking to by-pass the Regulations, the examinations under current arrangements are not sufficiently detailed to provide assurance that value-for-money has been achieved or that probity or equity has occurred in all cases.

**6.18** However, audit found that at an agency level significant reliance was placed on approvals provided by the Board. For example, in cases where detailed audit examinations disclosed deficiencies in the tender or selection process **the response from agency personnel suggested that approval of the State Tender Board was considered sufficient evidence that the entire process was satisfactory.**

**6.19** **Given this situation, there is some doubt as to whether the requirement for State Tender Board approval to be obtained on individual purchases adds value to the accountability process or merely absolves agency managers from their responsibilities to ensure value-for-money, probity and accountability have been achieved in purchasing activities.**

**6.20** An analysis of requisitions approved by the Board in 1992-93 indicated that around 40 per cent were for purchases with a value of less than \$100 000. Consequently, the change in the approval level will significantly reduce the number of transactions requiring central approval. It is proposed that the Government Purchasing Board will assume the responsibilities for this function.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*The new Government Purchasing Board will continue to add value through its role in monitoring agency compliance with guidelines and policy directions and will incorporate monitoring the extent to which agencies meet these standards. It is the Department's view that the Victorian Auditor-General's Office also has an important role to play in the conduct of audits relevant to agency performance and compliance.*

*The Department of Finance recognises the value-added role of the State Tender Board in ensuring that tender documentation submitted by agencies complies with the provisions set out in the Audit (Supply Management) Regulations 1993. Nonetheless, as part of the decision by the Government to devolve purchasing management and accountability in decision-making to agencies, it is intended that agencies will be progressively untied from the majority of State Tender Board contracts.*

*The new Government Purchasing Board will incorporate the residual functions of the State Tender Board, and will retain, or put in place a small number of central contracts for price or strategic bargaining purposes. The new Government Purchasing Board will become responsible for approval and management of remaining central contracts.*

*As an interim measure, the new Board will continue to evaluate and approve agency expenditure bids, in accordance with the limitations set in the new Supply Management Regulations 1994, a function which would be progressively devolved to agencies as systems and processes are established which satisfy government accountability requirements. The Board will work closely with agencies in the development of appropriate systems, management and accountability processes and in the development of performance standards which will provide the basis for accrediting agencies to undertake their own purchasing.*

**Non-compliance with approval requirements**

**6.21** Audit testing within agencies revealed a number of purchases over \$50 000, totalling \$1.9 million, which had not been approved by the State Tender Board prior to incurring liabilities. In the case of the Force, the examples comprised the following:

- In October 1991, the State Tender Board approved purchases from 2 suppliers of photographic services for the Traffic Camera Office. The amount approved was \$842 900 for the 2 year period ending 30 September 1993. By September 1992, the Force had expended an additional \$558 000 without seeking further approval of the Board;
- In May 1991, the Force purchased a payroll data entry service from a supplier for \$150 000 covering the period July 1991 to June 1992. Two further 6 month extensions to the contract were subsequently approved by the Board. However, in both cases, purchases were made under the extended contract, amounting to \$90 000 and \$97 000, respectively, prior to the approval; and
- In April 1992, State Tender Board approval was given for the installation and maintenance of a computer at a cost of \$7.9 million. Although additional purchases were made from the same supplier for items of equipment and software amounting to \$442 800 over a 6 month period, none of the purchases were submitted for Board approval.

**6.22** In 2 cases examined in detail within the Directorate of School Education, namely the engagement of legal services at a total cost of \$649 000 and the purchase of computer services amounting to a cost of \$78 000, liabilities were incurred prior to the Directorate having obtained the necessary State Tender Board approval.

**6.23** The Regulations also provide for 3 quotations to be obtained for purchases in excess of \$1 000. Where the amount involved was \$2 000 or less the quotations could be verbal but were to be documented and certified by the officer receiving the quotation. Quotations for purchases exceeding \$2 000 were to be in writing. As indicated in Part 5 of this Report, instances were identified during the audit where agencies had not obtained the required 3 quotations. Not only do these instances raise doubts regarding the extent to which value-for-money has been obtained, but the risk of collusion between staff and suppliers is also increased.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*It is the responsibility of the delegated officer to be fully conversant with the requirements of Regulation and Policy.*

*As indicated to the Supply Manager, dated 19 July 1993, the reason for the delay in submitting the appropriate documentation for the Payroll Data Entry System to the State Tender Board was ongoing negotiations held with the supplier regarding reducing the Bureau charges. As a result of these negotiations the Force successfully reduced the charges by 9 per cent, in other words annual savings of \$16 000 are being realised.*

**□ RESPONSE** provided by Director, Directorate of School Education

*As audit acknowledges in paragraph 5.41, the engagement of these legal services were undertaken in urgent circumstances imposed by an Equal Opportunity Board hearing.*

