

Corruption risks associated with supplier panels

Introduction

As part of their procurement strategy, NSW public sector agencies regularly establish panels of approved or pre-qualified suppliers. While designed to provide efficiencies in the purchasing process, unless properly established and managed, these panels are open to corruption and abuse.

This publication by the NSW Independent Commission Against Corruption (“the Commission”) explains the key corruption risks associated with forming, using and maintaining supplier panels.¹

What is a supplier panel?

Supplier panels are often used as part of an overall procurement strategy. They involve establishing a group of pre-qualified, or preferred, suppliers to provide goods and services of a specific type.

In some situations, appointment to a panel requires the suppliers to bid and agree to pricing and terms and conditions, for example, by offering set hourly rates for the duration of the panel (sometimes called a “standing offer” panel). Otherwise, the panel may be formed without obtaining any price information.

Benefits of using supplier panels

- Offers a fast and simple way of engaging suppliers without compromising the quality of the goods and services provided
- Reduces cost of bidding for discrete pieces of work
- Standardises how an agency buys from suppliers, including agreed terms and conditions
- Uses collective purchasing power to drive cost savings
- Establishes better relationships with suppliers that can lead to additional cost savings and other benefits
- Potentially locks in agreed pricing
- Provides opportunities to cooperate with like agencies when procuring similar goods and services

Supplier panels are typically established to procure goods and services that are required on a regular basis. Examples include temporary or contract staff, stationery and other office supplies, consulting and other professional services (such as legal or accounting advice), the purchase and maintenance of IT and/or minor capital expenditure items and various types of equipment hire.²

¹ The publication is intended as a reference for agencies wishing to establish their own (internal) supplier panels. It does not relate to whole-of-government schemes or contracts maintained by Procurement NSW or Local Government Procurement. Agencies should not establish their own panel in situations where use of an alternative government scheme/contract is mandatory. In some situations, however, it is appropriate to create an internal panel comprising suppliers already on a whole-of-government scheme or contract.

² It should be noted that the procurement of maintenance services and minor capital works involves some inherent corruption risks. See the Commission’s publication, *Controlling corruption opportunities in the provision of maintenance services* (February 2017).

Panels are also used for certain specialised or hard-to-procure items and goods and services that need to be sourced at very short notice.

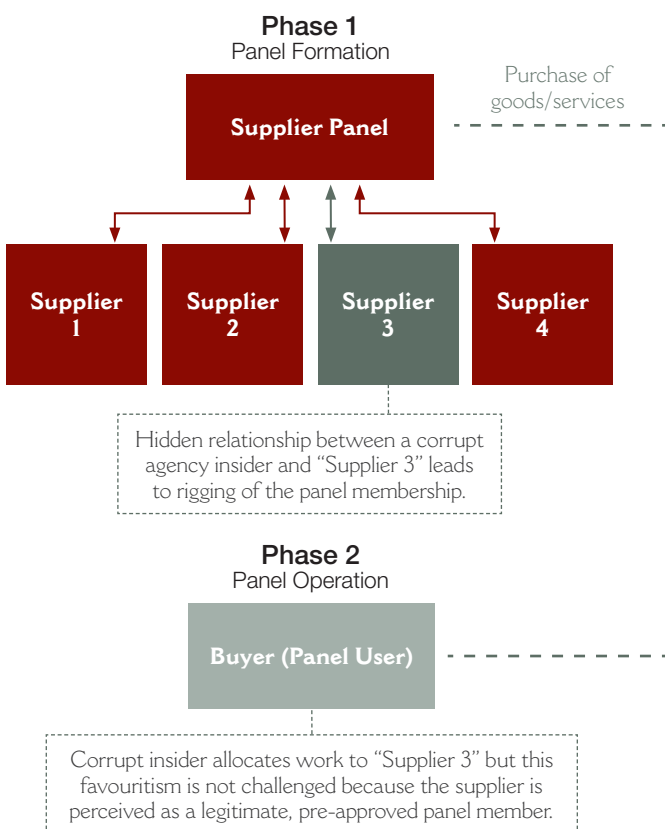
From a process perspective, supplier-panel procurement can be divided into three phases:

- 1) **Panel formation:** a competitive process is used to identify and select panel members, using agreed criteria.
- 2) **Panel operation:** once the panel is established, agency staff purchase specific categories of goods and services from approved panel members.
- 3) **Panel maintenance:** involves the ongoing monitoring and maintenance of the panel.

