



# Introducing our work about procurement



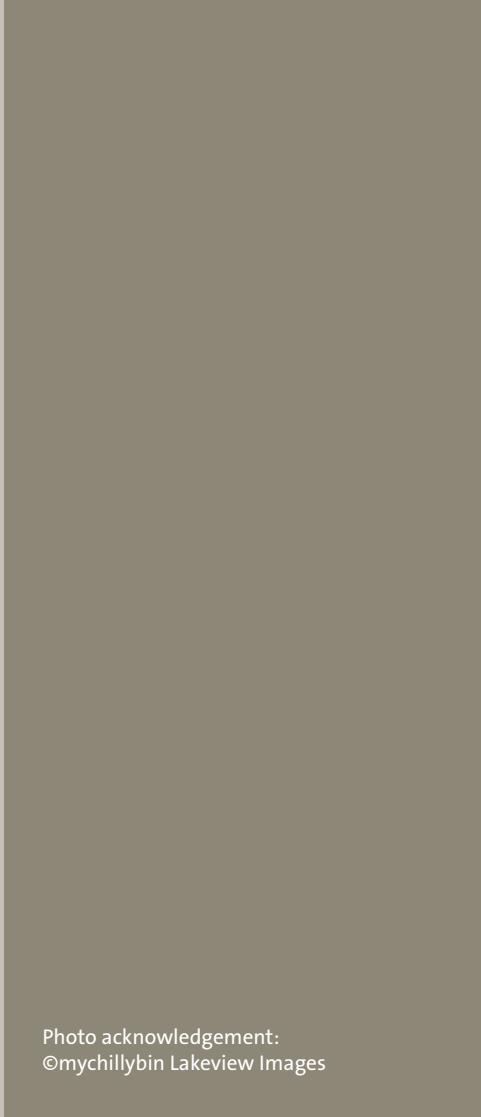


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# Introducing our work about procurement

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# Introduction

E ngā mana, e ngā reo, e ngā karangarangatanga maha o te motu, tēnā koutou.

For public organisations, delivering services well depends on doing procurement well. It is important that New Zealanders get the best possible outcomes from the significant public spending on goods and services.

New Zealanders expect that public resources, including taxes and rates, will be managed effectively and efficiently, competently, and with integrity.

This report introduces our work on procurement. Drawing from our audit work and conversations with people involved in public sector procurement, we summarise what we see as the main issues and opportunities for improving procurement practice in the public sector. It is our “conversation starter” for ongoing discussions with public organisations, people involved in procurement, and Parliament about where we want to add value.

In our view, the public sector still has work to do to improve procurement practices. Despite considerable focus on it, and despite improvements that have been made, we continue to see instances of procurement practice that give us cause for concern.

We will give special focus to procurement during the next three years. Through our work, we want to help improve how the public sector does procurement, including its planning of procurement, how procurement is carried out, and how it ensures that New Zealanders are getting the benefits from public spending that they expect and need. This will lead to stronger public accountability for the use of public funds and improved awareness about the implications of poor procurement.

We also want to help maintain the public sector’s reputation for honesty and integrity. Poor procurement practices can erode trust and confidence in the public sector. Through our work, we want to support people involved in procurement to manage it well and in a principled way. New Zealand has a strong reputation internationally for transparency and a low level of corruption. We want to help keep it that way.

Public sector procurement also has to work well for those who supply the goods and services. There need to be robust processes that support appropriate accountability for public expenditure without hindering innovation. A competitive market that does not impose unnecessary costs on suppliers needs to be maintained.

Leadership is an important element of public sector procurement. We will look at the Ministry of Business, Innovation and Employment’s leadership role in public sector procurement, including what it does to support effective and efficient

procurement and develop procurement workforce expertise and capability. We will look at the Government Chief Digital Officer's leadership role in information and communications technology procurement.

We will focus on procurement that is critical to improving outcomes for New Zealanders. We will look at the governance, management, and effectiveness of procurement in procurement-intensive public organisations and in high-spending areas. We will also look at procurement approaches that intend to achieve increased efficiency and innovation, including the use of all-of-government contracts, panels of suppliers, and public private partnerships. We are interested in how risks are managed where there is a dependence on suppliers of critical services.

Although we have planned a three-year programme of work, we will continue to review our programme to ensure that it reflects emerging findings and risks.

To get the best possible results from our work, we will communicate with and involve, as much as we can, public sector staff, procurement professionals, suppliers, and Parliament. As well as publishing the findings from our audit work, we plan to try new ways to ensure that our work makes a positive difference. This is likely to include directly taking our concerns and what we learn about good practice to specific audiences, speaking with groups of stakeholders at relevant conferences and events, and publishing our work and ideas in a range of media.

We encourage your input at all stages of our procurement work.

Nāku noa, nā,

A handwritten signature in black ink, appearing to read "JM Ryan".

John Ryan

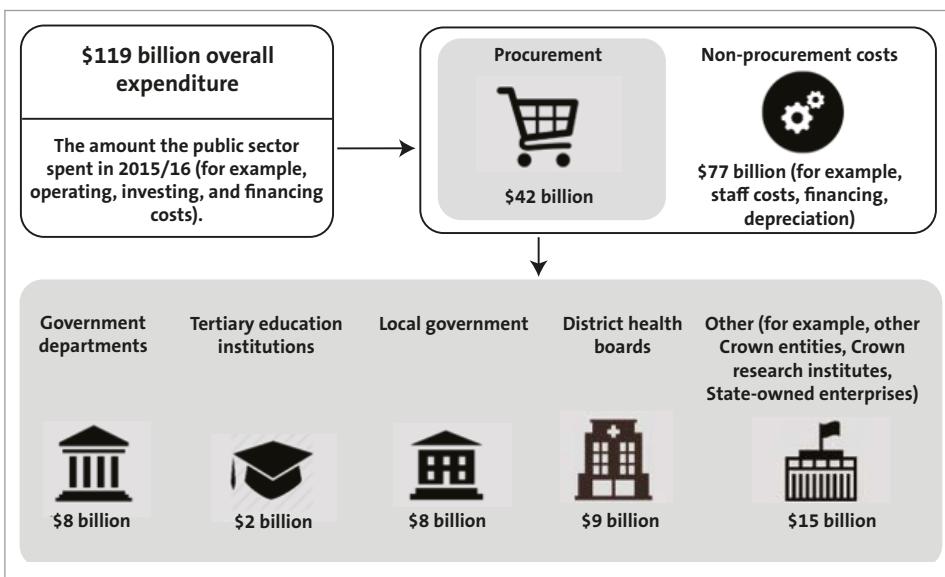
Controller and Auditor-General  
21 September 2018

# 1

## Why we are interested in procurement

- 1.1 Public organisations<sup>1</sup> use many different kinds of goods and services to support the work of both local and central government. Procurement is the process that public organisations use to acquire these goods and services. We want New Zealanders to get the best possible outcomes from the spending of public money.
- 1.2 Procurement involves a range of goods, from pens and paper to major construction projects, such as schools, hospitals, and roads. Procurement also involves services provided by third parties, such as social care and health services.
- 1.3 There is no easily identifiable overall number for how much the public sector spends on procurement. However, to give a sense of the significance and magnitude of the spending, we have provided an estimate. Based on 2015/16 financial statements, we estimate that the public sector spends about \$42 billion annually on procurement.<sup>2</sup> We illustrate the breakdown of this amount in Figure 1.

