



Australian Government

Department of Broadband,
Communications and the Digital Economy

Review of Procurement

September 2009

Final Report

KPMG Canberra

	Planned	Actual
Entrance Interview	March 2009	April 2009
Fieldwork	April 2009	May 2009
Draft Report	April 2009	May 2009
Management Comments	June 2009	September 2009
Final Report	June 2009	September 2009

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This report has been prepared as outlined in the methodology of this report. The procedures outlined in the methodology constitute neither an audit nor a comprehensive review of operations.

Due to the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. Our procedures were not designed to detect all weaknesses in control procedures as they are not performed continuously throughout the period and the tests performed are on a sample basis. As such, except to the extent of sample testing performed, it is not possible to express an opinion on the effectiveness of the internal control structure.

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1 Executive Summary

1.1 Background

The Australian Government has in place a range of legislation and related policies that set out the framework for procurement. This includes the Financial Management and Accountability Act 1997 (FMA Act), Financial Management and Accountability Regulations 1997 (FMA Regs) and the Commonwealth Procurement Guidelines (CPGs).

The FMA Act requires an agency's Chief Executive to promote the efficient, effective and ethical use of the resources for which they are responsible. Chief Executives have the authority to issue legally binding Chief Executive Instructions (CEIs) relating to the financial administration of their agency and these instructions can cover the agency's policies for procurement. More detailed procurement policies and procedures are usually developed to supplement the CEIs.

As part of the annual internal audit plan, the Department of Broadband, Communications and the Digital Economy's (the Department) Audit Committee has requested KPMG undertake an internal audit of procurement practices within the Department.

1.2 Summary of Findings and Recommendations

1.2.1 Positive Observations

Confidentiality of Procurement Information

The CPG Procurement Principles place particular importance on treating supplier submissions confidentially. Internal Audit observed that the Department ensures all procurement files are placed in 'in-confidence' files and are stored securely.

Contracting of suppliers

Practical Guide 2.6 – Procurement of Goods and/or Services requires a contract to be in place with a supplier before any goods/services are received. Internal Audit observed that in all procurements tested this had occurred.

Final Approval

Practical Guide 2.6 – Procurement of Goods and/or Services also requires a final Expenditure Approval Form be completed before entering into the final contracting stage. Internal Audit observed that in all samples tested, that the approval form had been appropriately completed and signed off by a suitable delegate, granting Regulation 9 and 10 approval.



Effectiveness of involvement of the Procurements with the Procurement and Funding Agreements Section

Internal Audit observed one procurement from the sample of 25 selected where the Procurement and Funding Agreements Section had been involved early in the planning of the procurement. This procurement was the only observed sampled item where no procedural non-compliance was evidenced.

1.2.2 Areas Requiring Remedial Action

Internal Procedure Gaps (CR3)

In performing an analysis over the existing Practical Guide 2.6 – Procurement of Goods and/or Services, Internal Audit noted a number of key Commonwealth Procurement Guidelines (CPG) requirements that were not covered within the internal procedures. Internal Audit considers these areas as fundamental aspects of a procurement control environment, which if not adhered to, may expose the Department to an increase in risk of CPG non-compliance.

Internal Procedure Non-compliance (CR2)

Internal Audit views the internal procedures as a key control over CPG compliance, thus a failure to comply with the Practical Guide 2.6 – Procurement of Goods and/or Services, exposes the Department to greater risk of CPG non-compliance.

In performing sample testing over 25 procurements performed within the Department during 2008-09, Internal Audit observed degrees of non-compliance against internal procedures in 24 of the procurements. Refer to Appendix 1 for test results.

Commonwealth Procurement Guidelines Non-compliance (CR2)

One instance of CPG non-compliance was noted where the Department failed to document the decision to pursue a direct source contract for \$199,677.73 with a service provider.



Summary of Advice

The objective of this review was to:

- determine the level of compliance with FMA Act and Regulations and CPGs; and
- consider the overall procurement framework in place at the Department.