Phase 1 – panel formation

In the Commission’s experience, there is considerable variability in the way supplier panels are formed: some are created following formal, open approaches to the market involving the application of merit-based criteria; others are little more than an ad hoc list of names and contact details.

The formation phase of a supplier panel is critical to reducing overall corruption risk as, once appointed, panel members can win work with limited or no competition. In this context, if the processes used to establish the panel in Phase 1 are flawed, then the panel’s operation (covered by Phase 2) becomes more susceptible to corrupt conduct, as shown in the diagram below.



Case study: corrupt manipulation of supplier panels

In its report, *Investigation into the awarding of contracts by employees of the former NSW Roads and Maritime Services (RMS) (Operation Ember, May 2022)*, the Commission found that an RMS manager (“the manager”) engaged in serious corrupt conduct by awarding work to two companies owned by close friends and, in return, receiving substantial corrupt payments.

Among other things, the manager was able to confer benefits on his friends and himself by causing the two companies to be placed on supplier panels for maintenance service and professional service contractors (PSCs). In each case, suppliers were not required to submit any pricing information in order to be placed on the panel.

The maintenance panel

Initially, the manager worked with his friend to place his new company “ABC Pty Ltd” on the RMS vendor master file and to allocate some small contracts. The manager then obtained permission to establish a maintenance panel. In a message to his friend, the manager said, “You need to prepare the tender response to be placed on a panel of successful vendors. Then we can procure all we like. No limits and no risk. Been working on it for months.”

In order to benefit ABC and himself, the manager:

- modified the scope of the “maintenance” panel to permit the procurement of goods sold by ABC
- set technical criteria that specifically suited the product ABC was licensed to sell
- required panel members to have experience supplying to the RMS, which the manager had already arranged for ABC
- personally assisted his friend to prepare the ABC tender submission to join the panel
- deliberately failed to disclose his clear conflict of interest.

In addition, all three of the RMS staff assessing the tenders worked for the manager and none of them were procurement professionals.

ABC was appointed to the panel and subsequently awarded a number of contracts, all of which involved corrupt conduct.

The PSC panel

The manager also had permission to set up a PSC panel and, on this occasion, arranged for another friend's company, "XYZ Pty Ltd", to be appointed.

As with ABC, the manager arranged for XYZ to be given a number of small contracts (which also involved corrupt conduct), thereby allowing it to claim experience working for the RMS. The Commission identified flaws in the panel creation process, including that:

- there was no procurement strategy
- no due diligence or reference checks were undertaken
- the selection criterion for experience was given a weighting of 80%, which was designed to favour XYZ
- criteria relating to management systems and skills, capability and financial capability were removed, again to benefit XYZ.

Once on the panel, XYZ was awarded four substantially more lucrative contracts, worth over \$850,000.

The Commission concluded that, "When established by poor processes . . . supplier panels can institutionalise corrupt arrangements at great cost to public authorities".

Some of the more common corruption and probity risks associated with panel formation are as follows.

Failure to treat panel formation as a procurement exercise

Creating a supplier panel does not, by itself, entail any expenditure. Accordingly, agencies may be tempted to adopt a highly informal process that makes it easy to manipulate which suppliers are placed on the panel.

Agencies should therefore treat formation of a supplier panel with the same level of formality and probity as a procurement exercise. Among other things, this should involve assessing the likely annual expenditure on goods and services procured from panel members and using this as the basis for determining the appropriate process for forming the panel.

In addition, agencies should ensure their financial delegation framework sets out who has authority to initiate and approve the creation of a supplier panel. Ideally, the agency's chief procurement officer or procurement unit should play a role, which might include approving the process at various key steps.

Preparation of an appropriate needs analysis

Suppliers face less competition once they have been placed on a panel, so a corrupt actor could dishonestly contrive the need for a panel.

Agencies should ensure that a robust needs analysis or business case has been carried out to justify creation of a panel. The analysis should be based on an appropriate level of market research, spend analysis and (if relevant) asset management issues. It should clearly support the establishment of a supplier panel as being the appropriate procurement method and/or explain why existing procurement outcomes would be improved under a panel arrangement. The needs analysis should also identify any whole-of-government panels or similar arrangements that could be used in lieu of an agency-specific panel.

Hidden conflicts of interest and corrupt benefits

Most corrupt procurement schemes involve a hidden conflict of interest. This may concern an agency official who wishes to confer benefits on a supplier that:

- is owned or operated by the official, a friend or relative
- currently employs the official (that is, secondary employment)
- has offered future employment.

