

## Chapter 17

### Liquor Procurement Processes

#### 1.0 MAIN POINTS

The Saskatchewan Liquor and Gaming Authority (SLGA) is responsible for the distribution, control, and regulation of liquor in Saskatchewan. In 2010-11, SLGA earned net income of \$442 million, of which \$215 million was from liquor sales. SLGA must achieve a balance among the elements of its mandate of generating revenue, promoting social responsibility, and providing customers with selection of liquor products and value. Provincial governments traditionally use liquor profits to subsidize government programs.

This chapter covers the audit of the effectiveness of SLGA's liquor procurement processes for the year ended February 29, 2012. We concluded that SLGA's processes to procure liquor were effective with the following exceptions. SLGA needs to:

- › Document what it uses and how it uses the information it has to ensure the product selection meets its customer needs
- › Develop written procedures for staff to use to objectively select all liquor purchases
- › Keep minutes for its Listing Committee to support the Committee's decisions on product listings and delistings
- › Formally evaluate new liquor products and share written results of these evaluations with unsuccessful suppliers
- › Obtain formal assurance that liquor products sold in Saskatchewan are safe to drink and contain their stated alcohol content
- › Develop and use written procedures for monitoring performance regarding sales targets, quotas, and product quality

Currently, Saskatchewan citizens do not have easily accessible information on the amount of markup and taxes included in the retail price of alcohol products. SLGA should make its pricing and procurement policies public to explain the retail price breakdown (e.g., cost, taxes, markup, etc.). In 2010-11, SLGA found that their retail prices were within the range of those set by other provinces.

#### 2.0 INTRODUCTION

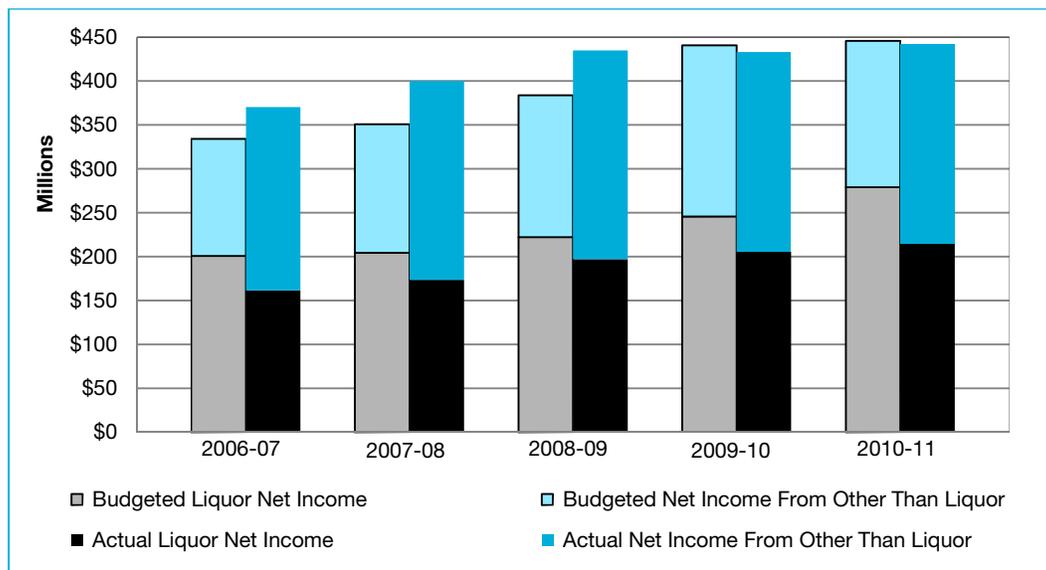
Under *The Alcohol and Gaming Regulation Act, 1997*, SLGA is responsible for the distribution, control, and regulation of liquor in Saskatchewan. SLGA's mission of "Serving Saskatchewan people with excellence while promoting growth through the socially responsible distribution, management, operation, and regulation of liquor and gaming products"<sup>1</sup> reflects this responsibility.

<sup>1</sup> *Plan for 2011-12 Saskatchewan Liquor and Gaming Authority*, p.1.