*The selection was made on the recommendation of the Victorian Government Solicitor and was necessary to defend an action which put at risk the Government's \$200 million asset sales program.*

*An approved panel of legal firms is now being put in place which will avoid any such difficulty in the future.*

## TENDERING PROCEDURES

**6.24** **Probity and equity considerations require that prospective tenderers have an equal opportunity to assess the agency's requirements and to submit offers.** An individual supplier should not be seen to gain an unfair advantage by virtue of time or knowledge. These principles need to be considered in all aspects of the tender process, including:

- Preparation of tender specifications in a manner which encourages suppliers to offer the most cost-effective and creative solution to requirements;
- Advertisement of tenders;
- Preparation of tender documentation. Such documentation should include information regarding the organisation, details of the selection criteria and process of selection, an indication of how offers should be presented and details of the basic terms and conditions of contractual arrangements;
- Receipt of tenders and tender opening and registration; and
- Evaluation and selection procedures.

**6.25** The manner in which these elements are managed should also be aimed at providing a measure of protection against allegations of impropriety levelled at those responsible for the tender process.

**6.26** Tender documentation available within the State Tender Board and the Supply Division of the Force was generally found to be of a high standard and reflected the sound management of purchases arranged in those areas. However, as detailed in the following paragraphs, certain aspects of tendering procedures need to be strengthened.

### Advertising tenders

**6.27** The State Tender Board is required by regulations to invite tenders by advertisement. An audit examination of the procedures followed by the Board during 1992-93 for a sample of period contracts indicated that all requirements relating to the use of public tenders and the placing of advertisements were complied with in the case of tenders initiated by the Board. Audit observed, however, that the Board had entered into a contract for advertising services following a tender process initiated and undertaken by the Department of the Premier and Cabinet. A selective tender procedure was used by that Department in this case rather than a public tender through advertisement.

**6.28** Agencies may enter into high value contracts for the supply of goods and services, without tendering publicly, provided the agency obtains the approval of the Board prior to entering into the contracts. However, where the goods or services are to be used by a number of agencies, it is necessary for the contract to be signed by the Board, on behalf of the Government, to enable the contract to be legally binding between the supplier and each agency. Consequently, in the case of the advertising services contract, the Board was asked by the Department of the Premier and Cabinet to enter into the contract.

**6.29** Audit was advised by the Secretary of the Board, that prior to signing the contract, the Board satisfied itself that the procedures followed were appropriate. Nevertheless, audit found that the procedures, in this instance, were not in compliance with regulations with respect to the requirement that contracts entered into by the Board, on behalf of the Government, be advertised publicly and all conditions of such contracts be determined by the Board.

**6.30** The credibility and independence of the Board's procurement procedures may, in audit opinion, be placed at risk when period contracts are signed by the Board in circumstances where it has not had responsibility or control of the tender process and where strict compliance with legislative requirements has not occurred.

**6.31** If it is considered by the Department of Finance that the requirement to publicly tender for all period contracts signed by the Board is no longer appropriate in the current purchasing environment, action should be taken to ensure the regulations are amended to reflect this view.

**□ RESPONSE** provided by Acting Secretary, Department of Finance

*The Department of Finance has a responsibility to review the legislative framework to determine appropriate changes which may be necessary from time-to-time to take account of the purchasing environment in which agencies operate.*

*The operating arrangements of the new Government Purchasing Board, including approvals procedures, will need to be examined in the context of an appropriate legislative framework, which defines the powers and functions of the Board.*

**□ RESPONSE** provided by Secretary, Department of the Premier and Cabinet

*In order to maximise the savings to the Government as quickly as possible after the change of administration, a number of administrative arrangements were changed. It appeared that, in practice, procedures for letting contracts had not previously been strictly observed and that regulations were not always consistent with practice. The advertising contract was expedited after being satisfied that the savings would be achieved. The Department of the Premier and Cabinet supports the review of tendering.*

### Closing date and time of tenders

**6.32** When advertising a tender it is important that a reasonable period of time is allowed between the advertisement and the closing date for tender submission so as not to disadvantage potential suppliers. Unnecessarily short time frames may discourage tenderers. Audit testing indicated that **the Force had allowed a satisfactory period of time between the advertisement and closing date of tenders.**

**6.33** In contrast, the practices followed by the Directorate of School Education for purchases in excess of \$50 000 indicated deficiencies in respect of the tender process. For example, some computer purchases by the Directorate's central office did not specify a closing date and tenders were accepted at any time. In this instance, potential tenderers may obtain, or may be perceived as obtaining, an unfair advantage over other tenderers who have already submitted their offers. In cases where a closing date was specified by the Directorate, the time between the issue of tender documents and the closing of tenders varied considerably from purchase to purchase with no apparent correlation between the complexity of the purchase and the time provided to submit offers.

