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### Public Procurement

# Audit of Procurement

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## Introduction

The scope of public procurement is broad and incorporates a wide range of activities, all of which have the common aim of providing resources for the execution of tasks. In all cases, the public body has to choose a supplier and pay for the goods delivered or services provided. In most EU Member States, procurement represents up to 30% of public spending.

Supreme audit institutions (SAIs) audit the use of public resources, but their audit mandates and activities vary, as do national budgeting systems and public procurement regulations. This Brief aims to give guidance that is relevant and applicable to auditors when auditing procurement, although they will certainly be operating within different frameworks and have different objectives and procedures. The Brief does not encompass all of the detailed steps of the procurement procedure. Based on audit experience, it examines the stages that are worth looking at and explains why and it highlights those aspects that are recommended to be considered in more detail. It also gives advice as to which documents the auditor is suggested to scrutinise in order to find evidence. Brief case studies, where available, and checklist questions for the auditor (grey boxes) illustrate the main aspects.

The illustrations focus on individual procurement procedures, with an emphasis on regular purchasing contracts for goods and services. Concessions and public-private partnerships (PPPs) are considered as alternative legal constructions and are touched on at the end of the Brief.

## Audit objective and criteria

The subject matter of the audit is the whole procurement process, which may be divided into three major phases:

- Definition of needs;
- Procedure to award the contract;
- Management of the contract until its completion.

The audit may be launched when the procurement procedure is in a more or less advanced stage of preparation or once it has already been completed. The mandate of some SAIs encompasses the audit of procedures in both stages. It goes without saying that the potential impact is greater the earlier the audit starts. However, any risk to see the auditor as participating in the process should be avoided.

The audit of procurement procedures involves both compliance audit and performance audit in most cases. Compliance criteria, against which the process is to be assessed, are based on the legal framework applicable in the particular context of the country. This context may differ significantly from country to country, and therefore the relevant context for the purpose of this Brief is considered to be the EU procurement regime.

In terms of performance, the auditor needs to assess whether the procedure and the decisions taken meet the "three E" criteria – economy, efficiency and effectiveness. Economy focuses on the paying the cheapest price for similar goods and services, whereas efficiency is getting the maximum output of goods and services for a given input of public administrative resources (not only money) or minimizing the input of such public resources for a given output of goods or services of the procedure. Effectiveness assesses whether the performance obtained, as an output of goods or services procured, meets the objectives that were set.

## **Audit work is generally designed to examine whether:**

- the process for determining the need for the particular procurement is valid; and
- the award procedure is legal and public resources being spent in line with applicable criteria.

In practice, the concrete aims and, accordingly, the scope of an audit may be quite varied. In some cases the audit may aim to find out whether the motivation of the public authority has properly justified the spending of public money for a particular procurement. Some SAIs may strive to verify if good public procurement practices have been followed, while others concentrate on matters of formal compliance. Accordingly, an auditor may want to look at the procurement function as a part of an audit of the accounts of a specific public authority; find out if it works efficiently; look at all or some of the procurement procedures to conclude if they safeguard competition or if they bring good value for the public authority; look for guarantees that fraud and corruption are prevented; or may else need to go through a specific procurement procedure to bring evidence of its regularity, its adequacy with respect to the needs, or the value for money provided.

While in most cases compliance criteria are clear in principle, the question often remains whether the auditee achieved the best conditions possible under the given circumstances, in particular with regard to good prices. Of course, indicators of current market prices or of prices achieved in previous procedures may serve as a reference point. However, each competition is a singular event that takes place under the very special circumstances in effect at the time of the procurement – varying quantities, capacities available in the market, technical progress. Thus, it is difficult to measure the results of a procurement process against set figures. Consequently, the audit may focus on whether the procedure followed was likely to achieve value for money. As a rule, such an achievement is only valid if the procedure has at the same time safeguarded competition, transparency and equal treatment.