**Figure 1**  
Procurement expenditure in the public sector, 2015/16



<sup>1</sup> Public organisations include government departments, Crown entities, schools and universities, district health boards, port companies, airports, State-owned enterprises, Crown research institutes, statutory bodies, licensing trusts, local councils, and council-controlled organisations.

<sup>2</sup> This estimate is based on the 2015/16 financial statements (group data) of local and central government organisations (2015 calendar year for TEIs). We used the “Other Operating Expenses” from the Financial Statements of the Government (excluding government transfer payments and subsidies, personnel expenses, depreciation, interest expenses, insurance expenses, grants and subsidies, rental and leasing costs, impairment). To this we added capital expenditure. We then added our estimate for local government (total expenses less fixed costs – interest, salaries and depreciation – plus capital expenditure). The total rounded to \$42 billion.

## **Part 1**

### **Why we are interested in procurement**

- 1.4 In this Part, we set out:
- what we mean by procurement;
  - why we chose to focus on procurement; and
  - what we hope to achieve by focusing on procurement for the next three years.

## **What do we mean by procurement?**

### **Procurement is more than just buying goods and services**

- 1.5 Procurement is more than just “buying something”. For us, and for the purposes of this report, procurement includes *all* the processes involved in public organisations acquiring and subsequently managing goods and services from a supplier.
- 1.6 Procurement begins with a public organisation determining what goods and services it needs to achieve its goals. Procurement includes planning for the purchase, the purchase process itself, and any monitoring to ensure that the contract has been carried out and has achieved what it was meant to.
- 1.7 Procurement is complete when:
- the goods and services have been supplied and the contract or the asset’s useful life is at an end; and
  - the process has been reviewed to ensure that all commitments have been met, all benefits realised, and any lessons that could be learned from the procurement have been recorded.
- 1.8 The Ministry of Business, Innovation and Employment (MBIE) describes procurement as having a life cycle of eight stages (see Figure 2). This is a useful way to consider procurement. Parts 3-10 of this report discuss each stage of the life cycle.
- 1.9 For a procurement to be successful, it is important for a public organisation to consider each of the eight stages in the procurement life cycle. Our audit work has shown that many of the problems we see in procurement are caused by poor project initiation, poor contract management, and a failure to ensure realisation of the intended benefits. We discuss those particularly in Parts 3, 9, and 10.

### **Procurement and commissioning**

- 1.10 It is important to understand the relationship between commissioning and procurement. Commissioning has become an important activity, particularly for health and social services.

**Figure 2**  
The eight-stage life cycle of procurement



Source: (Recoloured from) the Ministry of Business, Innovation and Employment.

- 1.11 Commissioning starts by asking what is the best way to achieve a specific outcome. The New Zealand Productivity Commission has defined commissioning as “a set of inter-related tasks that need to be carried out to turn policy objectives into effective social services”.<sup>3</sup> These tasks can include clarifying what is needed, understanding the needs of the targeted population, and choosing how the services will be delivered.
- 1.12 Commissioning might lead to include procurement, but not always. For example, if the commissioning need can be met by staff, procurement will not be necessary. Procurement starts with an assumption that public organisations will be procuring goods or services from suppliers.

<sup>3</sup> New Zealand Productivity Commission (2015), *More effective social services*, page 129.

## Part 1

### Why we are interested in procurement

#### Procurement and grants

- 1.13 Grants are not usually regarded as procurement but they do involve an exchange of funding in expectation of an outcome. In our 2006 good practice guide, *Principles to underpin management by public entities of funding to non-government organisations*, we set out a continuum of funding arrangements that public organisations engage in, including conditional and unconditional grants.<sup>4</sup>
- 1.14 Regardless of what funding arrangement is used, it is essential that public organisations plan, negotiate, manage, and monitor a funding arrangement well. Public organisations must be accountable for their use of public funds. In our view, the principles in our good practice guide are as applicable to a grant as they are to a traditional contract. For that reason, some of our work on procurement will consider how well grants are managed.
- 1.15 Public organisations need to be accountable for the funds, and act with the integrity that is expected in any funding arrangement.
- 1.16 We are interested in the \$1 billion annual (for three years) Provincial Growth Fund for regional economic development. The Provincial Growth Fund is designed to support non-commercial, quasi-commercial, and commercial investments. Grants will generally be used to fund non-commercial investments.

#### Why procurement?

##### Effective procurement contributes to improved outcomes

- 1.17 Procurement that achieves the strategic intent of the public organisation, and is managed well throughout the process, can ensure the provision of more effective and efficient public services, improving outcomes for New Zealanders.
- 1.18 Effective procurement can save money and ensure that more projects are delivered to time and budget, with reduced exposure to commercial risk, and less cost in doing business with government. It can lead to productivity gains and support innovation by suppliers.

#### Size and complexity

- 1.19 Suppliers play a significant role in the delivery of public services. They provide equipment, tools, and systems for government work. They also carry out government work, including complex projects, back-office administration, and public-facing services.
- 1.20 Some procurement is on a large scale. The 2016 Defence White Paper signalled plans to invest \$20 billion in defence capabilities over the next 15 years. The

<sup>4</sup> Conditional grants contain specified expectations to deliver certain services. Unconditional grants contain limited or no delivery expectations but are nevertheless, like conditional grants, given to achieve a public good.

Defence Capability Plan is being reviewed in 2018 and this review might result in extending the planning horizon. Another example is the range of district health board facilities that will need replacing during the next 20 years, at a likely cost of several billion dollars.

- 1.21 As the auditor of all New Zealand's public organisations, the Auditor-General can assess whether public organisations are carrying out their activities effectively and efficiently, as well as examine matters such as waste, integrity, legislative compliance, and financial prudence. The size and complexity of procurement means it is important that we assess how well public organisations are spending public money.

### Maintaining New Zealand's international reputation for transparency

- 1.22 New Zealand's public sector generally has an enviable reputation when it comes to fraud and corruption. For example, New Zealand rated first on the Transparency International Corruption Perceptions Index in 2017.
- 1.23 It is important not to be complacent. We continue to see cases of procurement-related fraud in the public sector. This kind of fraud is carried out mainly through using false invoices – for example, employees with delegated authority entering false or overstated invoices for payment. We continue to see the misuse of credit and fuel cards. Cyber-related fraud also continues to pose risks to public organisations.
- 1.24 We have also considered in recent years allegations of procurement-related corruption involving public organisations. We will continue to demand transparency in how public organisations use public funds and what they have achieved. This will help ensure that New Zealand maintains its highly regarded international reputation.

## What we want to achieve

### We want to improve public organisations' procurement practice

- 1.25 Procurement guidance, such as the *Government Rules of Sourcing*<sup>5</sup> and our own 2008 good practice guide, *Procurement guidance for public entities*, has been available to the public sector for the last 10 years.
- 1.26 We have seen improvements to procurement. However, we have also identified three stages of the procurement life cycle that public organisations need to improve in: the strategic analysis, which should be done at the start of the procurement life cycle; contract management; and checking that intended benefits are realised. We have also seen:
- variability in procurement capability in public organisations;

<sup>5</sup> The *Government Rules of Sourcing* documents are available at [procurement.govt.nz](http://procurement.govt.nz).

## Part 1

### Why we are interested in procurement

- poor governance and management of some procurement projects;
- inconsistency in whether an effective process is followed; and
- variable quality in planning and risk management.

1.27 We want our work on procurement to improve performance in the public sector by highlighting strengths and weaknesses in procurement practice, identifying opportunities for improvement, and encouraging public organisations to take them up.