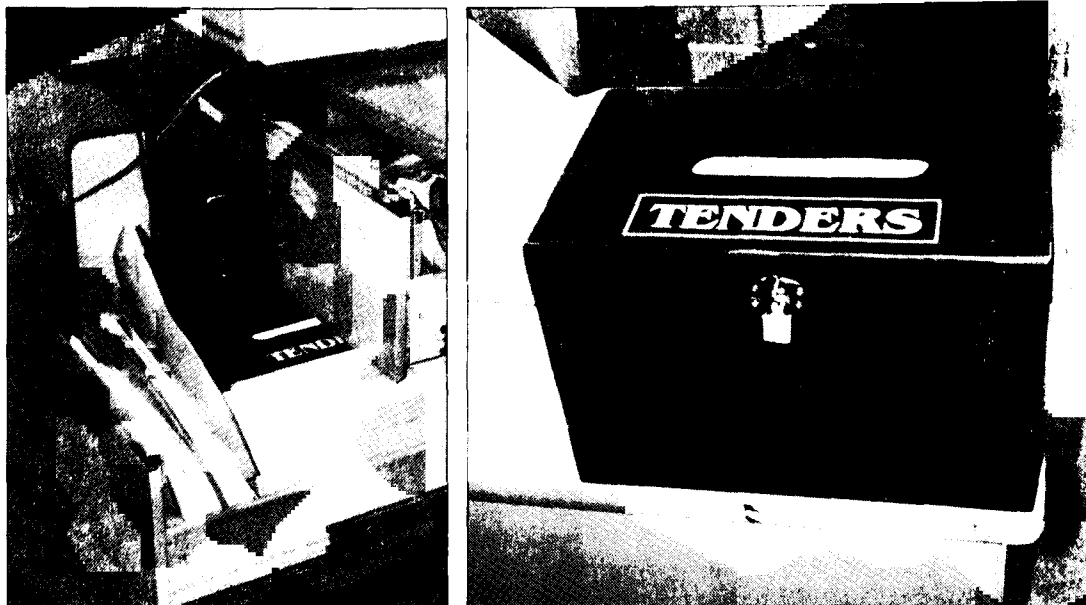
**□ RESPONSE** provided by Director, Directorate of School Education

*The consolidated Directorate Purchasing Manual will ensure that all necessary and appropriate procedures are issued with regard to closing date and time for tenders.*

### Receipt and opening of tenders

**6.34** The Treasury Regulations 1992 required that facilities for the lodgement of tenders be provided which ensured complete secrecy and security of tenders until the appointed date and time of opening. Tenders were required to be opened in the presence of 2 officers.

**6.35** Audit review of the Force's tender opening procedures indicated that a locked tender box is located at the Force's Russell Street premises. However, for security reasons, tenders cannot be placed directly in the box by the person delivering the tender, instead they must be handed to a uniformed officer at the reception desk for lodgement in the tender box. This requirement has sometimes resulted in a delay in receipt of tenders inadvertently placed into the internal mail system.



*Moveable tender box used by the Directorate of School Education.*

**6.36** Audit also found that the Directorate of School Education had not established a fixed, locked and secure tender box. In at least one instance this resulted in the storage of tenders in an unlocked drawer of a filing cabinet. In many cases tenders were opened by the unit calling the tender at the time they were received. Despite the fact that the predominant purchasing option used at the Directorate is selective tendering, a secure method of storing accepted offers should be provided.

**□ RESPONSE** provided by Director, Directorate of School Education

*The Purchasing Manual will highlight the practices necessary to be undertaken to ensure that the principles of equity and probity are met. The Directorate will undertake the necessary action to locate a fixed and secured tender box within head office.*

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*Due to perceived security issues, tenderers are required to hand their tenders to reception staff at Russell Street for placement in the Tender Box. This problem will be overcome with the relocation to the Victoria Police Centre where arrangements have been made to provide appropriate facilities for members of the public lodging tenders.*

**Tender evaluation**

**6.37** The tender evaluation and selection process requires the equitable treatment of tenderers and ethical behaviour by staff involved in the process. Until a supplier is approved and has been accepted, the number of people having access to the tender documents should be restricted solely to those with a direct involvement in the evaluation and selection process.

**6.38** In addition to the weaknesses in the selection process identified in Part 5 of this Report, a number of cases examined by audit disclosed matters which could leave agencies open to allegations of bias or inequitable treatment of suppliers.

**6.39** In one such example within the Directorate of School Education, audit found that consultant architects engaged by regions or school councils were given significant autonomy and control in terms of the selection of contractors for maintenance and minor works. Almost all recommendations made by the consultant architects in respect of the selection of organisations to provide the services were accepted by the Directorate. Recommendations regarding the successful tenderers were generally based on a prior relationship established between the consultant architect and the successful tenderer.