## **Main procurement phases and their key issues**

### **1. Defining the needs of procurement**

The definition of needs should usually be based on the identification of one or several gaps in the public authority's ability to fulfil its task with respect to its aim of delivering services or improving its performance. The procurement is intended to fill such gaps.

Main features of the definition of needs:

- Internal process;
- No restrictions or in the procurement law;
- Focus on performance aspects.

In any event, the auditor needs to assess whether the public authority has duly justified the procurement in terms of the quantity and specifications of the goods or services needed and whether it has considered and properly compared alternatives.

To accomplish that assessment, the auditor could look for supporting documents in the procurement files that:

- Motivate the scope and features of the procurement;
- In cases of procurement of high political or other risk and large value, consider alternatives to the solution envisaged;
- Compare the economic aspects of these alternatives under a value-for-money perspective<sup>1</sup>, if such assessment is an objective of the audit.

It should be emphasised that the public authority is responsible for delivering and documenting motivations and calculations of any kind that make it possible to assess whether the procurement was justified and successful.

### Case studies

- 1) A department procured 250 PCs to replace existing equipment that had not yet been amortised. This purchase was said to be necessary because new software was being implemented that, apparently, required a higher hardware capacity than the former PCs offered. The SAI scrutinised this motivation and discovered that the new software could have been used without restriction on the available PCs. The procurement was therefore unjustified.
- 2) The maintenance of public roads was carried out by regional offices which provided staff and equipment. The department purchased new machinery for one of those offices, inter alia a roller for EUR 50,000. Looking for alternatives to this purchase, the auditor checked how many rollers in total were already being operated and charged to capacity. He learned that several rollers in other offices had only a few hours of operation and inferred from the data available that one of those rollers, in accordance with actual local needs, could have been relocated instead of buying a new one for the office in question.

- Has the public authority justified the procurement in terms of economy / effectiveness?
- Is the number/scope necessary or would fewer/less also be sufficient?
- Are the concrete technical specifications indispensable or would a lower level also suffice?
- Did the department consider all reasonable alternatives?
- Did the department compare these alternatives, applying accurate figures, include all relevant aspects as well as agreed standards, and arrive at reasonable results?

## 2. Awarding the contract

Main features of the contract award process:

- External process;
- Substantial governance by procurement law;
- Focus on regularity, but leaving room for performance aspects.

<sup>1</sup>

See this notion explained in procurement brief No. 1 *Public Procurement in the EU: Legislative Framework, Basic Principles and Institutions*, p. 6.

When auditing public procurement the auditor should bear in mind the nature and purpose of the EU public procurement regime. Although it is still rooted in budgetary law, the EU regime is nevertheless not only supposed to save public money but also to build the European common market. Three basic principles are derived from this very nature and the underlying legislation: **competition, non-discrimination/equal treatment, and transparency.**

It is highly recommendable for the auditor to verify in the first place that the contracting authority has adhered to the spirit of these principles, rather than just to the wording of detailed regulations. However, this task is not a justification for disregarding the detailed rules. Although the violation of these rules in practice would appear to be a minor flaw that all too often leads to the exclusion of the economically most advantageous offer, it is necessary to emphasise that the fulfilment of these often formal requirements contributes in the end to the equal treatment of bidders.

Before the contracting authority may announce its intention to award a contract, a considerable amount of preparation needs to be done. This still an internal process, governed by the above-mentioned principles and a few more or less detailed provisions, provides the very basis for the whole award procedure and the upcoming contract. This is often scrutinised by the auditor. It is worth giving the following aspects special attention:

- Description of performance;
- Calculation of contract value;
- Tender documents;
- Award criteria;
- Award procedure;
- Notification;
- Assessment of tenders.

#### **a. Description of performance**

The performance description is the heart of the procurement procedure. Here the public authority describes its needs and the requirements (specifications) that the tenders must meet. This description has to be made in an unambiguous and comprehensive manner so as to ensure that all bidders understand it in the same way and that the tenders they submit are comparable.