### We want procurement to be carried out in a principled way

1.28 From time to time, people contact us with concerns about how a specific procurement has been carried out or conducted.

1.29 For example, they might be concerned that a procurement is in breach of legal requirements, that there has been bias or favouritism involved in selecting the supplier, or that there has been a poorly managed conflict of interest. There might also be claims of fraud.

1.30 Public organisations need to carry out their procurement in a principled way. Sometimes this is referred to as probity. Probity is a broad concept, but its principles are fundamental to how we expect public organisations to carry out procurement. These principles include:

- **Transparency** – Procurement processes, from developing a procurement strategy to signing a contract, should be well defined and documented.
- **Fairness and impartiality** – All interested suppliers should be encouraged to participate in a tender, without advantage or disadvantage. Processes should be applied lawfully and consistently, without fear or favour. Unfair advantages, including those arising from incumbent arrangements, should be identified and addressed.
- **Honesty and integrity** – Individuals and organisations should act appropriately and professionally. Public sector standards of conduct must be met.
- **Managing conflicts of interest** – Expectations about conflicts of interest and how they are managed should be clearly understood by all parties. Conflicting interests and roles, and the associated perceptions, should be identified, declared, and managed effectively.
- **Confidentiality and security** – Confidences should be respected and information should be held securely and safeguarded from wrongful or inadvertent disclosure.
- **Accountability** – There should be strong, but proportionate, project governance and reporting systems in place.

- 1.31 Probity is particularly important for procurement, not only because a lot of money is often involved, but because adhering to these principles is at the heart of people's trust and confidence in the public sector.

### We want stronger public accountability

- 1.32 To help elected members and officials act in the best interests of New Zealanders, public organisations need to be accountable for their stewardship over, and use of, public funds.
- 1.33 It is essential that public organisations are able to demonstrate what they are doing and why. Public organisations should expect their performance to be questioned, whether by members of the public, the media, the courts, or Parliament. This is accountability in action, and public organisations need to be publicly accountable for their actions and spending.
- 1.34 Accountability cannot be taken for granted. By focusing on procurement, we want to make sure that all public organisations understand their obligations and responsibilities to be accountable and that the processes they follow in procurement enable them to be held to account.

### We want public organisations to achieve value for money from procurement

- 1.35 Value for money means using resources effectively, economically, and without waste. Value for money when procuring goods or services does not necessarily mean selecting the lowest price, but rather the best possible outcome from the goods or services during their whole life.
- 1.36 Accordingly, we want to examine how well public organisations are conducting procurement in a way that achieves value for money and makes the most of their resources. It is important that they consider value for money at all stages of the procurement life cycle, not just at the beginning. Value for money is more likely achieved if the most appropriate procurement approach is selected.

### We want to improve trust and confidence in the public sector

- 1.37 It is important that New Zealanders have trust and confidence in the public sector to make decisions on their behalf. It is also important that taxpayers and ratepayers have trust that public money is used appropriately, effectively, and efficiently – and not mismanaged, misused, or wasted.

## **Part 1**

### **Why we are interested in procurement**

- 1.38 Public trust and confidence in the public sector can become eroded if public organisations mismanage or misuse resources through poor procurement. By encouraging public organisations to look at all stages of the procurement process, we hope that they will strengthen their procurement practices and their stewardship of public funds.

### **Structure of our report**

- 1.39 In Part 2, we provide a brief description of functional leadership roles. We then set out our proposed work looking at MBIE's and the Government Chief Digital Officer's functional leadership roles.
- 1.40 In Parts 3 to 10, we set out our main expectations and concerns and our planned work in the eight stages of the procurement life cycle. Each Part focuses on one of the eight stages of the procurement life cycle.

# 2

## Looking at functional leadership

- 2.1 In the first year of our work on procurement, we will look at MBIE’s leadership role for public sector procurement. We will be looking at how effectively and efficiently MBIE is:
  - improving procurement practices through its activities and its all-of-government contracts; and
  - developing procurement workforce expertise and capability in central government.
- 2.2 In this Part, we provide some context behind our proposed work on MBIE’s leadership role for public sector procurement. Specifically, we describe:
  - the reform of government procurement that placed MBIE as the “functional lead” of procurement in the public sector; and
  - our proposed audit work on MBIE.
- 2.3 We will also be examining the Government Chief Digital Officer’s role as the functional lead in information and communications technology (ICT) procurement.

### The Government introduced functional leadership for procurement

- 2.4 In 2009, the Government Procurement Reform programme was started to save costs in uncomplicated, common areas of spending through all-of-government contracts. Other programme goals were to build procurement capability and capacity, enhance New Zealand business participation, and improve procurement governance throughout government agencies.
- 2.5 As a result of the Government Procurement Reform programme, the former Ministry of Economic Development (now part of MBIE) and the Department of Internal Affairs established “centres of expertise” to deliver different parts of the Government Procurement Reform programme.
- 2.6 The reforms achieved some results. For example, it was estimated that, as of 2012, \$353 million in savings for all-of-government contracts would accrue over the contract life.<sup>6</sup> In 2012, the Government considered that more needed to be done to make a significant and lasting change in public sector procurement and enable it to work differently with the supplier market. To do this, the Chief Executive of MBIE was made a functional leader for government procurement.
- 2.7 The State Services Commission describes functional leadership as being aimed at maximising the benefits and reducing the overall costs to government of common business activities that might not be achieved by an agency-by-agency approach.<sup>7</sup>

<sup>6</sup> Cabinet paper to the Cabinet State Sector Reform and Expenditure Committee (2012), *Government Procurement Functional Leadership*.

<sup>7</sup> For more information on functional leadership, see [www.ssc.govt.nz](http://www.ssc.govt.nz).

- 2.8 The procurement functional leadership role has three main objectives:
- improve procurement and commercial capability;
  - create cost savings and deliver better value through better procurement; and
  - create an environment for business to succeed.
- 2.9 MBIE's role involved:
- leading policy advice about procurement;
  - providing procurement guides, tools, and templates for public organisations to use;
  - reviewing procurement plans for activities valued at more than \$5 million or where there are significant risks;
  - providing commercial assistance with strategic and high-risk projects;
  - establishing, overseeing, and facilitating collaborative contracts, for example, all-of-government, common capability, and syndicated contracts;<sup>8</sup>
  - building and measuring ongoing procurement capability; and
  - advising ministers on procurement-related matters.<sup>9</sup>
- 2.10 The procurement reforms used a devolved procurement model, with individual chief executives and governing bodies accountable for their organisation's performance in procurement. However, it is "centre-led", with the functional leader supporting improved procurement practices by providing leadership and encouraging greater collaboration between public organisations.
- 2.11 Functional leadership is intended to give clearer accountability, provide improved information about how well public organisations carry out procurement, and give increased opportunity to influence the quality of procurement.
- 2.12 To improve capability, MBIE has:
- set standards and expectations through frameworks and guidance;
  - prepared a self-assessment tool, the Procurement Capability Index, to enable organisations to assess their procurement capability and identify where they can make improvements;
  - developed a procurement graduate recruitment programme; and
  - established a specialised social services procurement team.

<sup>8</sup> See procurement.govt.nz: All-of-government contracts and common capability contracts are both supply agreements with approved suppliers for selected common goods or services purchased throughout government. The former are established by the procurement functional lead, and all eligible public organisations must purchase from the all-of-government contracts unless there is a good reason not to. Syndicated contracts typically involve a group of public organisations aggregating their respective needs and collectively going to the market for goods, services, or works.

