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The Institute of
Internal Auditors
Australia

Whitepaper

Public Sector Procurement

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Background

Purpose

The purpose of this white paper is to provide guidance on control and risk reduction in public sector procurement.

Background

There are myriad regulations, legislation and policies applicable to public sector procurement that do not also apply to private sector procurement. Procurement is a 'big spend' for governments and therefore, high financial risk area to governments. It also impacts on legal and reputational risk.

There are numerous examples of government procurement 'gone wrong'. Public sector internal auditors have an important role to play in identifying and mitigating associated risks. There is little relevant guidance for internal auditors to reference when required to conduct reviews of public sector procurement.

For public sector internal auditors, there are numerous auditing methods that can be applied to public sector procurement including, but not limited to, reviews of procurement frameworks, traditional 'post procurement' reviews, real time probity reviews, and gateway reviews. Knowledge and awareness of each type of review is essential for public sector internal auditors to assure risks are mitigated and audit effort is fit-for-purpose.

Discussion

Issue

The issue to be discussed is:

How can public sector procurement activities be properly controlled with appropriate transparency and accountability?

Discussion

Procurement is the first step in the procure to pay process, illustrated as follows:

Procure Goods or Services	<ul style="list-style-type: none"> - Concept or idea leads to business case including delivery method such as alliance, PPP, other. - Leads to procurement plan. - Which leads to requests for quotation / proposal / tender for goods or services. - Which lead to evaluation of responses. - Which leads to contract negotiation. - Which leads to a contract being awarded.
Manage Delivery of Goods or Services (Qualitative)	<ul style="list-style-type: none"> - Contract / Project management for delivery of goods or services. - Quality management of goods or services received.
Pay for Goods or Services (Quantitative)	Pay for goods or services delivered

This guide provides focus on the unique public sector aspects of procurement, for example, it considers among other things:

- > Serving the public interest.
- > Unique reputation risks versus private sector.
- > Unique outsourcing considerations.
- > Unique aspect of multi-agency procurements.
- > Unique project delivery methods, such as Public Private Partnership (PPP) or Alliance which also

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require unique procurement processes.

Regulatory Environment

Understanding the regulations, legislation and policies applicable to public sector procurement is the first step in the auditing process. Most governments publish their policies and guidelines on their respective websites. There is generally a government-wide set of policies providing the overarching policies and principles to be followed to achieve the best value-for-money outcome at the various levels of government – federal, state/territory and local. Sometimes, the lower levels of government procurement policies are tied to higher levels, for example local to state/territory). At the agency level there will be more specific policies and procedures designed to achieve the outcomes required from government-wide policies. Government internal auditors need to be aware of matters including, but not limited to, the following:

- › Regulatory bodies that set procurement policy.
- › Government policy on procurement.
- › Rights of tenderers.
- › Special rules, such as industry participation strategies, imported content, regional preference, free trade agreements, value-for-money, fairness and impartiality of processes.
- › Limitations placed on use of lobbyists.
- › Level and timing of involvement in the process by government ministers or local government councillors.

Procurement Types

There is a wide range of procurement methods available. The method to be selected will be dependent on the nature, size (volume) and complexity of the goods or services to be procured. The following provides a brief explanation of the most common methods.

Quotation

Quotations are generally requested from potential providers when the product or service delivery method is known and only a price to deliver that product or service is required. Quite often, quotations will be asked for relatively low size / low complexity procurements, and there is limited opportunity for vendors to differentiate between the qualitative aspects of the delivery method. Or, there may have been a pre-qualification process that has already assessed qualitative aspects, and there is no need

to re-evaluate. The contract to deliver is essentially based on price, but potential providers may be asked to meet pre-determined criteria.