In other situations, a supplier may be favoured because it has provided gifts, benefits or corrupt payments.

Officials who are tasked with creating a supplier panel should be asked to disclose conflicts of interest, but this obviously requires a degree of honesty. In addition to due diligence checks (explained below), agencies should incorporate an appropriate segregation of duties to prevent an individual from exerting end-to-end control over the process. As suggested above, having both operational management and procurement professionals involved will help to establish these segregations.

Biased selection criteria and weightings

Membership of a panel can be rigged by manipulating the selection criteria and weightings to suit a particular supplier.³

In practice, it can be difficult to identify when criteria have been corruptly manipulated but some red flags to look out for include:

- Imposing mandatory criteria that disqualify suppliers that could deliver the goods and services required by the agency.
- Requiring prior experience supplying to the agency, which will favour incumbents (but conversely, it is important to screen out suppliers with little or no experience of any description).
- Weightings that are illogical or not consistent with those used in other tenders or go-to-market exercises.
- Technical specifications that are not necessary to meet the needs of the agency.
- Favouring local suppliers without a clear business justification.
- Criteria that allow suppliers to merely assert but not demonstrate their suitability.

Case study: appointment to a panel as a corrupt inducement

In its report, *Investigation into the conduct of councillors of the former City of Canterbury Council and others* (Operation Dasha, March 2021), the Commission made corrupt conduct findings against a local council official who was establishing a panel of urban design experts.

The official was attempting to persuade a particular design consultant to provide a report that was favourable to a planning proposal. The planning proposal in question sought a substantial increase in the prevailing height and floor space controls. The officer suggested that the design consultant “could be considered favourably for inclusion” on the urban design panel, in return for preparing a favourable report.

Fortunately, the design consultant refused this inducement, but the Commission found that by offering it, the public official engaged in corrupt conduct.

Unskilled or biased personnel

In a worst-case scenario, a single official is tasked with assessing applications to join the supplier panel. This makes the selection process vulnerable to corruption and error.

But even with a committee comprising a number of officials, the selection process can be skewed by a lack of procurement acumen.

The Commission recommends that applications to join a panel be assessed by a group akin to a tender evaluation committee. The committee should:

- wherever possible, include a member of the agency’s procurement unit
- include members who do not have regular dealings with the suppliers applying to join the panel
- not contain a majority of members without experience in procurement
- not solely comprise staff who are subordinate to an individual manager.

Where a prospective panel member is also an existing supplier, it may nominate an agency employee as a referee. This can be a source of bias and may require limiting or supervising the role of the referee in other aspects of the evaluation. The Commission’s publication, *Dealing with incumbent providers in procurement* (November 2021), provides additional information.

Inadequate due diligence

The failure to conduct appropriate checks to verify a potential supplier’s background can allow conflicts of interest (or other probity-related risks) to be hidden.

The rationale for having a supplier panel is to facilitate a relatively simple process for making regular purchases, so it makes sense to complete most due diligence procedures when the panel is formed. This means a fresh set of due diligence checks will not be required each time a panel member is engaged. In particular, agencies should collect, check and store relevant insurance certificates of currency and business licences, certifications and qualifications at the time of forming the panel. Once validated, there should be no need for the supplier to resubmit this documentation for subsequent work.⁴

However, if the initial checks are inadequate, a buyer may get a false sense of security about the suitability of the panel members or, alternatively, be in a position to corruptly award work directly to a supplier with which they are connected.

The Commission’s publication, *Supplier Due Diligence: A guide for NSW public sector agencies* (June 2020), includes detailed advice about due diligence practices, which should be based on overall risk.

³ It should go without saying that a complete absence of any formal, documented selection criteria or methodology is conducive to corrupt conduct.

⁴ Unless the relevant document expires, in which case the updated version should be obtained.

However, with particular regard to panels:

- As a general rule, staff who might have an existing familiarity with a supplier may not be well-suited to conducting due diligence checks. An officer at arm's length from the day-to-day delivery of goods and services may be in a better position to carry out the checks. This is because they are less likely to have a relationship with, or bias towards, a particular supplier.
- If panel members can be awarded work without having to submit a competitive quote (that is, by direct negotiation), the level of risk is higher and additional due diligence procedures may be required.
- Gaining membership on a panel could lead to a significant volume of work, so agencies should consider due diligence procedures such as obtaining samples of prior work, product demonstrations and site visits.