The performance description must comply in particular with the principles of equal treatment and transparency, and thus must not discriminate against any product. This requirement means that the public authority is not entitled to demand any specified product brands or the like unless justified by the subject matter of the contract. The issue of technical specifications is particularly sensitive because by means of unjustified technical requirements, obstacles to competition and the preferential treatment of one supplier over another may take place without being easily noticed.

From the time of notification, the performance description has to basically remain unchanged, and it will become a part of the contract to be concluded. Only in negotiated procedures may the tenders be adapted, provided that the character of the performance required remains unaltered.

***The performance description should be based on the definition of needs and – for the purpose of economy – comprise only the requirements necessary.***

## Case studies

- 1) Specifications for the cushioning of office swivel chairs required a supporting slab made of compressed, moulded plywood with at least a tenfold veneer and chair wheels 55mm in diameter. **The vast majority of tenders submitted did not meet these requirements, whose compulsory character had not been duly motivated by the contracting authority and which did not have any influence on the functionality of the chairs.**
- 2) Specifications for PCs required white metal housing. In principle, these specifications were legally admissible. However, unless justified reasons are given, they unnecessarily exclude all other suitable products, thereby reducing competition. Furthermore, regardless of whether the public authority excludes all offers that do not meet the requirements and then assesses the remaining tenders or starts the procedure all over again with amended specifications, it will be acting against legal provisions and/or the principle of economy.

Besides the legal issues, the auditor may choose to verify whether the public authority has considered the following performance aspects that might have been suitable for enhancing the chances of receiving economically favourable offers:

- **Aggregation of demand** to make tendering attractive and thereby increase competition;
- **Short contract duration** – as short as possible to preserve the competitiveness of unsuccessful tenderers (but new invitations to tender would have to be launched in time);
- **Contract award by lots** to enable small and specialised companies to tender, thus increasing competition.

However, the auditor must bear in mind that these measures may conflict with each other and may not necessarily be beneficial in all cases; e.g., the possible advantages of a short contract duration would have to be set against the additional administrative cost of carrying out procurement more frequently. The motivation given by the auditee is important for an assessment.

- Was the performance description clear, unambiguous and comprehensive, giving a precise definition of the characteristics of the goods to be supplied and thereby making it possible for all concerned to understand it in the same way?
- Were the technical requirements strict enough to guarantee the desired performance without being unnecessarily rigid and thus bearing the risk of excluding otherwise favourable bids that do not comply with all of these requirements?
- Were any unjustified references to a specific make or source, a particular process, trademark, patent, type, or specific origin or production excluded from the technical specifications, thereby preventing the public authority from favouring or eliminating specific undertakings or products?

### **b. Calculation of contract value**

Public authorities often tend to calculate the estimated value of a contract in such a manner that it remains below the EU thresholds and thereby remains outside of the



scope of the EU Directive or national law. It should therefore be emphasised in this context that the calculation of estimated value is to take into account the total amount, including any kind of option (i.e. possible additional supplies or services) or renewal, and that the public authority must not split the contract in order to remain below the thresholds.

### Case study

An auditor suspects that the total amount needed for the procurement has been unduly split. To verify this suspicion, he needs to investigate beyond the related award documents. He may scrutinise the compilation of invoices for the current year to determine whether similar purchases have been executed. In other cases it may be more revealing to verify the definition of needs. A suitable approach may also be to estimate the total needs of the particular institution and compare them with the concrete procurement to verify their consistency.

- Did the public authority identify the required amount comprehensively, considering all of the relevant aspects of the performance, including options and provisions for renewal?
- Was the performance divided for valid reasons, rather than just for the purpose of remaining below the threshold amounts?
- Was the estimation based on realistic and up-to-date prices?