The number and form of quotations will vary according to the expected cost of the goods or services required. For example:

- › Low value items – verbal quotes.
- › Medium value items – written quotes.
- › Higher value items – a minimum number of written quotes

Expressions of Interest (EOI)

An Invitation for EOI may be used as the first phase of a larger procurement process. An EOI process is intended to identify vendors with the capability and capacity to deliver a particular outcome. The Invitation for EOI will include a range of criteria to determine a potential vendor's capability, capacity, experience and track record in the delivery of specific outcomes. They assess capability only and do not ask for pricing. Based on the outcome of the EOI evaluation, a decision will be made as to which vendors will be asked to proceed to the second phase of the procurement process (eg RFP, RFT, Alliance, PPP) where the vendors will be required to respond to in-depth qualitative criteria and provide pricing for their proposed solution. An EOI may also identify that the market cannot deliver a value-for-money outcome and the process may be terminated at that point.

Tender

Requests for Tender (RFT) are called when the proposed contract value exceeds a pre-determined level. The pre-determined level may be set by the organisation's procurement policy or legislated by government. RFTs will provide a design or service delivery method to follow and include a range of qualitative and quantitative selection criteria against which to evaluate tender bids. Selection criteria may include, but not be limited to:

- › Human resource capability to deliver.
- › Track record in delivering the service or outcome.
- › Financial capability of the organisation.
- › Insurance coverage.
- › Risk management approach.
- › Pricing.

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If a tenderer considers they have a superior delivery method or design than that described in the RFT, they may be able to submit an 'alternative' tender. Many RFTs also require alternative tenders to be accompanied by a conforming tender. Alternative tenders will generally be accepted when they are deemed to deliver a better value-for-money outcome than conforming tenders.

Proposal

Requests for Proposal (RFP) are similar to RFTs except that they allow, or require, proponents to identify the best delivery methods or designs available. That is, the government agency stipulates the required outcomes and the proponents provide their best value-for-money solution to achieve the required outcomes. The RFP is used to leverage private sector expertise to deliver innovative better practice outcomes in the most cost-efficient manner.

Early Contractor Involvement (ECI)

ECI allows for earlier involvement of respondents, generally in design-and-construct procurements. It allows input from the respondents to achieve a better outcome and better control of the project by the procuring organisation.

Best and Final Offer (BAFO)

Allows a short-listed respondent to reconsider its proposed pricing after short-listing and feedback from the procuring organisation.

It should be noted that once a procurement method is set it is unusual, and generally unacceptable, to change to another method at a later stage of the process. For example, unless BAFO is stipulated at the beginning of the process, it should not be introduced after pricing has been received from respondents.

Interactive Procurement Process (IPP)

An IPP is a tool used to assist entities to provide their best possible response to a procurement request for large and complex procurements. They consist of a series of controlled meetings between the procuring organisation and short-listed respondents. Meetings may be scheduled according to topic for example, legal, operational, design, pricing if specific specialist skill-sets may be required. They are most commonly used in Alliance and PPP procurements, and enable direct dialogue between parties to clarify requests for information during the evaluation phase.

Governance Requirements

The government legislation, or departmental policy, applying to large procurements may include the following requirements:

Initiating documents

Initiating documents are usually a combination of the following:

- › Business case.
- › Feasibility study.
- › Project initiation document.

Initiating documents should outline the need for the procurement, alignment with strategic objectives of the organisation, identify potential risks and benefits of the procurement, and include potential timelines. The business case may then be submitted to the appropriate level of delegated authority for endorsement and approval to proceed to the next phase.

Procurement Plan

The procurement plan builds on the initiating documents, with more substantive detail and may include, but not be limited to, the following:

- › Background information.
- › Scope.
- › Likely commencement date of contract.
- › Likely duration of contract.
- › Funding source.
- › Estimated contract value.
- › Procurement timetable.
- › Risk assessment and risk mitigation strategies.
- › Results of market research.
- › Proposed procurement approach.
- › Proposed evaluation approach including criteria and weightings, scoring scales, approach to determining best value-for-money when combining qualitative criteria, pricing and risk.
- › Proposed governance framework to be followed including oversight committee structures, delegated authorities, relationships between committees, and audit and probity requirements.

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Probity Plan

At a high level the probity plan will include guidance on the following:

- › Probity principles to follow.
- › Project members, their roles and delegated authorities and responsibilities.
- › Identity and role of the probity advisor.
- › Evaluation teams' roles and memberships.
- › Information Security requirements and processes.
- › Confidentiality of information requirements and how to manage actual, potential and perceived conflicts of interest.
- › Communication protocols (and possibly reference to a separate communications plan).
- › Protocols for interaction between the requesting and responding parties.