<sup>9</sup> Cabinet Office Circular CO (15) 5: Investment Management and Asset Performance in the State Services, pages 9-10. More generally, functional leadership aims to drive efficiencies, develop expertise and capability, and improve services and service delivery (See "Why Functional Leadership?" at [www.ssc.govt.nz](http://www.ssc.govt.nz)).

- 2.13 MBIE also works with local councils. Local councils are encouraged to apply the principles and guidance issued by MBIE, including the *Government Rules of Sourcing*, and to make use of all-of-government contracts. MBIE also provides some guidance and support to local councils with their procurement planning and activities.

### Other organisations involved in public sector procurement

- 2.14 The Treasury leads the Government's overall investment management. For procurement, it co-ordinates New Zealand's public private partnership programme, manages "Gateway" reviews on specific procurement projects,<sup>10</sup> and provides advice on the performance of functional leaders operating in the system.
- 2.15 The State Services Commission has an overall leadership role in public sector management, and supports organisations in exercising their functional leadership responsibilities.
- 2.16 The Chief Executive of the Department of Internal Affairs is the Government Chief Digital Officer (GCDO). As the functional leader, the GCDO is responsible for setting digital policy and standards, improving investments, establishing and managing services, developing capability, and system assurance (assuring risk management and effective investment throughout government) for the state sector. In relation to ICT procurement, the GCDO leads the establishment and management of all-of-government ICT contracts.

### Innovations in procurement processes

- 2.17 Further change in procurement continues. A recent example is the government digital procurement channel Marketplace<sup>11</sup>, developed by government and the wider market working together. It aims to reduce barriers for suppliers working with government and to make procurement easier for public organisations.

### Our proposed audit work

- 2.18 We propose to look at the functional leadership roles of both MBIE and the GCDO.
- 2.19 Functional leadership aims to build procurement capability, improve effectiveness, and reduce the overall costs to government of common business functions.
- 2.20 MBIE's initiatives as the functional lead of procurement are intended to:
- allow public organisations to access procurement expertise;
  - make procuring of common goods and services easier and allow public organisations to focus on achieving business outcomes; and

<sup>10</sup> These reviews examine programmes and projects at important decision points in their life cycle to provide assurance that they can progress successfully to the next stage.

<sup>11</sup> See "Start of a new era in digital government procurement processes" (9 August 2018) at [www.beehive.govt.nz](http://www.beehive.govt.nz).

- allow different individuals and organisations to share ideas, lessons, and best practice.
- 2.21 As functional leaders, MBIE and the GCDO are critical to enabling quality and effective procurement services across public organisations. MBIE has an important leadership role in improving procurement practices and capability, and improving efficiency through its all-of-government contracts and its activities. Likewise, the GCDO's functional leadership responsibilities require it to support ICT assurance and procurement throughout government.
- 2.22 ICT procurement can be particularly challenging and often high risk because of:
- the rapidly changing nature of ICT;
  - the specialised nature of ICT;
  - the size, value, and complexity of ICT procurement;
  - senior managers and boards often lacking the necessary capability to make informed decisions about ICT procurement;
  - the difficulty attracting the right commercial and technical expertise; and
  - the relatively small supplier market in New Zealand.

We intend to carry out performance audits looking at:

- how well MBIE's functional leadership creates efficiencies and improves services and service delivery. Our audit will specifically examine the part that all-of-government contracting plays in this; and
- how well MBIE's functional leadership develops procurement workforce expertise and capability in central government.

We intend to examine aspects of how well the GCDO is fulfilling its leadership role in ICT procurement.

# 3

## Initiating a procurement project

- 3.1 Our previous work has shown us that the early stages of planning for a procurement are critical to its success. The first stage of a procurement life cycle is initiating the project. In this stage, it is important that:
- public organisations take a strategic approach, that is, a proposed procurement aligns with the organisation's priorities and business objectives;
  - appropriate governance arrangements are put in place; and
  - public organisations have people with the appropriate skills and experience and any conflicts of interest are addressed.



### Procurement needs a strategic approach

- 3.2 It is important that a proposed procurement aligns with the organisation's priorities, business objectives, and strategic outcomes. At an early stage, organisations need to take a strategic view of their procurement and determine how it fits with their broader objectives.
- 3.3 If procurement is integral to a public organisation's overall business strategy, the organisation should prepare a procurement strategy. If procurement is not integral, a public organisation should at least be able to demonstrate:
- a knowledge of the type, value, and risk associated with the goods and services it procures; and
  - that policies and procedures are in place to ensure that staff who are involved in procurement activity use good procurement principles and practices.
- 3.4 Failing to understand the strategic importance of a proposed procurement can lead to poor results, as we have seen in previous audit work. For example, in our 2010 report *Spending on supplies and services by district health boards: Learning from examples*, we noted that district health boards needed to have more knowledge about which supplies and services were needed and why.

## Forming governance arrangements

- 3.5 Effective governance is needed for overseeing major procurements. For the procurement to be successful, public organisations need to clarify roles, responsibilities, and processes for decision-making, ownership, and oversight, at the start of the procurement life cycle.
- 3.6 Many of the problems we have seen with procurement have stemmed from poor governance arrangements.

## Getting people with the right skills and experience

- 3.7 Gaps in staff capability can pose a significant risk. Public organisations should consider whether they have people with the right expertise for procurement on a case-by-case basis. If they do not, then they should consider seeking external expertise. Getting the right expertise is particularly important for large procurement projects.

## Identifying and managing conflicts of interest

- 3.8 Our work sometimes shows that conflicts of interest are not always properly identified or managed during the procurement process. There are also variations in how well organisations understand the importance and practices of declaring, assessing, and managing conflicts of interest during a procurement.
- 3.9 Not all conflicts of interest will be apparent at the start of a procurement process. Some might come up at a later stage. It is important that public organisations remain mindful of conflicts of interest throughout the procurement process.

## Our proposed audit work

- 3.10 Our audit work has shown us that making the right start to a procurement is critical to its success. This includes ensuring that those involved in the procurement are suitably qualified and skilled, and that the appropriate governance arrangements have been adopted.
- 3.11 Procurement capability is still an issue for public organisations. Having the right capability is important for a procurement to be done well, generating favourable procurement outcomes, and making best use of the resources available. It also supports good investment decisions. Conversely, poor capability can result in wasted resources, unfair practices, a lack of transparency, and frustration for suppliers. Our intended work on MBIE as a functional leader (see Part 2) will look at how well it has addressed capability issues.

- 3.12 Local councils have a vital role in providing infrastructure, facilities, and services to their communities. This often means contracting third parties for a variety of goods and services, such as construction, technology, waste collection, and public transport. To do this well, local councils need people with the right skills to advise, manage, and make decisions about what to buy, how to buy it, and how to make sure they are getting what they have paid for.

Using a case-study approach, we intend to examine a small selection of procurements by local councils to highlight the importance of procurement capacity and capability and identify matters that local councils should focus on to reduce the risk of procurement failures.