In performing the fieldwork, Internal Audit observed no instances:

- of non-compliance against Regulations 9 and 10 requirements;
- where a signed contract was not in place before receiving goods/services from a supplier; and
- where procurement documentation was not stored confidentially.

In addition Internal Audit observed that in the one instance where the Procurement and Funding Agreements Section had early involvement in the procurement, there were no instances of procedural non-compliance.

As part of this review, Internal Audit assessed the existing procurement internal procedures, and identified a number of key CPG requirements that were not covered in the internal Practical Guide 2.6 – Procurement of Goods and/or Services. Internal Audit recommends that the Department address these areas in their internal procedures to strengthen the procurement control environment.

Internal Audit also identified 24 procurements from a sample of 25 with degrees of procedural non-compliance. Given that the one sampled procurement where non-compliance was not detected had involved the Procurement and Funding Agreements Section, Internal Audit recommends that the Department implement a mandatory process of notifying/approaching the Procurement and Funding Agreement Section when planning a procurement.

Internal Audit also identified one instance where a covered procurement was performed as a direct source to the supplier. In performing this, the responsible party failed to formally document the reasoning for using a direct source, which is a breach of the Commonwealth Procurement Guidelines, Section 8.34.

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2 Objective, Scope and Method

Objective

The objective of this review is to determine the level of compliance with the FMA Act requirements and CPGs and consider the overall procurement framework in place at the Department.

Scope

Audit procedures were limited to undertaking testing of a sample of transactions. Our sample was from the Department's AusTender contract register. Accordingly, contracts valued at less than the AusTender reporting threshold (\$10,000) were not considered. The review only examined contracts executed between 1 July 2008 to 28 February 2009.

We tested 25 procurements, which were selected so as to be representative of the ratio of contracts entered into by each Division.

Key areas that were considered during testing included:

- requirements definition;
- compliance with FMA Act, FMA Regulations and associated legislation;
- compliance with the Commonwealth Procurement Guidelines; and
- transition to contract management.

Method

The following outlines the methods used by Internal Audit in conducting this review:

Planning

- Liaised with Departmental staff to agree overall approach and sample size.
- Drafted and circulate Assignment Plan.
- Held opening conference with audit sponsor.

Familiarisation

- Examined the *Financial Management and Accountability Act 1997*, *Financial Management and Accountability Regulations 2007* and associated legislation.
- Examined the *Commonwealth Procurement Guidelines*.



- Examined the Department's policies and procedures on the procurement of goods and services.
- Liaised with the Department's Procurement and Funding Agreements Section to obtain an understanding of any relevant arrangements the Department has in place.

Fieldwork and Testing

- Commented on whether the Department's policies and procedures are consistent with the requirements of the FMA Act, FMA Regulations and associated legislation and identified key and relevant inconsistencies.
- Commented on the overall procurement framework in place within the Department.
- Selected a sample of procurements and obtained supporting documentation.
- Conducted testing on a sample of procurements and determined the level of compliance with relevant requirements.
- Investigated any identified issues or discrepancies.

Reporting

- Significant matters were discussed with the audit sponsor.
- A verbal briefing was held on matters identified during the audit with management at the completion of the fieldwork.
- A draft report was issued with recommendations on improvements to controls, procedures and process.
- Conducted an exit interview with the audit sponsor.
- Issued a final report incorporating management comments.
- Issued a final report considered and endorsed by the Audit Committee.

3 Findings and Recommendations

3.1 Internal Procedure Gaps (CR3)

Observation

Internal Audit considered the Department's Practical Guide for the Procurement of Goods and/or Services, against key CPG requirements and noted that the following CPG requirements were not included in the Practical Guide 2.6 – Procurement of Goods and/or Services:

- Specific directives for determining the cost of a procurement over the life of the agreement, including options, extensions or renewals.
- Specific rules around direct sourcing as opposed to approaching the market through and open tender process. This includes the accepted criteria for direct sourcing.
- A directive for dealing with suppliers in a non-discriminatory manner.
- Procedures for modifying evaluation criteria during a procurement.
- Procedures for the specific time limits around open tender procurements.
- Requirements for cancelling a procurement, after an approach to market has been delivered.