Governance Framework

The governance framework should document the delegated authorities of all those involved in the procurement process. It may include the relevant interactions between committees and individuals.

Evaluation Plan

An evaluation plan sets out the reasoning and methodology for assessment of responses and may include:

- › Procedural matters – these may be similar to those noted above in the probity plan.
- › Evaluation criteria.
- › Scoring guidelines for assessing each criterion.
- › Clarification process to be followed.
- › Consensus scoring approach eg following discussion of 'outlying scores' a specific agreed score is reached or an average score is used.
- › Approach to short-listing.
- › Final value-for-money assessment methodology.
- › Negotiation process.
- › Notification to successful and unsuccessful respondents.
- › Debriefing of unsuccessful respondents.

Negotiation Plan

Quite often there are elements of responses that depart from requirements of the request, and it is necessary to negotiate with a preferred respondent. Some departures are not negotiable, while others may be negotiable to allow for the best available value-for-money outcome. A negotiation plan will provide the framework to be followed during negotiations, to provide assurance negotiations do not depart from organisation requirements.

Specific Contract Types

The following specific contract types have differences to traditional contracts. Therefore, the procurement approach and guidelines vary accordingly.

Alliance

Alliance contracting is an integrated procurement method for infrastructure projects. Under an alliance contract, a government client contractually works collaboratively with private suppliers to deliver a project. The alliance participants work as an integrated, collaborative team to deal with key project delivery matters. Under alliance contracts, risks of project delivery are often jointly managed by the parties, although financial exposure lies mostly with government.

A procurement process to select an alliance contractor usually has similar selection criteria to 'standard' procurement methods such as RFP or RFT, but generally includes assessment based on workshops, where the potential alliance contractors work collaboratively with the evaluation team, and there is open dialogue regarding potential alliance structures.

Public Private Partnership (PPP)

A PPP is a service contract between the public and private sectors where government pays the private sector, typically a consortium, to deliver infrastructure and related services over a long-term. The private provider builds an infrastructure facility and operates or maintains it to specified standards over a long-term period. The private provider usually finances the project.

The government client is typically seeking whole-of-life innovation and efficiencies that the private sector can deliver in the design, construction and operating phases of the project.

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Panel (Common User) Contracts

A group of providers established to provide specific goods or services. These groups are established through a procurement process where the appointed providers have met specific qualitative and quantitative requirements. There is no guarantee of work for the appointed providers. To engage a provider, there is an established procedure to be followed to procure from the panel, including a contract established for delivery. These contracts may be established by an individual government entity or on a 'sector wide' basis. Government will stipulate whether use of panel contracts is 'mandatory' or 'non-mandatory' for government entities.

Auditing Methods for Public Sector Procurement

Probity (Insight / Foresight)

A probity role is generally included in a procurement process where the contract value will be high, or the procurement process will be complex or politically sensitive.

Probity review activities may be conducted throughout the procurement process, usually as a probity advisory role, or post-procurement through a probity assurance role. Or a lifecycle audit approach can be taken providing advisory services throughout the procurement, with assurance reports produced at key points of the process. Regardless of the approach taken, the following issues are paramount to probity of a process:

- › *Transparency* – The process should be documented and approved at the appropriate levels. Request documents should at least include a high-level guide to the procurement evaluation process including indicative key dates, weightings for each evaluation criterion, compliance criteria, lodgement methods, and staff to be contacted for clarifications of information. There should be approved plans for assessment and negotiation of responses.
- › *Fairness* – Request documents and evaluation process should be fair to all potential respondents. Wording of documents should not be such that it unnecessarily precludes certain entities from responding. For example, requesting proprietary products when there may be generic products available.
- › *Unbiased approach* – The procurement and evaluation process should be developed and approved in advance of receiving responses.

This removes opportunity or perception of processes that favour, or are biased against, a particular respondent.