- 3.13 Our work has also illustrated some issues with public organisations not undertaking a strategic approach to procurement, including in the health sector.
- 3.14 District health boards currently own more than \$6 billion worth of assets, with an estimated replacement value of more than \$16 billion. A significant proportion of these assets are hospital buildings. Existing facilities are not sufficient to meet future service demand in some areas, and much of the existing building portfolio is ageing and will need replacing in the next 20 years. Replacing existing facilities and creating more facilities will involve procurement and is likely to cost several billion dollars.<sup>12</sup>
- 3.15 New Zealand's healthcare system can be effective only with the right infrastructure. The large investment required increases risk, which must be managed through an effective strategy, planning, governance, as well as management of contracts, projects, and relationships. The current arrangements for hospital building projects are relatively new and are still developing, so there is an opportunity for us to provide an early and useful external review.

We intend to examine significant investments in the health sector. We are interested in how the health system determines what infrastructure investments are needed, where, and when. In subsequent years, we will also consider whether there is merit in looking at other aspects of significant procurement in the health sector either as part of our annual audits or as part of other projects.

# 4

# Identifying needs and analysing the market

- 4.1 The second stage in the procurement life cycle is identifying needs and analysing the market of suppliers that provide goods and services.
- 4.2 From time to time, we receive complaints that some public organisations do not properly understand the supplier market or the effect they are having on it.
- 4.3 Procurement decisions should be based on the best information available. Public organisations need to talk to stakeholders to inform the organisation's thinking and understand the supplier market and its role within it. For example, we note a recent initiative to co-design digital services with suppliers.<sup>13</sup>
- 4.4 The recent problems in the construction industry are a reminder that supplier markets can be prone to disruption. It is important that public organisations collate and analyse information about the supplier market and assess whether there are risks to their planned procurement that need to be considered when they make decisions.
- 4.5 It is important that public organisations:
- consult stakeholders at an early stage;
  - use the best possible information; and
  - understand the supplier market.



## Consulting stakeholders at an early stage

- 4.6 Stakeholders include people who will use the goods and services being procured and the people who form the market, such as suppliers.
- 4.7 It is important to consult relevant stakeholders at an early stage on a proposed procurement. This is to check that the procurement will meet specific needs and ensure a shared understanding of what is being procured and what stakeholders can expect.

## Using the best possible information

- 4.8 Effective planning relies on good data systems and good data analysis. It is also important to have the right information to base procurement decisions on.
- 4.9 In 2010, we carried out an audit to examine the effectiveness of the New Zealand Transport Agency (NZTA) in collecting information about the state highway network and using it to plan for maintenance and renewal work.<sup>14</sup> We found that the NZTA had good descriptive and condition information about the state highway roads. It had a planning framework that enabled it to use this information for day-to-day maintenance and renewal of the road network, on which it spent about \$500 million every year. However, not all of its information was complete, especially for structures such as bridges and tunnels.

## Understanding the supplier market

- 4.10 Public organisations need to consider how their approach to procurement might affect longer-term goals, such as maintaining competitive and efficient supplier markets.
- 4.11 Public organisations should gain an understanding of the nature of the relevant supplier market and how it works. This allows for informed decisions about how they will approach the market and improve understanding about market risks, such as the risk of market failure.
- 4.12 We understand that, increasingly, public organisations are carrying out activities to understand the supplier market. There are many ways to do this, including interacting with selected suppliers or using industry briefings before doing detailed procurement planning.

## Our proposed audit work

- 4.13 Because of the size of the NZTA's procurement for the state highway network, we intend to look at how well its delivery model supports a sustainable and competitive market for maintaining and renewing the state highway network.

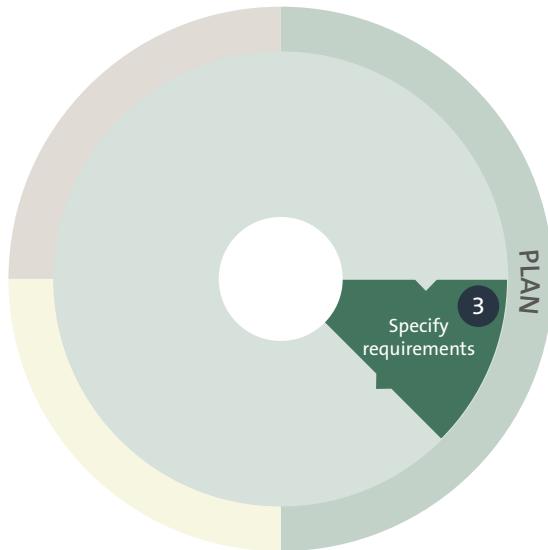
We intend to examine how well the New Zealand Transport Agency is working to help ensure a robust contracting market that is capable of delivering a competitive tendering environment when contracts for maintenance and renewal are completed.

<sup>14</sup> We published the findings of this audit in our report: *New Zealand Transport Agency: Information and planning for maintaining and renewing the state highway network*.

# 5

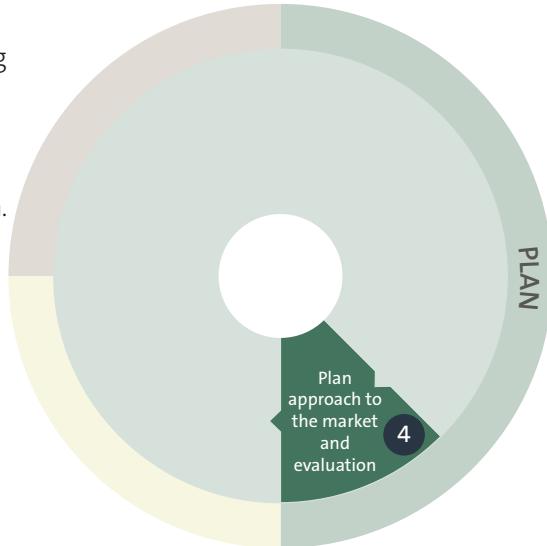
## Specifying requirements for a procurement

- 5.1 The third stage in the procurement life cycle is specifying requirements. Public organisations need to:
- have a clear understanding of what they want to purchase; and
  - a plan of how they will measure supplier performance before agreeing to a contract.
- 5.2 Having clear requirements allows the public organisation to monitor a supplier's performance (once a contract has been agreed) and determine whether the procurement was successful. Clear performance measures also provide a useful way to make suppliers and organisations accountable.
- 5.3 Although we have not planned any specific work examining this matter, we will continue to review our programme of work to ensure that it reflects emerging findings and risks.



# Planning an approach to the market and evaluation

- 6.1 The fourth stage in the procurement life cycle is planning how the procurement will be carried out and justifying these decisions. This is sometimes called the procurement approach.
- 6.2 There are various options for approaching the market, depending on the nature and complexity of the service, the value and length of the contract, and the size of the market or supplier community.<sup>15</sup>



## Planning the procurement approach

- 6.3 Planning the procurement approach is necessary to identify the best way to approach the procurement for the goods and services in question, and to identify risks and ways of achieving the procurement objectives.
- 6.4 How much detail is needed in planning the procurement approach will depend on the value and risk associated with a particular procurement. It can include project scope, the procurement method, whether the approach will be open or closed or multi-staged, how the public organisation will work with the market, and the form of contract. Planning the approach should also include selecting the evaluation model (including evaluation criteria) and process.
- 6.5 Our audit work has shown that public organisations are increasingly using a range of collaborative procurement approaches to deliver important infrastructure and other large-scale projects. These include open competitive processes, working with suppliers to develop solutions, or partnerships where the risks are shared. One such approach has been public private partnerships, which have been used in a number of sectors in recent years.
- 6.6 As well as giving full consideration to the principles and good practice guidance and rules, public sector procurement also has to work sensibly for suppliers. There need to be robust processes that will work well in a collaborative environment for an innovative and fast-moving public sector, and when there is urgency about a procurement.