Implication / Risk

Internal Audit views the Practical Guide as a key control mechanism in assisting the Department's staff in complying with CEI's and mandatory CPG requirements, and as such a failure to detail the key CPG requirements as outlined above increases the risk of CPG non-compliance by staff members who adhere to the Practical Guide 2.6 – Procurement of Goods and/or Services.

While Internal Audit recognises that there is a directive not to replicate the CPGs within the Practical Guide 2.6 – Procurement of Goods and/or Services, and that staff are directed to comply with CPGs when referring to Practical Guide 2.6, the above requirements are embedded within the detail of the CPGs and may not be clear or visible to staff members.

Recommendation

Internal Audit recommends that the Procurement and Funding Agreements Area amend the existing Practical Guide 2.6 – Procurement of Goods and/or Services to include the following major CPG requirements:

- Directives for determining the cost of a procurement (CPG Reference 8.5 – 8.10).
- Mandatory rules for Direct Source procurements (CPG Reference 8.31 – 8.33).



- Principles of non discriminatory dealings with suppliers(CPG Reference 8.45 – 8.47).
- Principles for modifying evaluation criteria (CPG Reference 8.51).
- Directives for time limits of open tender procurements (CPG Reference 8.58 – 8.68).
- Principles around cancelling a contract once an approach to the market has been made (CPG Reference 8.71).

Management Comments

The Department accepts the observation that a small number of CPG requirements are not reiterated within the Department's current Practical Guides to do with procurement and has amended this guide to incorporate all six points noted above. The revised Practical Guide is currently going through the final clearance process and is planned for release at the end of August 2009.

The revised Practical Guide notes at 1.2.5 that if performing duties relating to the procurement of property and services, officers must act in accordance with the Commonwealth Procurement Guidelines.

The Practical Guide will further strengthen the procurement processes within the Department. "Quick Guides" are being added to the Practical Guide as attachments, to assist staff members to deal with some specific and/or more complex areas within the procurement cycle. These Quick Guides give step by step instructions on contracting and purchase orders and consolidate the information contained in the body of the Practical Guide. A Procurement Process Checklist has also been developed and added as an attachment to the revised Practical Guide. Both the Quick Guides and the Checklist are complimentary and should not be viewed in isolation.

The Department has recently improved its focus on procurement and contract management by establishing a Procurement and Contract Management section. A key responsibility for this section will be a continuous training regime for staff involved in procurement activities and a focus on the continuous improvement of procurement related documentation.

Additionally, the Department has recently hosted the Department of Finance and Deregulation's Financial Framework Policy Branch in conducting general awareness sessions covering the changes the FMA Regulations 7, 7A, 9, 11,12 and 13.

Agreed

Responsible Officer - Michael Honan- Manager Procurement and Contract Management
Deadline for Implementation of Corrective Action – with the release of the revised Practical Guide 2.6

3.2 Internal Procedure Non-compliance (CR2)

Observation

In testing a sample of 25 procurements, Internal Audit noted 24 instances of non-compliance with Practical Guide 2.6 – Procurement of Goods and/or Services. The instances of non-compliance varied between each item tested; however in each of the 24 instances there was an element of non-compliance (See Appendix 2).

Some of the key procedural breakdowns were:

- Failure to complete a business case (16 instances);
- Failure to perform a risk assessment (19 instances); and
- No evidence of initial contact with the Procurement and Funding Agreements; and Legal areas (24 and 17 instances respectively).

There was one instance where no procedural non-compliance was detected, this procurement was the only sampled item that had been performed with the consultation of the Procurement and Funding Agreements Section.

During the course of the review, Internal Audit was also informed that it is not mandatory for staff to notify the Procurement and Funding Agreement Section of a procurement, or to approach the area for advice.

Implication / Risk

The Practical Guides in use within the Department act as a medium to ensure compliance with CEI's which in turn ensure compliance with the FMA Act. In addition, Practical Guide 2.6 – Procurement of Goods and/or Services acts as a control to assist in the compliance with CPG requirements. Thus a failure to comply with Practical Guide 2.6, increases the risk of non-compliance with the FMA Act and CPGs.