Failure to plan for the size of the panel

The Commission has observed situations where suppliers have been corruptly appointed to a panel despite receiving extremely low scores (in some cases, zero) when assessed against the agreed evaluation criteria (see Operation Paragon example below). In other cases, every supplier that applied was appointed to the panel.

Agencies should determine the ideal number of suppliers that will be on the panel and/or the minimum score required to be appointed. Preferably, this should be under consideration when conducting the initial needs analysis or business case.

As a general rule of thumb, there is little point in appointing a supplier to a panel if there is no realistic prospect that it will ever be awarded any work. From time to time, the

Case study: “. . . you'll have to hand over your firstborn”

The Commission's report, *Investigation into the awarding of Roads and Traffic Authority and Roads and Maritime services contracts* (Operation Paragon, March 2023), examined aspects of a supplier panel.

The investigation found that a supplier was added to a maintenance panel despite submitting a late application and scoring zero on all three selection criteria. The Commission's report found that a public official was motivated to include this supplier on the maintenance panel because he would be in a position to receive corrupt payments in return for arranging work for this supplier. The official sent the supplier an email saying, “Told you if this works you'll have to hand over your firstborn”.

Commission receives complaints from suppliers alleging that, despite being appointed as a panel member, they have not been awarded any work due to corrupt favouritism.

Phase 2 – Panel operation

Once a panel is established, agency staff can procure goods and services from its members. This operational phase entails a number of corruption risks. The Commission's advice for using panels is set out below.

Appoint a panel owner or administrator

As a general rule, panels that operate with a high degree of informality are more susceptible to corrupt practices.

The Commission recommends that agencies consider appointing a panel owner or administrator. There is some benefit in appointing an officer who is not the day-to-day “buyer” of goods and services from panel members. This is the approach typically used under a category management model (see more detail below).

It should, however, be remembered that one of the main objectives of creating a panel is to streamline administrative processes associated with procurement. While the panel administrator would be expected to carry out various tasks (see “Panel housekeeping” on page 8), buying from the panel should be a simpler process than going to the market from scratch.

Category management

According to the Chartered Institute of Procurement and Supply, category management involves the segmentation of spending into areas that contain similar or related products.⁵ Category management is designed to generate economies of scale, reduce risks, and help maintain partnerships with suppliers.

A category management approach is often used by larger agencies with significant volumes of spending. Typically, category managers are appointed to manage the procurement for each specific group (or category) of goods and services.

Examples of public sector organisations that may use category management include:

- a local hospital district for the purchase of pharmaceuticals and medical devices
- a university for the purchase of journals and books
- an emergency services agency for the provision of fleet.

In many ways, the rationale for adopting category management is the same as for creating supplier panels.

⁵ www.cips.org/intelligence-hub/category-management. Accessed 11/7/2023.

Induction

Because they are likely to be providing goods and services on a regular basis, it may be economical to provide panel members with a formal induction. This could address the agency's:

- methodology for awarding work
- payment procedures
- safety requirements
- expectations regarding subcontracting
- expectations regarding ethical conduct
- channels for reporting suspected misconduct or making complaints.

Procedures for awarding work

Many agencies fail to document agreed procedures for allocating work to panel members. This heightens the risk that work will be allocated corruptly.

The Commission does not endorse any particular approach, but it is important to document a repeatable method for allocating work to panel members. This could include:

- seeking quotations from panel members for each new procurement (the procedures should say whether some or all members are asked to quote)
- rotating work evenly among panel members
- using a form of cab-rank rule (that is, the first available supplier gets the work)
- ranking panel members based on their performance and offering work (or a higher percentage of the work) to the highest ranked member(s) (that is, a scorecard approach)⁶
- allocating suppliers to a particular geographical territory (which might be appropriate for an agency whose operations cover a large territory)
- allocating work to a supplier based on particular areas of specialisation (for example, a panel of legal firms might be used according to expertise in areas such as environmental law, industrial relations law, contract law and so on)
- combining some of the above.

Another useful integrity control is to give the panel visibility over how much work is allocated to each member and the basis for awarding the work. This can be done in summary form so that commercial-in-confidence information is not divulged.

⁶ This approach would require all panel members to be provided with at least some initial work, so that a fair ranking could be established. This may not be practical in certain situations, but the idea of giving all panel members a chance to demonstrate value for money has intuitive appeal.