**6.40** Audit found that the documentation supporting the selection process in these cases was inadequate. In addition, procedures at the school or regional level for monitoring the selection process were poor. In such circumstances, it would be difficult to refute any allegations of collusive or fraudulent practices.

**□ RESPONSE** provided by Director, Directorate of School Education

*The Directorate believes that the key purpose of engaging consultant architects is to provide professional advice of a quality not available from within either the school council or the Directorate. It is logical and consequential therefore that in relation to such issues as the selection of contractors if the advice of the project manager is not to be heeded by school council the basic reason for their engagement is thrown in question.*

*The Directorate will review its guidelines to ensure that all tenderers are treated fairly and equitably. These updated guidelines will be included in the consolidated Purchasing Manual and in appropriate documentation relating to tender processes.*

## INTERNAL CONTROLS

**6.41** For the majority of purchases made in the budget sector, the following sequence of events occurs:

- Preparation of a requisition authorised to indicate that the item is required and that funds are available for its purchase;
- Preparation of a purchase order, reflecting the details of the requisition. A copy of the order is sent to the supplier as a formal record of the item ordered, together with the agreed price and any delivery requirements;
- Issue of an invoice by the supplier, once the goods or services are delivered; and
- Payment of the account. Officers within agencies are responsible for checking the details on the invoice and ensuring that the goods or services have actually been received. Documentation supporting payment of the invoice should be signed as an indication that the account is correct.

**6.42** Effective internal control over these processes is directed at ensuring responsibilities are clearly assigned, all relevant regulations and internal policies and procedures are adhered to, and certain duties are performed by separate officers to minimise the risk of fraudulent activity or errors.



## Delegations

**6.43** The Secretary of a department may delegate authority to incur expenditure to other members of staff. In accordance with the Treasury Regulations 1992, certain officers were also to be nominated by the Secretary to carry out the following duties associated with the payment of accounts:

- *purchasing officers* with responsibilities for the issue of purchase orders;
- *authorising officers* who are responsible for checking documentation prior to payment;
- *certifying officers* responsible for certifying that all purchases over \$1 000 comply with the requirements of the Regulations; and
- *paying officers* who are responsible for the payment of accounts.

**6.44** It is important that delegations are made in line with departmental operational needs and reflect the accountability framework established within the department in areas such as budgetary control. For this reason, delegations should be regularly updated to reflect any changes in responsibilities or organisational structures.

**6.45** Audit found that all agencies had developed delegation packages for areas of responsibility relevant to the purchasing function. However, a sample of payments examined in the selected agencies revealed instances of the following deviations:

- authorisation of expenditure by officers outside, or in excess of, their delegated authority;
- delegated authority and position not detailed on purchase orders;
- claim forms not properly certified and authorised;
- indecipherable signatures on claim forms and position details not indicated on the form; and
- purchase orders not signed.

**6.46** Audit also found that the September 1992 delegations manual in place within the Directorate of School Education at the time of the audit did not accurately reflect the structure and delegation of responsibilities within the Directorate. Audit was advised that delegations have been updated since that time.

**6.47** Substantial variations were also found between the number of delegates and the expenditure limits in place in various sectors of the Department of Arts, Sport and Tourism. Audit concluded that the number of officers delegated authority in some sectors of the Department was in excess of operational requirements.

**□ RESPONSE** provided by Secretary, Department of Arts, Sport and Tourism

*The Report recommends that the delegated authority limits within the Department be reviewed. I agree that a review of these delegations is appropriate and will ensure that this is done in conjunction with the introduction of the new financial regulations which will come into operation on 1 July 1994.*

**□ RESPONSE** provided by Director, Directorate of School Education

*Since the change of Government in October 1992, the Directorate has updated financial delegations on 2 occasions as its administrative reorganisation has progressed. The last update was issued in November 1993. A final revision incorporating the Directorate's ultimate revised structure is now being prepared for issue.*

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

Three of the "delegations" investigated by audit relate to the accounting function and do not relate to the Supply Process. The critical delegations relating to authority to create liability and authorise expenditure (to accept offers for supply) do not appear to have been subject to detailed audit examination. Information on the supply process, regulations and policy is available to all personnel through the following publications:

- *Audit (Supply Management) Regulations;*
- *Government Supply Policy Manual;*
- *The Supply Process; and*
- *Force Delegations Manual.*

which are supplemented by internal training courses.

Force Supply Policies currently under development by the Supply Division will clarify requirement by documenting the intent of the Regulations and Policy as well as the process.

## Procedures and guidelines

**6.48** With a view to communicating internal policies and procedures to relevant staff, the agencies examined had each issued various manuals and guidelines. A review of these documents indicated that:

- in some cases the matters addressed were not consistent with central regulations and guidelines or internal policies and organisational structures;
- there was a need for a number of procedural documents to be consolidated into a single manual;
- relevant documents had not been made available to all staff with responsibilities in the purchasing area; and
- guidance statements had not been issued on many aspects of the purchasing function such as contract negotiation, development of specifications or tender selection processes.