- › *Compliance* – There should be compliance with pre-determined standards. This can be especially difficult to manage where there is 'live' interaction between the parties eg ITPs.
- › *Confidentiality* – Confidentiality of respondent information and assessment processes must be preserved.
- › *Conflicts of interest* – These may apply to members of the procuring organisation involved in evaluating responses, or it can involve respondents themselves having a conflict in delivering requested goods or services. There should be a sound approach in place for assessing actual, potential and perceived conflicts of interest to ensure they don't negatively impact on the procurement process.

Gateway Review (Insight)

Gateway reviews are short reviews of generally less than one week conducted at critical decision points throughout the procurement process. They are usually conducted by a government team of subject matter specialists, external to the procuring organisation. In a number of jurisdictions, gateway reviews are standard practice.

Procurement Framework Review (Foresight)

A broad scope review that assesses the overall organisation procurement framework for risks and mitigating strategies. It may also consider potential efficiency and effectiveness of the procurement framework in achieving its desired outcomes.

Capability Maturity Assessment (Insight / Foresight)

A capability maturity model is the measurement of key process areas against a maturity continuum. This may be a powerful tool in reducing the expectation gap between where management or the board think a process has matured to, as opposed to, the actual maturity of the process. It can provide a roadmap to progressing through the maturity levels until the desired level is reached.

Traditional 'Post Procurement' reviews (Hindsight)

These may focus on specific procurements, or a sample of procurements from a particular time period. They are useful in providing assurance as to how specific procurements were undertaken and

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managed and can provide useful information on systemic issues and 'lessons learned' which can be applied to future procurements.

Each of the abovementioned reviews may be undertaken individually or may be components of a larger review. Whatever audit approach is taken, it should be suitable for the risks applicable to the procuring organisation at a particular point in time.

Conclusion

Summary

Public sector procurement activities need to be properly controlled with appropriate transparency and accountability.

Therefore, it is imperative that public sector procurement activities:

- › Select the most appropriate procurement type.
- › Apply fit-for-purpose governance arrangements from inception to conclusion.
- › Have the best fit contract type.
- › Receive appropriate assurance review activities commensurate with the level of assessed risk.

Conclusion

Procurement processes must be fair, open, transparent to all parties, and be defensible. The essential elements that must exist throughout a procurement process are:

- › Compliance with laws and policies.
- › Consistent approach for all potential respondents, and all bids received.
- › Effective management of conflict of interest.
- › Fairness and impartiality.
- › Security and confidentiality.
- › Open and competitive tender process.
- › Accountability – consistency and transparency of the procurement process.
- › Proactive mitigation of tender risks.

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Purpose of White Papers

A White Paper is a report authored and peer reviewed by experienced practitioners to provide guidance on a particular subject related to governance, risk management or control. It seeks to inform readers about an issue and present ideas and options on how it might be managed. It does not necessarily represent the position or philosophy of the Institute of Internal Auditors–Global and the Institute of Internal Auditors–Australia.

Author's Biography

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Stephen is Director of Assurance Advisory Group Pty Ltd providing internal audit, probity advisory and audit related services. He has held senior positions in professional services firms for over 20 years where he has delivered assurance and advisory services to the public and private sector, from one-off projects through to fully outsourced arrangements. Prior to that, he enjoyed a career in a Western Australia statutory authority where he held senior positions in internal audit, financial accounting and management accounting.

He spent 10 years on IIA global guidance committees (Professional Issues Committee and Public Sector Committee) where he co-authored a number of Practice Guides. He co-authored Probity Handbook HB325–2008 'Assuring probity in decision-making'.

Stephen has delivered numerous presentations on probity and internal audit throughout Australia, including at SOPAC and other state conferences, and IIA International Conferences in London and Anaheim Los Angeles.

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As the chief advocate of the Internal Audit profession, the IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for Internal Audit integrity and professionalism around the world with its 'International Professional Practices Framework' (IPPF), a collection of guidance that includes the 'International Standards for the Professional Practice of Internal Auditing' and the 'Code of Ethics'.

The IIA-Australia ensures its members and the profession as a whole are well-represented with decision-makers and influencers, and is extensively represented on a number of global committees and prominent working groups in Australia and internationally.

The IIA was established in 1941 and now has more than 200,000 members from 190 countries with hundreds of local area Chapters. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

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