

COMPLIANCE OF THE PUBLIC PROCUREMENT INTERNAL CONTROL SYSTEM WITH ITS REQUIREMENTS

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No. ATA-1

SUMMARY

Relevance of the audit

About 4,000 contracting authorities annually carry out public procurement with a value EUR 5-6 billion, which represents about 1/3 of total public expenditure and around 12 % of the country's GDP¹. The COVID-19 pandemic has highlighted weaknesses in the decentralised public procurement system, and rapid procurement has not paid sufficient attention to assess whether the products offered by suppliers met the requirements and were of good quality². As of 1 January 2020, public sector entities had³ to establish an internal control framework to mitigate the negative impact of risk factors, including the pandemic, on their activities. An appropriate set of internal controls helps contracting authorities to ensure the acquisition of the necessary supplies, services or works through the rational use of the allocated appropriations, a smooth procurement process and the management of risks in this area.

In order to assess whether there has been a positive change in the improvement of the internal control system for public procurement, we carried out a public audit of the compliance of the public procurement internal control system with its requirements.

¹ Public Procurement Office Activity Report 2021, available at: <https://vpt.lrv.lt/lt/administracine-informacija/planavimo-dokumentai/metines-veiklos-ataskaitos-1> (accessed on 11 April 2023).

² COVID-19 procurement report prepared by the PPO: open data, identified procurement weaknesses and recommendations, available at: <https://vpt.lrv.lt/lt/naujienos/vpt-parengta-covid-19-pirkimu-ataskaita-atviri-duomenys-nustatyti-pirkimu-trukumai-ir-rekomendacijos> (referred to on 11 April 2023).

³ Law on Internal Control and Internal Audit, Art.4.

Objective and scope of the audit

The objective of the audit is to assess whether the internal control system created by the public sector entities ensures that public procurement is carried out in accordance with its requirements.

Key audit issues:

- ✓ whether the internal control system established and maintained in the area of public procurement complies with the objectives set for the elements of the system and the internal control principles (in accordance with the Guidelines for internal control standards in the public sector of the International Organisation of Supreme Audit Institutions (INTOSAI) transposed into Lithuanian legislation⁴;
- ✓ whether the system in place ensures that the procurement process is conducted in accordance with its requirements.

Audited entities:

- ✓ The Ministry of Economy and Innovation, as it is responsible for the formulation, organisation, coordination and control of State policy in the field of public procurement⁵;
- ✓ The Ministry of Finance, as it is responsible for the formulation, organisation, coordination and control of State policy in the areas of internal control and internal audit⁶;
- ✓ The Ministry of Culture and the Ministry of Social Security and Labour, because, having assessed the risks in the area examined, we selected the budgetary institutions in the fields of governance of the ministers with the highest number of public procurement contracts (10.1 thousand units, EUR 212.4 million) in 2020-2021 for the collection of audit evidence:
 - In 2020, 3.8 thousand public procurement contracts (worth EUR 77 million) were concluded by budgetary institutions in the field of management of the Minister of Culture (i.e. 16.7 % out of 22.4 thousand of contracts awarded by central government authorities and their subordinate budgetary bodies in 2020);
 - In 2021, 1.9 thousand contracts (worth EUR 41 million) were concluded by budgetary institutions in the field of governance of the Minister of Social Security and Labour (i.e. 15.7 % out of 12.1 thousand contracts concluded by central government authorities and their subordinate budgetary bodies in 2021).

During the audit, in order to gather appropriate and sufficient audit evidence, we collected information in the Ministry of Culture and 20 budgetary bodies in its field of governance, and in the Ministry of Social Security and Labour and 10 budgetary bodies in its field of governance.

The audited period was selected from 1 January 2020 to 30 September 2022.

⁴INTOSAI GOV 9100 'Guidelines for internal control standards in the public sector'.

⁵Regulations of the Ministry of Economy and Innovation approved by Government Resolution No 921 of 23 July 1998, p. 7.1.

⁶Regulations of the Ministry of Finance approved by Government Resolution No 1088 of 8 September 1998, p. 7.12.

The audit was carried out in accordance with international standards of supreme audit institutions. The scope of the audit and the methods used are described in more detail in Annex 2, 'Audit Scope and Methods' (Page 41).

Main audit results

The internal control developed by the bodies in the field of public procurement does not comply with all internal control elements and principles applicable in accordance with the COSO model. Weaknesses in public procurement were not established in 9 out of 32 institutions assessed.

1. The internal control environment for public procurement formed by the bodies partially complies with the applicable principles.