Recommendation

Internal Audit recommends that a mandatory planning procurement step be put in place to ensure staff performing procurement obtain advice from the Procurement and Funding Agreements Section, now the Procurement and Contract Management section who can then track compliance against the procurement Practical Guide 2.6.



Management Comments

The Department accepts the observation that it has the capacity to achieve further compliance which will involve strengthening and supporting procurement processes, particularly at the initial procurement stages.

None the less, discussions with relevant line areas indicate that at least in the majority of cases, consideration of risk and the business need were taken into account, but were not documented.

The planned improvements will be achieved with the Procurement and Contract Management section introducing a mandatory centralised process for registering and monitoring all spending proposals (including funding) requiring a purchase order as per Clause 1.17 of the draft procurement Practical Guide 2.6 and Sub-Clause 1.1.4 of the draft funding Practical Guide 2.8. This will require all areas undertaking this type of spending of public money to register their process, upon which they will receive a spending proposal identification number (SPIN). As a result of registering a spending proposal, the staff member will receive an information pack relevant to their process which will provide them with essential initial advice including a Procurement Process Checklist documents for procurements and sources of further information.

The implementation of these procedures and the associated guidelines is expected to commence with the introduction of the revised procurement and funding Practical Guides.

Agreed

Responsible Officer - Michael Honan- Manager Procurement and Contract Management
Deadline for Implementation of Corrective Action – with the release of the revised Practical Guide 2.6

3.3 CPG Non-compliance (CR2)

Observation

Mandatory Procurement procedure 8.34 of the CPGs requires the following:

'...for each contract awarded through direct sourcing, agencies must prepare and appropriately within the agency's central filing system, a written report that includes;

- a. the value and kind of property services procured; and*
- b. a statement indicating the circumstances and conditions that justify the use of a procedure other than an open or select tender process.'*

Internal Audit observed an instance where a covered procurement (value of \$199,677.73) was undertaken using a direct source method of approaching the market, where no documentation or evidence could be provided justifying the use of a procedure other than an open or select tender (as outlined above).

Implication / Risk

The CPGs are issued by the Minister for Finance and Deregulation under the *Financial Management Regulations 1997*, and as such a breach of the CPGs can lead to an agency being in breach of the FMA Act.

Recommendation

Internal Audit recommends that the Department strengthen the control framework around CPG and internal procedure compliance through the implementation of Recommendation 1 and Recommendation 2 above to reduce the risk of non-compliance.

Management Comments

The Department notes that within the observations for 3.3 above, an instance where a covered procurement (value of \$199,677.73) was undertaken using a direct source method and no evidence could be provided justifying the use of that procedure. The procurement was for the renewal of Oracle software licences currently used in the Department. The Department accepts that this was a new procurement but also notes that it is a procurement exempted under clause 8.33 (e) of the CPGs. Further investigation indicates that the chosen process was justified under the CPGs as per the clause stated above. The Department agrees that there has been a failure in this instance to adequately document this renewal of licences procurement decision as is required under 8.34(b) of the CPGs.

The Department agrees to implement recommendations 1 and 2 which it believes will strengthen the control framework around CPG and internal procedure compliance.



Agreed

Responsible Officer - Michael Honan- Manager Procurement and Contract Management

Deadline for Implementation of Corrective Action – with the release of the revised Practical Guide
2.6



4 Appendix 1 – Testing Results

The following table summarises the testing results performed over a sample of 25 procurements performed in the 2008-09 Financial Year.