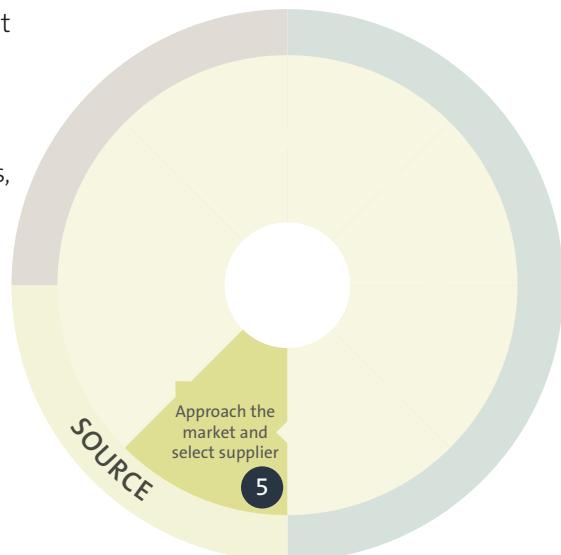
## Our proposed audit work

- 6.7 We will continue to consider through our audit work how public organisations plan procurements to ensure that they are done in a principled way, and use practices that work for suppliers and are responsive to the needs of an innovative and fast-moving public sector.
- 6.8 At this stage, we have chosen to look at public private partnerships because local councils and central government have used public private partnerships to fund and build major infrastructure projects. We have a long-standing interest in their use and have published reports on public private partnerships in 2006 and 2011.<sup>16</sup>

We intend to examine how collaborative arrangements have been established and managed for best effect, and provide assurance that the expected benefits are well defined, monitored, and assessed. Because there have been a number of public private partnerships set up already in the transport, education, and justice sectors, we propose in the first instance to explore how effectively these public private partnerships are delivering on their intended outcomes. We intend to identify lessons from these examples that might be applicable to various forms of collaborative contracting that involve a large amount of public expenditure.

# Approaching the market and selecting a supplier

- 7.1 The fifth stage in the procurement life cycle involves initiating the procurement process in the supplier market, providing information to potential suppliers, answering any questions they might have, and selecting a preferred supplier.
- 7.2 It is important that public organisations:
- plan the whole procurement process; and
  - ensure that good process and practice are followed in implementing the procurement process, including evaluating tender responses and making decisions about suppliers.
- 7.3 When shortlisting potential suppliers or before negotiating or awarding the contract, public organisations should independently verify that a supplier is who they claim to be and has the capacity and capability, both financial and otherwise, to deliver throughout the life of the contract.



## Initiating the procurement process in the market

- 7.4 Public organisations should consider the process and relevant principles and requirements. These can be found in the *Government Rules of Sourcing*.
- 7.5 Failing to properly plan the procurement process could risk the procurement not being handled in a principled way. For example, the procurement process might be flawed and lack integrity. Or the conduct of individuals and public organisations might fall short of the appropriate ethical standards. In either case, the procurement process could be at risk of being challenged, proving costly in terms of time and money.

## Implementing the procurement process

- 7.6 Procurement good practice guidance and rules exist to address some of the issues we have seen when looking into specific procurement processes. The guidance includes the *Government Rules of Sourcing*, Cabinet circulars, legislative requirements, and our 2006 and 2008 publications on good procurement practice. The guidance helps to:
- ensure that decisions are made carefully and for appropriate reasons;

- promote open and fair competition, domestically and internationally; and
  - protect against the risk of corruption or inappropriate influence.
- 7.7 It is important that public organisations follow relevant rules and guidance when selecting a supplier. Failure to do so puts an organisation at risk of litigation or claims of bias. It can also damage the public's trust and confidence in the organisation.
- ## Our proposed audit work
- 7.8 We are frequently asked to look at public organisations' procurement processes. Much of our work on procurement is about process and whether public organisations follow established good practice guidelines and rules.
- 7.9 Our work in the last few years has identified issues with the way some public organisations have carried out the procurement process. We will continue to look for improvement in the process because it is important to the integrity of the way the public sector does business.
- 7.10 We are also interested in what we understand to be the increasing use of panels of suppliers by public organisations to secure efficiencies in the selection process. We have not previously done any work specifically on panels of suppliers.
- 7.11 A supplier panel is a list of suppliers of goods and services that have been pre-approved by a public organisation and that have agreed to the terms and conditions of the procurement. The panels are set up to enable efficient future procurement of goods or services. A supplier panel should have suppliers that offer the best skills and experience required to deliver the specified goods or services.
- 7.12 Suppliers are appointed to the panel through a competitive process and the public organisation selects the supplier either for direct appointment or through a competitive process involving two or more panel members.
- 7.13 We are interested in how these panels are used, how well they are operating, and how effective they are in increasing efficiency while ensuring open and fair competition.
- 7.14 We propose to carry out two specific projects on supplier panels.

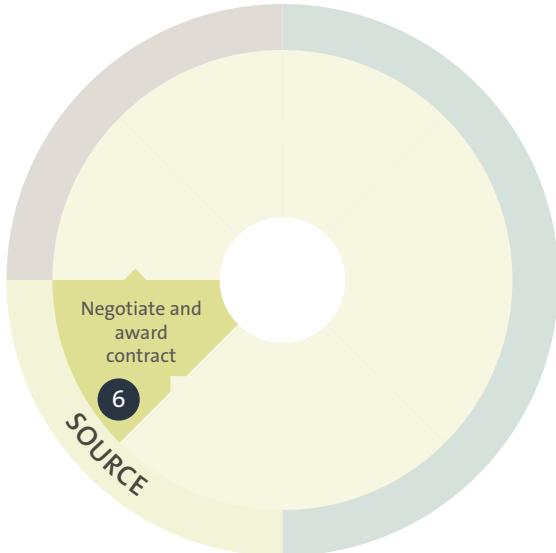
We will survey a sample of public organisations to find out the extent to which panels of suppliers are used, how they are used, and their purpose. We intend to publish the survey results.

Based on the survey results, we will identify aspects of the effectiveness of panels of suppliers for future work. For example, we might focus on whether public organisations are using panels appropriately, are following good procurement practice in establishing and operating panels, and have the capability to use them effectively. We might also consider whether the expected benefits are being realised.

# 8

## Negotiating and awarding contracts

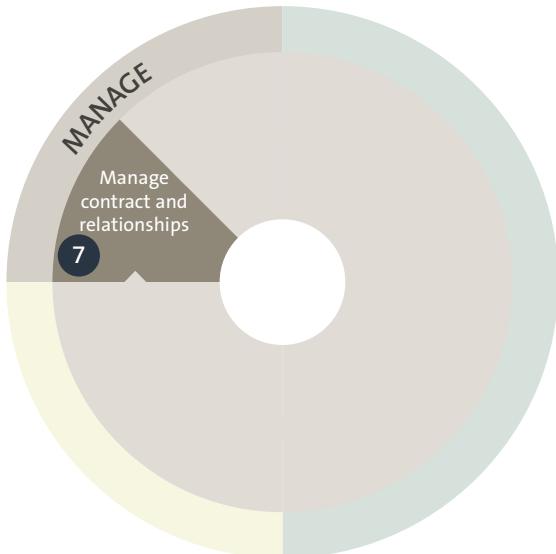
- 8.1 The sixth stage in the procurement life cycle is negotiating the terms and conditions of a contract, establishing and agreeing to levels of service with the supplier, and providing feedback to both successful and unsuccessful suppliers.
- 8.2 Public organisations should establish a clear negotiating mandate, plan how they are going to negotiate the contract's terms and conditions, and understand what they can move on and what the "non-negotiable" items are. They should also ensure that the negotiations meet standards of fairness; for example, not negotiating a contract that is substantially different from what was tendered.
- 8.3 A careful and informed approach to contract negotiation can ensure that public organisations meet their objectives and appropriately manage their risk.
- 8.4 It is also important that the contract negotiations result in a shared understanding of what the procurement will deliver. This allows the public organisation to monitor supplier performance and also allows the public organisation to check that contractual commitments have been met.
- 8.5 This is an important part of the procurement process and we will consider it in our annual audit work where relevant and appropriate. We will continue to examine public organisations' policies and practices for awarding contracts as part of our annual audit work, particularly for public organisations that do a significant amount of procurement.