### c. *Tender documents*

In addition to the performance description, the tender documents provide all the relevant conditions for the competition. They inform the bidders about the contents and form of the documents that they are obliged to submit, attesting to their professional and financial ability, and about all the declarations that the public authority requires. The public authority has some discretion concerning the documents required and the attestations it seeks, provided that this discretion is justified by the subject matter of the contract. Furthermore, the public authority should be aware that unnecessarily strict requirements limit competition and reduce value for money. It should also bear in mind that it is obligatory, including for the public authority itself, to adhere to the rules once they have been set.

The auditor may choose to check especially that requirements concerning the suitability of bidders are both justified and sufficient so as to exclude unsuitable bidders and that the conditions allow a swift and smooth, transparent and non-discriminating procedure.

One measure to enhance the chances of advantageous offers is to allow variant offers to be included in procedures where the public authority is not intent on a particular technical solution.

- Did bidders fully understand, without any ambiguity, which documents and declarations had to be presented with the tender?
- Can bidders learn all relevant information straight from the tender documents or does the public authority make reference to information available only from other sources, besides the tender documents?
- Did tender documents fix requirements for the suitability of bidders concerning their personal situation, minimum capacity levels in terms of economic and

**d. Award criteria**

The economically most advantageous offer has to be determined on the basis of objective criteria. Furthermore, each criterion must be weighted in relation to all of the other criteria so as to provide an indication of its relative importance. The contracting authority is obliged to define these criteria and their weightings, which are to be published either in the notification or, as is often the case, in the tender documents. Clear, objective and admissible criteria are crucial for impartial and transparent awards, reducing the scope for arbitrary and corrupt decisions. Legally admissible are all criteria that are reasonably linked to the subject matter of the contract. As a rule, this is never true for criteria linked to the suitability of bidders, which consequently must not be considered as admissible award criteria.

**Case study**

The relative importance of award criteria for a purchasing contract, as determined in the tender documents, is as follows: 50% price, 25% experience of the company, and 25% financial standing. Experience and financial standing as a rule are not award criteria but refer to the eligibility of bidders.

The auditor may choose to also verify that the criteria are designed to increase the probability of achieving value for money, not in general but with regard to the particular contract. To this end, the various aims of the criteria, weighting, and scoring method include the following:

- **Criteria**
  - Explicitly representative of the performance desired;
  - Linked to economic aspects;
  - Transparent and easily understandable for bidders.
- **Weighting**
  - Corresponding to the relative importance of the particular aspect for the public authority;
  - Inclusive of price elements.
- **Scoring method**
  - Manageable;
  - Correct and fair;
  - Balanced, allowing an even allocation of assessment points.

**Case study**

The criteria and weighting for the purchase of copy machines were as follows: 50% purchase price, 30% technical specifications beyond the minimum parameters, and 20% environmental aspects. However, legally compliant copy machines may vary significantly in terms of their lifespan, spare parts supply, consumables (e.g. toner), availability, and cost of maintenance. These aspects need to at least be considered and decisions duly documented by the public authority.



***A proper relation between the definition of needs, the performance description and the award criteria is crucial for achieving value for money. Specifications legitimately required for the task must be highlighted in the minimum requirements of the performance description and accordingly reflected in the design of award criteria and their relative weighting.***

- Has the public authority clearly defined the award criteria?
- In the case where the award criteria target the most economically advantageous tender, are the sub-criteria (a) different from those defined for the qualification of bidders; and (b) linked to the subject matter of the contract, properly reflecting the main focus and the importance of the elements of the performance?
- Is the weighting coherent, convincing and concise, leaving little scope for arbitrary evaluation?
- Are the criteria and sub-criteria suitable for selecting the tender that offers the best value for money? Do they take the price into consideration in a reasonable way?

#### **e. Award procedure**

The selection of the award procedure has consequences for the scope of competition.