**6.49** In view of the deficiencies in purchasing disclosed throughout the audit, the development by each agency of a comprehensive up-to-date manual is seen by audit as an essential tool in assisting staff in understanding their responsibilities and applying sound management practices.

**□ RESPONSE** provided by Director, Directorate of School Education

The Directorate acknowledges the need, as a matter of priority, to develop and provide for regular updating of a consolidated manual relating to all aspects of its purchasing functions. This will be made available to all staff involved in its purchasing activities at various levels throughout the system. This consolidated manual will draw on the procedures developed in the regional offices following the devolution of responsibility for most purchasing activities as a result of the major restructure of the Directorate in 1986-87. This manual will be available for distribution to Directorate Administrative Units within 2 months.

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

The Force supply policies being developed will reinforce and facilitate improvement of Internal Controls relating to the Supply Process.

## Segregation of duties

**6.50** With a view to achieving effective segregation of duties, procedures need to be implemented which ensure that the request for goods and services and authorisation of payment are separated from the certification and processing of payments. Audit found that each of the agencies had policies in place aimed at ensuring adequate segregation of these functions.

**6.51** However, the decentralised structure of some agencies resulted in situations where small numbers of staff had responsibility for the administration of their area, including purchasing, making it more difficult for effective segregation of duties to occur. This factor contributed to instances where the same officer had performed a number of duties associated with a purchase, for example, certifying and authorising payments in addition to inputting the payment for processing.

**6.52** To minimise the risk of error or fraud, agencies need to take action to ensure that an adequate segregation of duties is achieved within all areas of their purchasing functions. This will become even more important with greater devolution of the purchasing function, especially within the Directorate of School Education.

**□ RESPONSE** provided by Secretary, Department of Arts, Sport and Tourism

*As acknowledged, a suitable means of segregating duties within Arts is difficult due to the relatively small size of its Finance Section. Nevertheless, the current arrangements within Arts are being reviewed to ensure that adequate segregation of duties does occur.*

## Internal audit coverage

**6.53** Internal audit forms a critical component of an organisation's accountability framework through its role in the monitoring and review of compliance with internal controls, regulations and procedures.

**6.54** Audit found that each of the agencies examined had established internal audit units which had undertaken reviews in the area of purchasing in recent years. These reviews focused on identifying deviations from internal controls and the requirements of regulations rather than on the extent to which value-for-money had been achieved in agency purchasing arrangements.

**6.55** Steps have been taken by the agencies, in some instances, to rectify the problems raised by internal auditors. Nevertheless, a number of non-compliance issues and control weaknesses identified in this Report had previously been identified by internal auditors on at least one occasion.

## DOCUMENTATION

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**6.56** As actions taken in the purchasing process may be the subject of complaint, audit, investigation or possible legal action in the event of breach of contract, decisions need to be fully documented, including the rationale supporting the decision. Documentation should provide evidence indicating whether actions have been undertaken in an accountable, open and efficient manner by officers within an organisation.

**6.57** Audit testing revealed the standard of documentation to support the decision-making process was generally poor. In particular, audit found the following deficiencies:

- lack of verification that the goods or services had been received;
- cases where the relevant supplier had to be contacted by audit to obtain the contractual documentation covering the purchase;
- an absence of requisitions and purchase orders;
- receipt of invoices prior to the issue of a purchase orders;
- services received prior to the preparation of a requisition and purchase order;
- numerous inconsistencies in documentation prepared; and
- incomplete payment documentation.

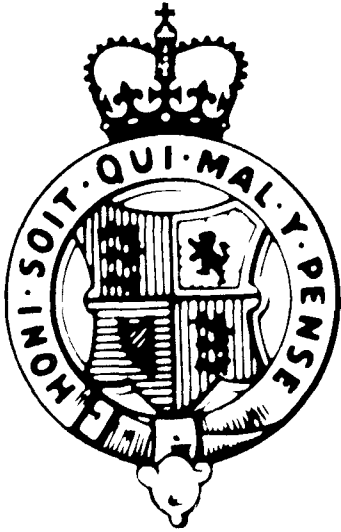
**6.58** In these circumstances, **agencies were not in a position to substantiate the decisions made, to verify that charges were in accordance with contractual arrangements or to ensure that actual goods and services paid for had in fact been received by the agency.**

**□ RESPONSE** provided by Director, Directorate of School Education

*The Directorate acknowledges the need for instruction of staff on the use of documentation to support the expenditure on goods and services. This will be facilitated by the development of the consolidated Purchasing Manual and will require the conducting of appropriate staff training programs for the personnel involved.*

**□ RESPONSE** provided by Chief Commissioner, Office of the Chief Commissioner of Police

*The Force Supply Policies being developed by the Supply Division will address any lack of knowledge or misunderstanding of the purpose of purchasing documentation. The recommendation of audit is supported.*



# Part 7

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# Administrative Arrangements

## OVERVIEW

**7.1** In line with government policy directions, the administrative structures of budget-sector agencies have become increasingly decentralised in recent years. This trend has been accompanied by a move away from centralised specialist purchasing areas to the devolution of the purchasing function to many individual areas of agencies.