Test Performed	Non-Covered Procurements		Covered Procurements		Total	
	No. Tested	Unsatisfactory	No. Tested	Unsatisfactory	Tested	Unsatisfactory
Planning Evidence of:						
Risk assessment	16	15	9	4	25	19
Approval before approaching market	16	11	9	0	25	11
Determination of procurement value	16	8	9	1	25	9
Initial contact with Procurement and Funding Agreements Area	16	16	9	8	25	24
Initial contact with Legal Group	16	14	9	3	25	17
Business case	16	11	9	5	25	16
Procurement Plan	16	12	9	3	25	15
Evaluation (Does not apply to 10 Direct Sources in Sample) Evidence of:						
Evaluation Plan	9	3	6	0	15	3
Evaluation Plan Approval	9	3	6	1	15	4
Evaluation Committee	9	2	6	0	15	2
Confidentiality Deeds signed by Evaluation Committee	9	2	6	0	15	2
Evaluation Report	9	0	6	0	15	0
Expenditure Approval Form	9	0	6	0	15	0
Tender Responses	9	1	6	1	15	2
Decision Evidence of:						
Contact with Legal Group before signing contract	16	4	9	2	25	6
Notification of unsuccessful Tenderers	16	1	9	0	25	1
Contract in place before services received	16	0	9	0	25	0

5 Appendix 2 – Classification of Findings

Assigning a category to an internal audit finding is one of professional judgement. There are various factors that will be considered when an internal auditor assigns a category classification.

The purpose of assigning a classification to a finding is to communicate the importance of that finding with the Audit, Risk and Evaluation Committee, management and staff of DBCDE. This communication plays an important part in interpreting the internal auditor's opinion with respect to what priority a finding and its associated recommendation should be given.

In the table below are a number of the factors an internal auditor considers when assigning category classifications.

It is important to note that an internal auditor will assign a category classification with the best interests of the 'organisation as a whole' in mind.

Factors considered when categorising findings	CR1 Finding	CR2 Finding	CR3 Finding
Priority of attention required (<i>Who</i>)	Secretary / Deputy Secretary	Deputy Secretary	Deputy Secretary
Priority of attention required (<i>timeliness of action required</i>)	Immediate commencement of corrective action	As soon as practical within the next 3 – 6 months.	When resources permit at the discretion of the organisation.
Likelihood or impact of the uncontrolled risk	Catastrophic / Major The likelihood/impact of the uncontrolled business or financial risk may threaten either the operation of the Department or the effective function of a critical/significant project and/or have a severe impact on the Department's reputation and credibility.	Moderate / Minor The likelihood/impact of the uncontrolled business or financial risk would threaten the efficiency or effectiveness of an aspect of operations.	Insignificant The likelihood/ impact of the uncontrolled business or financial risk could be dealt with by routine operations.



Factors considered when categorising findings	CR1 Finding	CR2 Finding	CR3 Finding
<i>Suitability of the policies and/or procedures</i>	No policies and/or procedures exist. Policies and/or procedures are not considered appropriate to manage a significant risk or function of the organisation.	No policies and/or procedures exist. Policies and/or procedures are not considered appropriate to manage a core business risk or routine function.	Policies and/or procedures are appropriate but out of date (the effect is not considered of serious consequence).
<i>Compliance with documented procedures and policies</i>	Policies and/or procedures are not being complied with.	Policies and/or procedures are not being complied with consistently (frequency and quality). Documentation does not reflect proper compliance with procedures and policies	Infrequent instances of non-compliance with policies and procedures were identified.
<i>Breach of delegations (financial and non-financial)</i>	Any one of the following individually or in combination. Dollar values: - Large Frequency of breaches: - Regular	Any one of the following individually or in combination: Dollar values: - Medium Frequency of breaches: - Periodic	Any one of the following individually or in combination: Dollar values: - Small Frequency of breaches: - Isolated



Factors considered when categorising findings	CR1 Finding	CR2 Finding	CR3 Finding
	Documentation to support exercise of delegation: - Doesn't exist What/how: - Breach of delegation exercised by Branch Head and/or above All fraud or corrupt conduct identified is reported as CR1	Documentation to support exercise of delegation: - Not adequate What/how: - Breach of delegation by middle management	Documentation to support exercise of delegation: - Could be improved What/how: - Breach of delegation reflecting ignorance
Fraud	N/a	N/a	N/a

B/R Business Improvement Recommendation - Arises where the internal auditor considers that the recommendation, if implemented, would result in a benefit accruing to the organisation (for example, through more efficient and/or cost effective processes, a reduction of expenditure or an increase in revenue).