Order splitting

As with other forms of procurement, it is likely that an agency's procedures will permit relatively small purchases to be made from panel members without seeking multiple quotes. For example, the Victorian Independent Broad-based Anti-corruption Commission (IBAC) reported on a case involving a local council's minor civil works panel. The council's practices permitted work valued at less than \$50,000 to be awarded directly to a panel member, without seeking competitive quotes. A council project manager admitted receiving cash and other benefits from a panel member, "Company B". The manager had "a great deal of discretion" to determine which panel member would be allocated work and the IBAC investigation found that, over a 14-year period, 54 per cent of all invoices valued at \$50,000 or less were from Company B. This outcome suggests that work was split in order to keep the amount below \$50,000 and avoid scrutiny.

For these lower-value purchases, the project manager did not have to give reasons for his selection and no checks were conducted to monitor the distribution of relatively low-value jobs.⁷

Inappropriate sharing of information

A panel member can be favoured by providing confidential information about its competitors. This can occur when panel members are asked to submit quotes for individual pieces of work and an agency official advises a supplier of the amount it needs to bid in order to win. Requiring bids to be sent to a secure electronic "box" with a fixed closing date/time is an obvious way to reduce this risk.

Suppliers can also collude to the detriment of the agency. This collusion can involve arrangements to share the available work at higher prices. This can be achieved by not bidding for work, submitting uncompetitive bids or subcontracting to other panel members.

Collusion may be a problem on panels because suppliers are likely to know who the other members are.

Collusion is difficult to detect but can be addressed by:

- locking in agreed pricing at the commencement of the panel, or at least seeking indicative pricing
- requiring subcontracting arrangements to be approved by the agency
- varying the panel members that are asked to submit quotes (unpredictable arrangements make it harder to collude)
- encouraging panel members to report misconduct and anti-competitive behaviour
- having terms and conditions that permit the removal of panel members.

⁷ Independent Broad-based Anti-corruption Commission, *Special report on corruption risks associated with procurement in local government*, September 2019, pp. 22–23.

Failure to formalise contractual arrangements

As noted above, the Commission recommends that formal procedures be established for awarding work to panel members. But, by themselves, these procedures do not necessarily entail executing a contract or even creating a purchase order.

In many situations, panel members must agree to standard pricing or terms and conditions relating to timeliness, quality standards, ethical standards, payment terms and so on. But this will only have effect if the activities of the panel are brought under a master contract or a formalised “rate card”. Consequently, the Commission recommends that an agency’s legal or contract management staff be involved in executing the necessary contractual arrangements.

Regardless of the contractual instrument used, suppliers and buyers may, over time, deviate from the intended pricing, terms and conditions. These deviations can be monitored by the panel administrator or even accounts payable staff.

Finally, while it is important to embed streamlined procedures for buying from panel members, agencies should also be careful about setting up blanket or open-ended purchase orders for a preferred supplier. These can encourage suppliers to invoice for work that is not needed or performed.

Buying “off-panel”

Usually, but not always, agencies mandate the use of their supplier panels for the approved goods and services. One common exception is for very large procurements not covered by the terms of the panel, or which require a new open tender.

However, if mandatory use of the panel is not enforced, it is relatively easy to divert work that should be going to panel members.

Case study – “bump up your rate an extra \$10 an hour”

The Commission investigated a NSW local council that had established a panel of civil works contractors. The investigation found that a council officer received corrupt payments from a supplier that was not on the panel. The supplier told the Commission that the officer instructed him to “bump up your rate an extra \$10 an hour” in order to finance the corrupt payments. The Commission concluded that, had the supplier been a member of a properly administered panel, it would have been more difficult to increase its prices in this way.

Agencies should:

- ensure that staff are aware that the panel exists and its use is mandatory
- minimise the administrative tasks associated with allocating work to panel members (which, after all, is one of the reasons for forming the panel)
- monitor procurement data to identify any off-panel expenditure.

Panel scope creep

The opposite of buying off-panel is using a panel for unauthorised purchases.

For example, if an agency uses a panel of firms to hire plant and equipment, it should not allow the panel to also be used for a different purpose such as construction project management.⁸

This panel scope creep could arise from the laziness of a buyer, who wants to piggyback on the convenience of the panel arrangements, or a supplier who wants to avoid competing for work.

As above, scope creep can be deterred by ensuring staff are aware of the panel rules and by monitoring data for anomalies.