The public authority may optionally follow an open or a restricted procedure, but it must not conduct a negotiated procedure unless exceptional conditions, as described in the legislation, are given. In practice, negotiated procedures are often used, regardless of the fact that conditions are rarely verified. Notable consequences of this practice are restricted competition and negotiations on performance and price, which make it more difficult for the public authority to guarantee equal treatment and transparency. Public authorities have frequently awarded contracts without launching any kind of procedure, which is a major violation of EU procurement regulations and may lead to nullity of contracts. The auditor may uncover such cases by verifying the compilation of invoices and requesting the corresponding award documentation.

#### **Each restriction of bidders may imply:**

- Exclusion of potentially favourable offers;
- Enhanced risk of undue influence in the assessment;
- Facilitation of unauthorised cooperation between bidders.

Bearing the above in mind, auditors would often ask:

- Did the public authority take a documented and well founded decision on the choice of procurement procedure?
- Did the public authority opt for the procedure offering the most open competition given the circumstances?
- When exceptional negotiated procedures were used, did the contracting authority give sufficient and reasonable reasons and evidence for its choice, explaining why an open or restricted procedure was not possible?
- Did those conditions actually exist?

## **f. Notification**

Notifying the intention to award a contract and publishing the rules governing the procedure are crucial for a fair and open competition. The EU Directives include a series of regulations concerning the form of notification and the time frame for the procedure. These regulations establish the conditions for ensuring true competition, adequate time for preparing serious tenders, equal treatment, and transparency. The Court of Justice of the European Union (CJEU) considers, therefore, that their violation would have serious consequences for the legitimacy of the procedure. It is therefore important that the auditor also verifies the relevant decisions taken in this regard.

## **g. Assessment of tenders**

Award procedures are typically conducted in four separate steps:

- Formal review of bids;
- Assessment of the suitability of bidders;
- Confirmation of exclusion causes for tenders;
- Evaluation of tenders.

The analysis of the steps must be carried out in the framework of each specific procedure.

Before the assessment of bidders takes place there should be a **formal verification** of the compliance of candidates with basic requirements, such as meeting deadlines and submitting information.

- Did the contracting authority evaluate only bids meeting formal requirements?
- Are the reasons for the acceptance and rejection of tenders in line with the tender documents and properly documented?

The contracting authority should admit only those **bidders** that demonstrate **eligibility**, including the minimum capacity levels set in the procurement documents.

When assessing the suitability of bidders according to the conditions established in the tender documents, the principles of equal treatment and transparency must also be observed.

The contracting authority must document the process of selecting candidates, stating the reasons for the selection or rejection.

- Was the qualitative assessment of candidates independent and did it occur prior to the evaluation of tenders?
- Is the process of selecting candidates documented, including the reasons for their selection or rejection?
- Did the contracting authority assess the suitability of bidders exclusively on the basis of the requirements and certification previously announced and in a non-discriminatory manner?

Practical experience has shown that it is important that these steps be performed separately, as the focus shifts between the bidders and the tenders themselves. It is

crucial to not confuse the criteria that are relevant at each stage. This is often not duly considered by public authorities.

Once the suitability of bidders has been verified, the subsequent steps of the award process deal only with the tenders and no longer with the bidders. From that moment on, only bids that have met all of the announced requirements are admissible for evaluation.

For the evaluation, the public authority may first of all exclude tenders that cannot be accepted for various reasons, such as not fulfilling performance conditions. In the case of abnormally low prices the bidder must be given the chance to explain the cost estimates prior to exclusion.

- Did the contracting authority verify whether the tenders met performance requirements?
- Is there evidence of an abnormally low price?

The final evaluation and award process must be demonstrably objective and transparent and based **solely on all the published criteria**. Admissible variants that meet the requirements must be evaluated in the same way as the other bids.

The award decision is based on the result of the evaluation of tenders.

In open and restricted procedures, any dialogue with candidates that could be construed as a negotiation on price or other tender elements is forbidden.

- Is the evaluation process documented?
- Did the contracting authority evaluate only the tenders that had been duly accepted in the three previous steps?
- Did the contracting authority evaluate and rank bids against all criteria, and only those, and the relative weighting that it had published in the procurement documents?