- ✓ The principle of professional conduct, which includes the prevention of conflicts of interest, was in line with the internal control environment of 4 (or 13 %) bodies inspected, with 15 institutions (47 %) with partial and 13 institutions (41 %) with significant non-compliances. In order to prevent conflicts of interest, internal controls were developed by half of the bodies: 16 (out of 32) during the audited period did not appoint persons who control that the persons involved in the procurement process have signed confidentiality statements, declarations of impartiality and that the persons who are required to submit declarations of private interests to the Chief Official Ethics Commission do so in due time. 10 of them had not provided in their internal procedures for the submission of documents to prevent conflicts of interest from participants in the procurement process. After checking sample procurements in 21 bodies, including also 12, which developed related controls, we found that documents for the prevention of conflicts of interest were not submitted or were not submitted on time by all participants in the procurement process. Bodies misinterpret the existing regulation and do not require these documents to be provided by persons who are not initiators, organisers or members of the public procurement committee but who are involved in the procurement process and may influence its outcome (e.g. with whom various documents relating to the procurement are agreed).

In the absence of control over the prevention of conflicts of interest and the submission of related documents, there is no control over the risk that persons who are in a situation of potential conflict of interest will not be removed or excluded from the process of preparation, consideration, adoption or monitoring of procurement decisions in a timely manner, thereby failing to ensure the principles, objectives, fair competition in public procurement, and making it more difficult for the contracting authority to manage reputational risks (Section 1.1, page 14).

- ✓ Risks related to the principle of competence were identified in all institutions, of which 24 (or 75 %) institutions were significant. Public procurement training for staff involved in this process was organised at least once during the audited period by 31 bodies (out of 32), and on average only 23 % of the staff involved in the procurement process or likely to influence the outcome of the procurement process improved their qualifications at least once. The internal control training was organised by 11 bodies, and on average, only 4 % of the staff involved or likely to influence the results of each body's procurement process developed qualifications in this area at least once.

In 29 bodies (out of 32), staff were appointed to carry out procurement during the audited period, for whom this is not their primary function. During the period covered by the audit, 11 institutions did not have procurement specialists or units whose main functions would be limited to procurement.

Institutions do not seek to ensure that all staff involved in procurement and internal control processes have the necessary expertise to reduce errors and non-compliance with procurement requirements (Section 1.2, page 16).

- ✓ The principle of management philosophy and management style in the internal control environment, which includes the definition of internal control policies and procedures, was met by 12 (or 38 %) institutions, partial non-compliances were identified in 16 institutions (50 %), significant – in 4 (13 %) institutions. We identified regulatory weaknesses for the stages of the procurement process in 17 bodies (out of 32). The regulation of the stage of performance of the procurement contract is most to be improved – it is not discussed how the result of the procurement will be assessed, its compliance with the needs of the institution (9 institutions) and the regulation of the stage of demand formation – the procedure for conducting and documenting the market research, the assessment of the possibility of purchasing through the central purchasing body (8 institutions) has not been established.

7 bodies did not have an approved list of documents governing the implementation of internal controls (required part of the internal control policy), which should also cover internal procurement procedures, of which 2 did not submit an approved internal control policy.

If the institutions do not regulate all stages of the procurement process, without identifying the actions carried out during them and their perpetrators, the risk is not managed that the responsible staff (particularly in the event of a change in them) will not know when and what actions they are required to carry out. This will have a negative impact on procurement results (Section 1.3, page 17).

- ✓ The principle of organisational structure in the Internal control environment was met by 9 (or 28 %) institutions, partial non-compliances were identified in 19 institutions (59 %), significant – in 4 (13 %) institutions. We identified regulatory weaknesses in the roles and responsibilities of the persons involved in the procurement process in 18 bodies (out of 32). The definition of the functions and responsibilities of the person responsible for planning, organising and supervising procurement and the administrator of the Central Public Procurement Information System (CPS) should be improved the most. The internal procedures of the institution do not define which internal control procedure is carried out or the responsibilities of the staff with whom the procurement process documentation is coordinated. 17 bodies had weaknesses in the designation of persons recommended by the PSP in the procurement process, of which ten did not appoint persons responsible for planning, organising and supervising procurement.

Without appointing specific staff or defining all their functions and responsibilities in the procurement process there is no guarantee of the traceability of which of the staff member is responsible for which stage or action of the process. In the event of failures or significant violations, it will not be possible to assess at which stage of the process and which internal controls have not worked, they will not be revised accordingly to avoid new violations or errors in the future (Section 1.4, page **Klaida! Žymelė neapibrėžta.**).