**7.2** This change, together with the downsizing of the budget sector, has resulted in a decrease in purchasing skills. The allocation of responsibilities to relatively junior staff and the absence of comprehensive training and development activities to support the function has exacerbated this situation.

**7.3** To ensure that any potential savings or administrative inefficiencies are identified within a devolved structure, there is a need for effective information systems and communication mechanisms to be established within agencies. However, audit found that a marked absence of such systems and processes has not allowed management to effectively assess purchasing performance with a view to ensuring that resource allocations and administrative practices adopted are appropriate.

## MANAGEMENT STRUCTURES

**7.4** Administrative arrangements and the level of expertise required to undertake purchasing responsibilities within agencies is to a large extent governed by the nature and volume of purchasing requirements and the design of the agency's overall management structure

**7.5** In the case of the agencies examined, audit found 3 different structures were in place in relation to the management of purchasing, namely:

- the Directorate of School Education operates within a decentralised environment where responsibility has been devolved to individual regions and schools with very minimal control remaining at a central level;
- the Office of the Chief Commissioner of Police has also been decentralised for a number of years and has devolved many aspects of the purchasing function while retaining a specialist central Supply Division with responsibility for the management or co-ordination of certain large purchases; and
- the Department of Arts, Sports and Tourism has very small purchasing requirements and has assigned purchasing responsibilities to 2 separate areas under the overview of a central administrative area

**7.6** Irrespective of the management structure established, it is important that cost-effective processes are maintained in relation to purchasing. In a devolved structure, however, the following mechanisms are of particular importance:

- training and professional development of all staff involved in the purchasing function with a view to ensuring that they maintain a knowledge of current developments in purchasing techniques and accountability requirements;
- effective communication between functional areas;
- minimisation of costs through the elimination of duplication;
- adequate information systems for overall management purposes;
- a regular review process to identify potential cost savings; and
- a mechanism for the sharing of surplus resources between functional areas.

**7.7** Based on the findings disclosed during examinations, audit concluded that **the majority of these aspects have not been given adequate consideration in the devolution process which has occurred in the budget sector.**

*□ RESPONSE provided by Chief Commissioner, Office of Chief Commissioner of Police*

*The recommendations of the Project Arbiter (Organisational Restructure) Phase II Review Team, particularly in relation to the Administration of Force Tenders and Contracts, gave recognition to the importance the Force placed on this aspect of administration and the knowledge and the expertise existing in the Supply Division.*

## EXPERTISE AND TRAINING

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**7.8** The increase in complexity of purchasing arrangements in recent years, resulting from the gradual increase in the use of innovative purchasing methods and outsourcing arrangements coupled with technological developments such as the use of EDI, have necessitated an expansion of the skill and knowledge base of staff carrying out the purchasing function. As suppliers have become more adept at selling their products and negotiating agreements, there is a greater need for personnel within the public sector to have skills in areas such as:

- negotiation;
- development of contractual arrangements;
- information systems;
- project management; and
- project monitoring and evaluation.

**7.9** **The downsizing of the public sector in addition to the decentralisation and devolution processes have, in audit opinion, resulted in a decrease in the purchasing skill base.** The absence of a comprehensive training structure in the area has also contributed to this situation.

### Level of staff assigned purchasing responsibilities

**7.10** As indicated throughout this Report, poor and costly decisions can occur if staff involved in the purchasing process are not well trained or do not have access to expert advice to assist in carrying out their duties.

**7.11** Historically, many budget sector agencies operated separate central areas with responsibilities for purchasing, warehousing and management of stores and equipment. These areas contained specialist staff with full-time responsibility for these functions.

**7.12** The abolition of the majority of these areas and the allocation of purchasing responsibilities to numerous decentralised locations has resulted in the current position where a large number of staff are assigned purchasing responsibilities as one of many components of their duties.

**7.13** In many cases the function has been given a low priority with responsibilities assigned to relatively junior staff. In addition, current arrangements do not provide a defined career path for specialist staff in the purchasing function.

## Training and development activities

**7.14** To effectively undertake their duties, staff responsible for purchasing need expertise in the application of sound management practices and a knowledge of accountability procedures. For this to be achieved, it is essential that agencies have in place clear policy statements and guidelines supported by effective training and development mechanisms.

**7.15** Where agencies, or components of agencies, do not have the resources to support a specialist purchasing function, as is the case in small agencies such as the Department of Arts, Sport and Tourism and in individual schools, expertise and advice needs to be available within a specialist area of the agency, on a shared basis with other agencies or within budget sector agencies with central responsibilities for purchasing policies.