### 3. Managing the contract

Once the contract has been concluded, public procurement regulations are no longer applicable. In this phase the auditor may focus on whether the contract is duly executed, while safeguarding the rights of the public authority. In this context, the auditor may check how the public authority handles payment commitments or issues of warranty, contractual shortcomings and damages. This verification often covers aspects of compliance, and even financial auditing may be included with regard to adherence to budgetary regulations for payment.

However, in the execution stage public authorities often have the need to complement the goods or services contracted, which raises the question of whether these additional goods or services must be awarded in a new procurement procedure.

Changes may result from several circumstances:

- Unexpected technical reasons, such as geological surprises or new legal requirements;
- Suggestions for replacement of technical solutions or materials;

- Supplementary needs, as the public authority is purchasing more than was awarded.

Flexibility to change performance without going through a new procurement procedure might be necessary in order to fulfil needs and obtain savings, but such flexibility could also represent a disrespect for the rules of the game, a decision favouring or rewarding a supplier, avoidance of an open procurement procedure, or a way of overcoming budgetary constraints, most of the time involving supplementary costs. Additional contracts may thus only be directly awarded in exceptional cases.

- Did the additional goods/services introduce only minor changes to the performance described in the contract documents?
- Were the changes justified by a situation that did not exist previously?
- Were the changes absolutely necessary for the completion of the original performance?

### Other audit subjects (apart from individual public contracts)

Although this Brief concentrates on individual procurement procedures leading to an individual contract, audit may also cover framework agreements, concessions and public-private partnerships (PPPs), or it may focus on other aspects of the procurement system.

Concerning **framework agreements**, the auditor usually checks three aspects:

- Was the agreement awarded according to the rules described above?
- Was the public authority entitled to use the agreement?
- Was the contract within the scope of the agreement?

**Concessions for services** are not<sup>2</sup> covered by the EU regime, which covers only concessions for works. The basic principles of such concessions are nevertheless derived from the EU Treaty, and these principles must be applied and respected. Thus competition, notification and a fair and transparent treatment of bidders are indispensable.

**PPPs** constitute basically an issue of economy. The issue is whether PPPs, if compared to the public contract solution and considering financial arrangements, are eventually the most favourable solution for the contracting authority. To compare the two solutions, the auditor may assess, by consulting the documents of the public authority, whether consideration has been given to all cost elements, especially those that become effective only in the long term and those that are risk-related, and this is often difficult for the auditor to do. Again, it is the public authority that has to provide sufficient justification and evidence, and if it fails to do so, in the audit report the auditor often highlights this failure as a substantial shortcoming. In terms of compliance, the procurement regime is applicable to PPPs, offering special regulations for comprehensive and complicated issues, such as the competitive dialogue.

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<sup>2</sup> This changes with the application of the new Concessions Directive, published 28 March 2014.

### ***Further reading:***

For further information concerning the legal aspects mentioned above, refer to the following Briefs:

- [Setting the Award Criteria](#) (SIGMA Public Procurement Brief 8, 2011);
- [What are the Public Procurement Procedures and when Can they be Used?](#) (SIGMA Public Procurement Brief 10, 2011);
- [Detecting and Correcting Common Errors in Public Procurement](#) (SIGMA Public Procurement Brief 29, 2013);
- [Selecting Economic Operators](#) (SIGMA Public Procurement Brief 7, 2011);
- [Public Procurement in the EU: Legislative Framework, Basic Principles and Institutions](#) (SIGMA Public Procurement Brief 1, 2011);
- [Performance Measurement](#) (SIGMA Public Procurement Brief 21, 2011);
- [Monitoring of Public Procurement](#) (SIGMA Public Procurement Brief 27, 2013);
- [Tender Evaluation and Contract Award](#) (SIGMA Public Procurement Brief 9, 2011);
- [Understanding the EU Financial Thresholds](#) (SIGMA Public Procurement Brief 5, 2011).