Inappropriate relationships with panel members

Because panel members are typically used on a regular basis, there is a risk that professional relationships between buyers and suppliers could begin to take on characteristics of a personal friendship. This could arise from over-familiarity between individuals but may also be driven by the provision of gifts and hospitality, or grooming.

In addition to the necessary policies, procedures and training, agencies should also identify suppliers that, for no valid reason, seem to win a large proportion of work from a particular employee or unit within the agency.

Commission investigations have also identified occasions where a regular supplier has been engaged by an agency employee to provide goods and services in a private capacity. For example, hiring a member of a minor works panel to carry out renovations at the residence of a public official.

This is a high-risk situation because the supplier may feel pressure to provide discounted or free work, which could constitute a corrupt transaction. In some situations, the official may corruptly pay a supplier’s inflated invoices (submitted to the agency) in order to obtain a private benefit. Even if the official pays the full market price for private goods and services, their ability to maintain a professional, arm’s-length relationship with the supplier may be jeopardised.

⁸ This is not to say that a panel member can never be used to provide other categories of goods and services, but this should not be permitted under the terms of the panel.

Phase 3 – Panel maintenance

To minimise the potential for corruption and probity risks, supplier panels require a minimum level of ongoing maintenance or housekeeping.

Adding and removing panel members

Over the life of the panel, the legitimate need may arise to remove or add members.

A member may need to be removed if it:

- goes out of business
- merges with or is taken over by another company (which could also be a panel member)
- fails to maintain necessary insurance, licences and accreditation
- continually refuses work
- engages in poor performance and/or misconduct, or breaches relevant terms and conditions.⁹

New panel members may be required if:

- the agency has underestimated the amount of work that needs to be awarded to panel members
- a critical mass of existing members is removed, or declines work offered by the agency
- there is a structural or technological change in the market
- there is a relevant change in legislation or government/agency policy.

In addition, the agency may adopt a policy of permitting new suppliers to periodically apply to join a panel. This generally will be at the discretion of the agency but, for obvious reasons, this process should be no less rigorous than the initial panel creation process.

Panel housekeeping

As noted in various places above, the Commission recommends appointment of a panel administrator who can complete tasks such as:

- monitoring any off-panel expenditure, panel scope creep or order splitting
- enforcing the agreed rules for allocating work to panel members
- verifying that agreed prices and terms and conditions are being applied

- conducting a benefits realisation. That is, verifying that the panel arrangement is delivering value for money and the original business case remains valid
- maintaining any due diligence checks in areas such as licensing, insurance and accreditation
- organising training for panel members and buyers
- monitoring any conflicts of interest
- providing any necessary reports or dashboards to management, the audit and risk committee, external bodies or panel members.

Planning for the end of the panel

In the normal course of events, a supplier panel exists for a fixed period. While it may be tempting to simply rollover the existing panel membership, the agency should plan a new, competitive process.

As noted above, it is preferable to maintain contemporaneous records of how panel members are performing. These records can be used when creating a new panel, but the agency should be wary of the advantages and disadvantages of incumbency, including “inside” knowledge of confidential information. For more information, see the Commission’s publication, *Dealing with incumbent providers in procurement* (November 2021).

Particular care should be taken during the lead up to the panel’s expiry date, where efforts may be made by panel members to gain favour in the hope of being reappointed (for example, using a combination of gifts, entertainment and/or hospitality).

To minimise this risk, agencies should ensure that public officials are provided with ongoing refresher training, and that suppliers are made aware of the agency’s policies relating to conflicts of interest, and to gifts and entertainment.

Managing complaints

It is not unusual for members of a panel to complain about not receiving work and, at times, this can extend to complaints alleging improper favouritism towards a competitor.

Agencies should note that allegations made by a supplier could fall under the *Public Interest Disclosures Act 2022*. This is because the definition of a “public official” under the legislation can include suppliers.

Accordingly, panel members should be provided with information about the agency’s authorised public interest disclosure reporting channels, and the panel administrator and agency buyers should be trained in the agency’s procedures.

Further information

The Commission’s corruption prevention staff are available to advise public officials about managing corruption risks associated with supplier panels. Telephone 02 8281 5999 or 1800 463 909 or email advice@icac.nsw.gov.au.

⁹ Before removing a panel member, the agency should check the relevant contract or seek legal advice. For example, it may not be permissible (or desirable) to remove the member without providing it with an opportunity to address its performance issues or respond to allegations of misconduct.

Notes



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