# 9

# Managing contracts and relationships

- 9.1 The seventh stage in the procurement life cycle is:
- actively managing the supplier's performance, including contract management planning and supplier relationship management;
  - involving senior management in overseeing contracts; and
  - ensuring that risks are managed.



## Monitoring supplier performance

- 9.2 The public sector needs to be aware of the contracts that are critical to service delivery across government. There have been instances, locally and overseas, where the government has had contracts with suppliers for critical services and these critical services have either failed or required government intervention. We are interested in how public organisations monitor contracts for critical services and whether they are being appropriately managed on an ongoing basis. We will consider what further work we should do as our procurement work progresses.
- 9.3 Public organisations need to monitor and manage a supplier's performance to assess whether they are receiving what was contracted. They should determine the extent of the managing and monitoring based on risk management and cost–benefit assessments.
- 9.4 It is not just a few large contracts that need to be managed well. The effective delivery of low-cost, high-volume contracts can also be critical to a public organisation's purpose, for example social services that support vulnerable individuals.
- 9.5 Monitoring and managing suppliers' performance – especially the performance of critical suppliers – should be a priority for public organisations.

## Involving governance and senior management in contract management

- 9.6 We have noted that contract management capability can be a concern, particularly where organisations or their business units carry out large or "once in a lifetime" projects. This means it is important that senior managers and

governors of public organisations have oversight of, and support, important procurement projects. Senior management can help to ensure that the procurement remains on track and that any issues are dealt with when they arise.

## **Monitoring and managing risks**

- 9.7 Procurement risks need to be actively managed. Identifying and managing risks needs to be systematically carried out for each procurement process.
- 9.8 Managing risk does not mean eliminating all risks but instead fully understanding risks and then taking appropriate action about them. Such action would usually involve allocating the risk, mitigating the risk, and, where required, monitoring it. Effective risk management increases the likelihood that a procurement will go well and that the public organisation can deal with any issues when they arise.

## **Our proposed audit work**

- 9.9 Effective contract management is important for effective procurement. If a contract does not deliver to expectations, then no matter how efficient or well-conducted the purchasing process was, the procurement has not been effective. Effective contract management helps ensure the effective delivery of services as well as facilities.
- 9.10 Public organisations need to monitor and manage a supplier's performance to assess whether they are receiving value for money. Public organisations should determine how much they need to manage and monitor supplier performance based on risk and cost-benefit assessments. Monitoring and managing supplier performance should be a priority. We intend to look into contract management.
- 9.11 Many larger public organisations have entered into smaller contracts (less than \$0.5 million) with a broad range of suppliers. Collectively, the total contract value and risk exposure can add up to tens or hundreds of millions of dollars. Ensuring consistency of contract management and service delivery, and providing assurance throughout a large portfolio of small contracts, can be challenging. This is particularly true of large public organisations, where responsibility and oversight of contract management can be devolved across multiple teams.
- 9.12 We intend to look at the challenge faced by public organisations to effectively manage and monitor many smaller contracts to ensure that they are getting value for money.

We will review the management of low-cost, high-volume contracts in selected central government agencies.

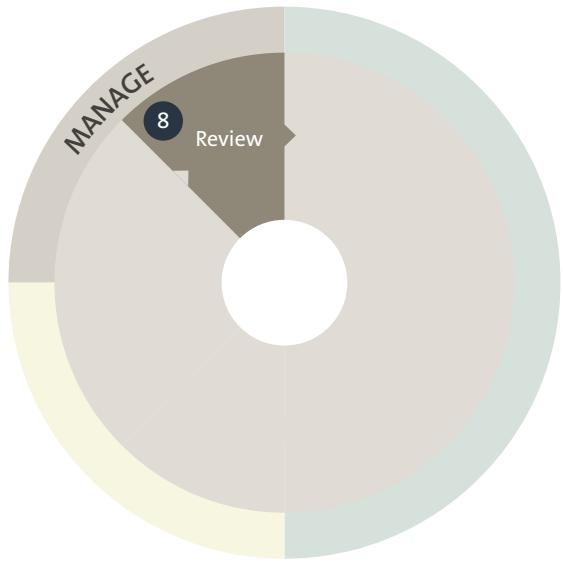
- 9.13 Social services play a vital role in the lives of New Zealanders. Social services provide New Zealanders access to health service and education opportunities and protect and support the most vulnerable. The quality of these services and their accessibility for people in need are important.
- 9.14 Planning and delivering social services can be particularly difficult because:
- there might be few credible suppliers of a particular service;
  - services can be complex, for example, services might be unable to be fully recorded in a specification or service level agreement, so the contract alone cannot be relied on to deliver them;
  - the Government is not always the end user of the service and might not be present at the point of delivery. This can make it difficult to assess the quality of provision;
  - required services cannot always be provided through one contract, and the current system needs better ways to join up services for people with multiple and complex needs;
  - contracted services do not always meet the needs of their users; and
  - current government budgeting processes and accountability mechanisms often favour the use of prescriptive contracts, a short contract period, and onerous reporting requirements.<sup>17</sup>
- 9.15 We will also look at contract management in the social services sector.

We intend to look at how well the procurement of social services meets community needs. We will consider how well procurement is managed, monitored, and adjusted to support the achievement of desired outcomes for communities. We will also examine how effectively public organisations work together to ensure that procurement of services is well co-ordinated and aligned with community needs.

# 10

## Evaluating and reviewing the procurement

- 10.1 The final stage in the procurement life cycle is assessing whether the intended benefits from a procurement have been realised and whether any lessons can be learnt from the process.
- Realising benefits**
- 10.2 Benefits management starts earlier in the life cycle when the public organisation defines what procurement and business outcomes are needed. Benefits should be aligned to a public organisation's strategic goals. The delivery of the intended benefits needs effective project management and active monitoring of progress and the benefits to be realised.<sup>18</sup>
- 10.3 At times, we have found in our work that public organisations do not understand the importance of managing benefits or do not have effective arrangements to assess them.
- 10.4 Benefits are the reason procurement is carried out. To successfully deliver any procurement, it is essential that the project managers and governors focus on realising the benefits of the procurement from the start of the procurement process. They should:
- understand clearly what the intended benefits are and how they can be achieved;
  - be agile enough to ensure that benefits can be fully realised and enhanced; and
  - be able to adapt the project, if required, to realise the intended benefits.
- 10.5 Showing the benefits that resulted from a project is also a way to show accountability. Reporting on what was achieved from a procurement is one way of being transparent about the procurement process and accountable for how the money was spent.
- Learning lessons**
- 10.6 It is important that, by the end of a procurement, public organisations assess what went well and whether there are any lessons to be learned.