**7.16** **Given the value of funds associated with the procurement of goods and services, it was surprising to find that within the budget sector, training in purchasing has been substantially neglected for many years.**

**7.17** Specific findings in relation to training and development included the following:

- Comprehensive training programs had not been developed at a central level by the Department of Finance;
- Formal training of staff involved in purchasing activities within the Directorate of School Education was last conducted in 1987. Since that time, training had become the responsibility of individual regions with training at that level ad-hoc and predominantly on-the-job in nature. Audit was advised that under the Directorate's program of devolving responsibilities under the Schools of the Future Program, it is not planned to have a specialist purchasing area at a central level;
- Formal training had not been provided in some areas of the Office of the Chief Commissioner of Police while in others it had been limited to the use of the Force's information systems; and
- Staff undertaking purchasing functions were not fully aware of the expertise available within specialist areas of the budget sector such as the State Tender Board, State Supply Service and the Supply Division of the Force.

**7.18** The lack of training within agencies was evident during the audit process with some staff interviewed not fully aware of the requirements in relation to regulations and internal policies. Practices adopted in isolated areas also highlighted the inexperience of staff assigned purchasing responsibilities. For example, in one area of the Office of the Chief Commissioner of Police the process involved obtaining quotations, preparing requisitions and raising orders for the purchase of consumables from the one supplier on numerous occasions over the year for amounts of only \$250 to \$500. The purchases could have more efficiently been arranged through the use of Corporate Card facilities or by raising an annual order for the items. In another example, delays in the preparation and processing of paperwork for the procurement of maintenance services in successive years resulted in the Force incurring penalties of \$7 900.

**7.19** To support the devolution process, action needs to be taken to increase the skill level of staff carrying out purchasing duties. While this responsibility rests, to a large extent, with individual agencies, audit considers that there is a key advisory and training role for central agencies in this area, as previously discussed in Part 4 of this Report. The proposed Government Purchasing Board will play an important role in this regard



**□ RESPONSE** provided by Acting Secretary, Department of Finance

*The new purchasing Board will provide the central focus for training access, including accreditation, as appropriate.*

**□ RESPONSE** provided by Director, Directorate of School Education

*The Directorate agrees that personnel involved in the purchasing function should receive ongoing training to ensure the operation is efficient and effective. Given the Directorate's policy to reduce the size of the central bureaucracy and to devolve decision-making functions to Schools of the Future, the Directorate is not convinced that the establishment of a specialist central purchasing area as such is the most appropriate way to proceed. Rather, it believes that the same result can be achieved by ensuring that well-trained staff at various levels of the system are working according to directions given by responsible senior officers who are familiar with all relevant purchasing policies, procedures and guidelines.*

**□ RESPONSE** provided by Chief Commissioner, Office of Chief Commissioner of Police

*Due to the nature of operations undertaken by the Air Wing, variation to purchase order amounts is quite often necessary. For example, helicopter fuel supply is decentralised to cover contingencies. As emergencies arise, they are dealt with and variations need to be made to cover crisis requirements.*

*Personnel in this area have been made aware of requirements which must be adhered to in order to minimise unnecessary expenditure.*

*The delays in the preparation and processing of relevant paperwork for procurement of maintenance services have been identified and addressed, and procedures implemented to ensure requirements are complied with.*

*Development of Force Supply Policies Manuals comprising:*

- *Force Supply Policy Statements;*
- *Regulations and Government Policy;*
- *State Tender Board Contracts;*
- *Victoria Police Contracts;*
- *Police Store Catalogue;*
- *Procedural Handbooks on Specific Goods/Services; and*
- *Operating Procedures*

*will provide source material which reflects best practice and provides a sound basis for implementing both sound procurement practice and training.*

## MONITORING PROCEDURES

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### Information systems

**7.20** In order to successfully identify potential areas for cost-savings and improvements in purchasing practices, effective management information systems are required which are accessible to all functional areas of the agency and all relevant personnel involved in the purchasing function. Audit considers that in a devolved environment, there is also a key role for monitoring of the function at a central level of large agencies and, as indicated in Part 4 of this Report, within agencies with policy responsibilities in relation to purchasing.

**7.21** An effective management information system should enable the identification by purchasing managers of:

- overall trends and purchasing patterns;
- the best prices available for certain products;
- areas for further savings through mechanisms such as central tendering;
- surplus items no longer required by an area;
- administrative costs associated with purchasing;
- workload indicators such as the number of purchase requisitions and orders generated or quotations sought, and
- output indicators including the number of contracts arranged and price variations processed.