2. 66 % of institutions do not assess procurement-related risks

The risk assessment requirements were met by 3 (or 9 %) audited bodies, partial non-compliances were identified in 9 institutions (28 %), significant – in 20 (63 %):

- ✓ 25 institutions (out of 32) have developed and regulated the risk assessment process, but 21 of them did not assess the risks associated with the procurement process. Without analysing these factors, measures to mitigate or eliminate the adverse effects of the risk are not selected. Institutions do not establish a risk-proportionate and optimal internal control system for procurement to ensure compliance with the requirements and principles applicable to procurement and to ensure a procurement result to meet the needs of the institution (Section 2.1, page **Klaida! Žymelė neapibrėžta..**).
- ✓ 27 institutions do not monitor the efficiency or performance indicators of public procurement, therefore they do not have the information necessary for the qualitative assessment of risks, about the strengths, weaknesses and improvements of the institution's procurement and control system, which makes it difficult to make reasonable decisions on the selection of appropriate measures to improve the public procurement system in the institution (section 2.2, page **Klaida! Žymelė neapibrėžta..**).

3. Controls created by 72 % of institutions did not ensure that purchases were carried out in accordance with set requirements

The principle of selection and improvement of controls was met by 1 institution's control activities, partial non-compliances were identified in 15 (or 47 %) audited institutions, significant – in 16 institutions (50 %):

- ✓ 18 bodies (out of 32) do not regulate internal controls at all stages of the procurement process to verify the compliance of operations. The largest number of institutions (11) had not created a need for controls at the stage of formation, execution of the procurement and award of the contract.

18 institutions have defined in their internal procedures the obligation for originators to conduct market research, but 14 of them did not set minimum requirements for what should be known before the start of the procurement, and only two set out a procedure for recording the results of market research.

13 institutions have defined in their internal procedures the conditions under which only one supplier is allowed to be interviewed in low value procurement. According to the legal regulation, a single supplier may be interviewed whenever a low value purchase is carried out by means of an unpublished survey, i.e. when the value of the contract is up to EUR 10 thousand excluding VAT (from 1 January 2023 – up to EUR 15 thousand excluding VAT) and, in exceptional cases, higher values. In order to make rational use of funds, so that goods, services or works are purchased at more competitive prices, it is recommended to interview more than one supplier. Eight institutions envisaged additional conditions for interviewing more than one supplier in the context of a low-value procurement by means of an unpublished survey.

The failure to establish internal controls by the institutions at each stage of the procurement process, the risk of errors and violations is not managed. If the procurement is not properly prepared – without carrying out a market research, without assessing the possibility of contacting several suppliers – the risk that the

goods, services or works will be purchased at non-competitive prices is not managed (Section 3.1, page **Klaida! Žymelė neapibrėžta.**)

- ✓ There is no separation of functions in 29 institutions: in 13 purchases procurement performance is not separated from initiation, in 13 purchases procurement performance is not separated from both initiation and contract performance supervision, in three institutions the persons exercising control over the procurement process were appointed to the procurement commissions under their control. Bodies, especially those with a small number of administrative staff, have difficulties in ensuring the separation of functions, which increases the likelihood of fraud or corruption. In cases where a proper separation of functions is not possible, more control should be exercised by the head of the body, and it is therefore essential that internal procedures set out his/her actions in the procurement process (Section 3.1, page 26).
- ✓ 21 bodies (out of 32) had not regulated the performance review in the field of public procurement and 5 did not provide evidence of such a review. 15 bodies did not regulate the monitoring of procurement legislation and, in case of changes thereto, a review of domestic legislation.

The failure to carry out a performance review of the procurement area by the institutions does not ensure the timely adjustment and improvement of the procurement process in the light of changed conditions or requirements applicable to procurements, which may not guarantee the legality of the procurement and the achievement of the result (Section 3.1, page 27).

The control activities of 9 (28 %) bodies complied with the principle of applying policies and procedures, with 4 (13 %) of institutions having partial non-compliances and 19 (59 %) with significant non-compliances.

- ✓ In the procurements audited in 23 bodies (out of 32), we found non-compliance with the requirements of the legislation and internal procedures, including also four, for which we did not identify weaknesses in the establishment of internal controls in their internal procedures. Most non-compliances were established: in the procurement phase (16 bodies) - the wrong procurement method was used, the procurement documents were drawn up with shortcomings, the evaluation of tenders was not properly carried out; in the initiation and preparation phase (15 bodies) - failure to complete or incorrectly prepare the procurement application, failure to record the decision to whom the procurement is entrusted, and failure to properly control the preparation of the application; in the procurement planning phase (10 bodies) - the purchase is not included in the plan, the value of the purchase is not properly calculated, the decision not to purchase from the CPO is not reasoned.

Insufficient internal control of procurement in institutions leads to non-compliance of the procurement process with the requirements laid down in legal acts and internal procedures, therefore, compliance with the basic principles of procurement is not ensured and the risk of achieving the main procurement objective, i.e. to acquire what is needed by the organisation through the rational use of the allocated appropriations, is not ensured (Section 3.2, page 28).