- 10.7 For significant procurements, it is particularly important that any lessons are recorded and passed on to other public organisations for which they are relevant.
- 10.8 Public organisations should not wait until the end of a procurement to learn from the process, because by then it might be too late. Public organisations should be willing to learn “along the way” and improve the procurement when they can.
- 10.9 Lessons can be learned from a range of different procurements. For example, the Ministry of Defence produces an annual Major Projects Report that we review and provide some assurance on. Through its continuing improvement process, the Ministry of Defence has sought to address the matters that have been raised.

## Our proposed audit work

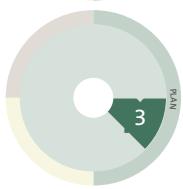
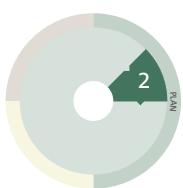
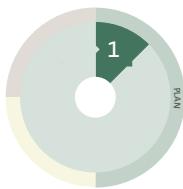
- 10.10 The aim of procurement is to support the delivery of services to the public and to do it well. Not all public organisations understand the importance of, or have the arrangements in place, to assess whether the procurement has achieved its intended benefits. Some of the work that we have already signalled (for example, in paragraphs 6.8 and 9.15) might look at this. We are considering what other work to do on public organisations’ evaluations and reviews of their procurements.
- 10.11 There is a continuum of funding arrangements that public organisations use that includes procurement but also conditional and unconditional grants (see Part 1). We expect appropriate accountability for the effective and efficient use of public funds regardless of what funding arrangement is used. This approach is reflected in our proposed work.
- 10.12 MBIE is responsible for administering the annual \$1 billion Provincial Growth Fund. MBIE has also had responsibility for the KiwiBuild programme after the KiwiBuild unit was set up in the Ministry in December 2017. The unit will move to be part of the new Ministry of Housing and Urban Development, which is due to start operating on 1 October 2018. Given the size and complexity of both the Provincial Growth Fund and the KiwiBuild programme, we will do additional work in the course of our annual audits to give assurance about processes and systems for administering funding and investment.
- 10.13 MBIE has a significant role in awarding grants and other funding to third parties and administers a range of grant programmes (for example, the Endeavour Fund and the Partnerships Scheme). This type of expenditure is expected to increase in the next three years with the establishment of the Provincial Growth Fund, because grants are envisaged as the main mechanism to fund non-commercial projects under the Fund. We will continue to build on earlier work in the annual audit to give assurance about processes and systems in MBIE to award and evaluate grants.

# Appendix

## Our proposed work on procurement

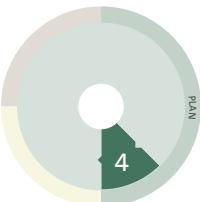
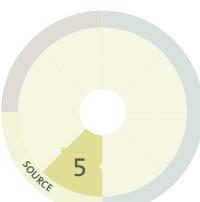
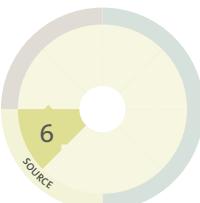
After reviewing the results of our recent audit work, talking to our auditors, consulting with Parliament, and holding workshops with various public sector organisations and groups, we have chosen the following topics for our proposed work on procurement. We will review our proposed work over time in response to emerging findings and risks. We encourage input by any interested parties at all stages of our procurement work.

Topic	Our proposed work
Functional leadership	We intend to carry out performance audits looking at: <ul style="list-style-type: none"><li>• how well MBIE's functional leadership creates efficiencies and improves services and service delivery. Our audit will specifically examine the part that all-of-government contracting plays in this; and</li><li>• how well MBIE's functional leadership develops procurement workforce expertise and capability in central government.</li></ul>
	We intend to examine aspects of how well the GCDO is fulfilling its leadership role in ICT procurement.
Initiating a procurement project	Using a case-study approach, we intend to examine a small selection of procurements by local councils to highlight the importance of procurement capacity and capability and identify matters that local councils should focus on to reduce the risk of procurement failures.
	We intend to examine significant investments in the health sector. We are interested in how the health system determines what infrastructure investments are needed, where, and when. In subsequent years, we will also consider whether there is merit in looking at other aspects of significant procurement in the health sector either as part of our annual audits or as part of other projects.
Identifying needs and analysing the market	We intend to examine how well the New Zealand Transport Agency is working to help ensure a robust contracting market that is capable of delivering a competitive tendering environment when contracts for maintenance and renewal are completed.
Specifying requirements for a procurement	Although we have not planned any specific work examining this matter, we will continue to review our programme of work to ensure that it reflects emerging findings and risks.



## Appendix

### Our proposed work on procurement

Topic	Our proposed work
 <p>Planning an approach to the market and evaluation</p>	<p>We intend to examine how collaborative arrangements have been established and managed for best effect, and provide assurance that the expected benefits are well defined, monitored, and assessed. Because there have been a number of public private partnerships set up already in the transport, education, and justice sectors, we propose in the first instance to explore how effectively these public private partnerships are delivering on their intended outcomes. We intend to identify lessons from these examples that might be applicable to various forms of collaborative contracting that involve a large amount of public expenditure.</p>
 <p>Approaching the market and selecting a supplier</p>	<p>We will survey a sample of public organisations to find out the extent to which panels of suppliers are used, how they are used, and their purpose. We intend to publish the survey results.</p> <p>Based on the survey results, we will identify aspects of the effectiveness of panels of suppliers for future work. For example, we might focus on whether public organisations are using panels appropriately, are following good procurement practice in establishing and operating panels, and have the capability to use them effectively. We might also consider whether the expected benefits are being realised.</p>
 <p>Negotiating and awarding contracts</p>	<p>This is an important part of the procurement process and we will consider it in our annual audit work where relevant and appropriate. We will continue to examine public organisations' policies and practices for awarding contracts as part of our annual audit work, particularly for public organisations that do a significant amount of procurement.</p>
 <p>Managing contracts and relationships</p>	<p>We will review the management of low-cost, high-volume contracts in selected central government agencies.</p> <p>We intend to look at how well the procurement of social services meets community needs. We will consider how well procurement is managed, monitored, and adjusted to support the achievement of desired outcomes for communities. We will also examine how effectively public organisations work together to ensure that procurement of services is well co-ordinated and aligned with community needs.</p>



Topic	Our proposed work
Evaluating and reviewing the procurement	<p>We are considering what work to do on public organisations' evaluations and reviews of their procurements.</p> <p>MBIE is responsible for administering the annual \$1 billion Provincial Growth Fund. MBIE has also had responsibility for the KiwiBuild programme after the KiwiBuild unit was set up in the Ministry in December 2017. The unit will move to be part of the new Ministry of Housing and Urban Development, which is due to start operating on 1 October 2018. Given the size and complexity of both the Provincial Growth Fund and the KiwiBuild programme, we will do additional work in the course of our annual audits to give assurance about processes and systems for administering funding and investment.</p> <p>MBIE has a significant role in awarding grants and other funding to third parties and administers a range of grant programmes (for example, the Endeavour Fund and the Partnerships Scheme). This type of expenditure is expected to increase in the next three years with the establishment of the Provincial Growth Fund, because grants are envisaged as the main mechanism to fund non-commercial projects under the Fund. We will continue to build on earlier work in the annual audit to give assurance about processes and systems in MBIE to award and evaluate grants.</p>



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