**7.22** The system should also assist strategic planning, measurement of achievements and funding bids.

**7.23** Neither the Office of the Chief Commissioner of Police or the Directorate of School Education had established systems which adequately met these requirements and even basic information such as the costs of administering the purchasing function, the amount of funds spent on different categories of goods or the quantity of items purchased from particular suppliers could not be readily obtained. As a result, senior management of the agencies were not in a position to measure the costs associated with the purchasing function, to identify administrative inefficiencies, or to recognise areas where cost savings could be made. In the case of the Directorate, it was also found that a system was not in place which facilitated the identification and sharing of surplus supplies.

**7.24** As the purchasing activities of the Force and the Directorate involve the generation of large volumes of transactions in the form of purchase orders, lodgment of quotations and the payment of accounts, the implementation of electronic trading, including automated ordering and electronic funds transfer, could achieve substantial savings in administrative effort, time and resources.

**7.25** As previously discussed in detail in Part 4 of this Report, audit considers that a whole-of-government approach to the implementation of such facilities within the budget sector is required.

## Performance measures

**7.26** Given the absence of data on purchasing activities, audit issued a questionnaire to the 3 agencies examined seeking information on the number of requisitions raised together with the value of goods and services they covered. Audit also requested agencies to identify the classification, annual salary and proportion of time spent by personnel involved in the purchasing function. Expenditure relating to salary on-costs, utilities and personal expenses associated with purchasing was not sought.

**7.27** Table 7A, prepared on the basis of information provided in response to the questionnaire, sets out the total cost of administering purchasing within the 3 agencies as well as the costs of the State Tender Board in relation to the management of the period contracts and the administration of the Approved Supplier Policy.

**TABLE 7A**  
**ADMINISTRATION COSTS OF PURCHASING, 1992-93**

<i>Agency</i>	<i>Value of purchases administered</i>	<i>Salary cost</i>	<i>Salary cost as a proportion of the value of goods and services administered</i>
	(\$'000)	(\$'000)	(per cent)
State Tender Board (a)	180 000	600	0.3
Office of the Chief Commissioner of Police	134 000	1 080	0.8
Directorate of School Education	102 400	2 071	2.0
Department of Arts, Sport and Tourism	2 986	150	5.0

(a) Represents the total annual value of period contracts managed by the State Tender Board.

**7.28** As indicated in the above table, significant differences existed in the cost of resources assigned to purchasing as a proportion of the value of purchases administered. In the case of the Department of Arts, Sport and Tourism, the costs were particularly high in comparison with the other agencies.

**7.29** Similarly, audit found that anomalies existed in the number of staff allocated to purchasing in various regions of the Directorate of School Education, compared with the workload associated with purchasing in the form of requisitions raised. Table 7B, which sets out the number of full-time equivalent (EFT) staff assigned to the purchasing function in each region and the number of requisitions raised per staff member, highlights this position.

**TABLE 7B**  
**DIRECTORATE OF SCHOOL EDUCATION**  
**COMPARISON OF WORKLOAD ACROSS REGIONS**

<i>Region</i>	<i>Number of purchasing staff (EFT)</i>	<i>Requisitions raised per purchasing staff</i>
Central office	18.0	146
North Western Metropolitan	13.2	169
South Eastern Metropolitan (a)	9.6	570
Loddon-Campaspe	5.5	118
Goulburn North Eastern	5.0	302
Gippsland	4.1	199
Barwon South Western	3.5	265
Central Highlands Wimmera	2.8	392
<b>Total</b>	<b>61.7</b>	<b>..</b>

(a) Amalgamation of Southern and Eastern Metropolitan regions commenced in April 1993 and was completed by 30 June 1993

**7.30** As illustrated in the above table, in some regions such as North Western Metropolitan the number of staff assigned to purchasing was high in comparison with the workload in the form of requisitions processed. Conversely, in the South Eastern Metropolitan region a smaller number of staff had responsibility for a large number of transactions.

**7.31** While recognising that the structures and sizes of the agencies and regions together with the nature of purchases may contribute to certain differences in administrative costs, audit considers that the analysis highlights the need to regularly measure and monitor performance data and investigate anomalies.

**□ RESPONSE** provided by Director, Directorate of School Education

*The Directorate is committed to ensuring that the most cost-effective methods of purchasing are used by it. This will be achieved by an ongoing review of its policies, operations and functions in line with the principles of best business principles and practice. The recommendation to charge a fee for the preparation of tender documentation in certain circumstances has some merit, and will be investigated and implemented in appropriate circumstances.*

**□ RESPONSE** provided by Chief Commissioner, Office of Chief Commissioner of Police

*As indicated in response to the recent Internal Audit on Supply Processes, the Supply Division is developing, in conjunction with Financial Systems, a range of reports designed to monitor and report on issues relating to the supply function.*

*The purchasing module of the Force's Financial Management Information System has the capability of delivering some detail in the area of performance measurement. It is reliant, however, on the recording of additional information of past purchases. Systems are currently under development to enable this additional information to be obtained to facilitate a trial along the lines recommended by audit.*