4. Documentation of decisions and control actions taken in the procurement process and publicity of procurement information to be improved

- ✓ In 5 (out of 32) institutions we found undocumented procurement process decisions, their motives or procedures, blank forms of approved documents or used other than approved ones, omitting relevant information.

Without documenting the actions of the procurement process and the reasoning behind the decisions taken, the transparency of procurement and the traceability of the decisions taken is not ensured, information is not collected to identify areas for improvement in this process and, accordingly, to identify possible corrective actions (section 4.1, page 29).

- ✓ 28 (out of 32) bodies have set up controls for the mandatory publication of information in the Central Public Procurement Information System, but in 16 of the procurement contracts audited, the information in the system on contracts signed, the tenders of successful suppliers, the procurement reports was submitted late or incomplete, including 13 where we did not find any weaknesses in the set-up of the control measures. This indicates that controls in this area should be strengthened.

The lack of control results in inaccurate or untimely information being fed into the central public procurement information system, which undermines the transparency of procurement and the quality of the procurement information collected by the Public Procurement Service (PPS), and also affects the procurement indicators monitored by the PPS, which are necessary for the formulation of the policy and decision-making on these procurements (Section 4.2, page 33).

5. Public procurement internal control activities in bodies are not reviewed

- ✓ The principle of continuous monitoring and periodic evaluations was met by 5 (or 16 %) institutions' internal control monitoring, partial non-compliances were identified in 15 (47 %) audited bodies, significant – in 12 (38 %) bodies. The internal control monitoring was regulated in all 32 audited bodies, but 27 did not provide evidence of the internal control monitoring carried out by the Agency's own staff in the field of public procurement. Of these, 12 did not carry out any procurement-related verifications (including internal auditors or external reviewers) that would demonstrate the effectiveness of the internal control of the procurement process.

Non-compliance with the principle of assessment and reporting of weaknesses was found in 6 institutions, no non-compliances were found in 10 institutions, in the remaining 16 institutions we did not assess compliance because they did not carry out assessments or because no weaknesses were identified by the entities that carried out the assessments. 80 % (16 out of 20) the auditors or other external reviewers of the centralised internal audit services of the bodies found violations in the legality of public procurement. Weaknesses in the internal control system for public procurement are also reflected by the fact that 5 bodies did not provide evidence that their management considered the issues identified and made decisions on improving the internal control of these procurements.

Failure by the institutions to ensure regular monitoring of the internal control of the procurement process (by combining self-monitoring with those carried out by centralised internal audit services or other external evaluators) does not identify in a timely manner weaknesses in the functioning of controls and the effectiveness of internal control of procurement (Section 5, page 34).

Recommendations

For the Ministry of Culture:

1. In order to have an effective internal control system in the bodies in the field of governance of the Ministry of Culture that helps to manage the risks associated with public procurement, we recommend assessing the internal control of other bodies in the field of governance, analysing its weaknesses and taking reasonable measures by considering centralisation and/or consolidation of part of the procurement, by carrying out joint procurements, thus reducing the administrative burden of bodies by addressing the lack of competence (key audit results 1, 2, 3, 4, 5).

For the Ministry of Social Security and Labour:

2. In order to have an effective internal control system in the bodies in the field of governance of the Ministry of Social Security and Labour that helps to manage the risks associated with public procurement, we recommend assessing the internal control of other bodies in the field of governance, analysing its weaknesses and taking reasonable measures by considering centralisation and/or consolidation of part of the procurement, by carrying out joint procurements, thus reducing the administrative burden of bodies by addressing the lack of competence (key audit results 1, 2, 3, 4, 5).

For the Public Procurement Office:

3. In order to assist contracting authorities in setting up an effective internal control system for procurement, we recommend updating the procurement organisation and internal control guidelines, detailing the stages of the procurement process, the requirements applicable to them, the participants implementing internal controls and measures, covering all five elements of internal control (key audit results 1, 2, 3, 4, 5).

During the audit, we made a written recommendation to the Public Procurement Office regarding methodological support for contracting authorities in ensuring effective prevention of conflicts of interest in the field of procurement and reducing the risk of different treatment of the provisions of the law, and a proposal to provide for automated measures to ensure the correctness of data in the newly developed public procurement information system.

The measures and deadlines for the implementation of the recommendations, the expected impact of the audit and the indicators for assessing changes are presented in the part of the report entitled 'Plan for the Implementation of the Recommendations' (page 36). Relevant information on the state of implementation of recommendations, results and changes that have taken place is published in open data on the website of the National Audit Office <https://www.valstybeskontrole.lt/LT/AtviriDuomenys>.