SLGA is also expected to generate revenue for the Government. Figure 1 provides a five-year comparison of actual to budgeted net income overall and for liquor. In 2010-11, SLGA earned net income of \$442 million of which \$215 million was from liquor sales.<sup>2</sup> SLGA contributes significantly to meeting the Government's revenue needs for the funding of other programs. SLGA must achieve a balance among the elements of its mandate of generating revenue, promoting social responsibility, and providing customers with selection and value.

**Figure 1 – Five-Year Comparison of SLGA Budgeted And Actual Net Income**



Source: 2006-07 to 2010-11 Saskatchewan Liquor and Gaming Authority annual reports

It is important that SLGA have a defined model for its procurement of liquor that supports the organization in achieving its mandate, that its buying practices are fair and transparent, and that equal opportunities are provided to suppliers<sup>3</sup> to have new products considered.

## 3.0 BACKGROUND

### 3.1 Retail Pricing Structure

Like other Canadian jurisdictions, SLGA has a policy that sets its liquor retail price based on a fixed markup of the wholesale price. Although markup rates vary by product category, SLGA uses the same rate for all products within one category. The mark-up rates ranges from 40% to 184% (e.g., most spirits such as whisky, gin, rum and vodka have a markup of 162%). Exhibit 6.1 sets out the fixed markup formula approved by the Government and used for a number of years. In addition, the formula includes other costs related to the sale of liquor (e.g., federal and provincial taxes, fees, levies and freight).

<sup>2</sup> 2010-11 Saskatchewan Liquor and Gaming Authority Annual Report, p. 38.

<sup>3</sup> Suppliers includes agents who represent suppliers as well direct suppliers of liquor products.

In April 2010, SLGA implemented a social reference price policy. This policy sets a minimum retail price with a direct relationship to alcohol content. The intention of the policy is to price products with high alcohol content and low wholesale cost at a level that reduces the risk of abuse.

Given the relationship of the wholesale price to its retail price, the main ways for SLGA to increase liquor revenue are to increase the sales volume by adjusting the product mix to increase consumer demand, enhance customer service, or to increase the mark-up percentage. The growth in Saskatchewan's population provides SLGA with an opportunity to increase consumer demand, while encouraging responsible liquor consumption.

The majority of the time, SLGA deals with suppliers who are the sole supplier of a particular brand of liquor product. SLGA's buying strategy is to ensure it is charged a reasonable price for the product. However, we note that SLGA's fixed pricing structure does not provide an incentive to negotiate lower wholesale costs as doing so would result in lower retail prices and, in turn, lower profits. Lower profits would be contrary to its mandate of generating profits for the General Revenue Fund and encouraging responsible consumption. SLGA has been successful in consistently generating increased profits for the General Revenue Fund year after year.

Periodically, SLGA compares its retail prices for popular products to other Canadian jurisdictions through information gathered by the Canadian Association of Liquor Jurisdictions (CALJ). In 2010-11, SLGA found that their retail prices were within the range of those set by other provinces.

As SLGA's Pricing Policy is not publicly available, the public does not know how liquor is priced. As a result, citizens do not know how much of the retail price of a liquor product is related to the cost of the product and how much of the retail price is comprised of taxes and direct mark-up. Provincial governments across Canada have traditionally used liquor profits (taxes and mark-ups) to subsidize government programs.

- 1. We recommend that Saskatchewan Liquor and Gaming Authority make its procurement and pricing policies public and provide a breakdown of liquor price (e.g., cost, taxes, markup, etc.).**

## 3.2 Liquor Purchasing Process

SLGA, like most Canadian jurisdictions, buys primarily brand name liquor products for resale. In the Canadian liquor industry, certain companies are the only source for a particular brand. Suppliers, who often represent multiple liquor products, sell their products to SLGA.

SLGA sells approximately 2,100 retail products including domestic and imported spirits, wine, coolers, and beer. In addition, customers can also special order cases of liquor products that SLGA does not regularly carry. During 2010-11, beer sales accounted for \$259 million or approximately half of SLGA's liquor sales. Of the remaining \$291 million in liquor sales from wines, coolers, and spirits, 64% of liquor sales come from the 500



top selling products (approximately 20% of SLGA's product mix). Of the wines, coolers, and spirits liquor sales, 40% of liquor products sold come from the top five suppliers who conduct business with SLGA.

When SLGA selects a new product to list, it negotiates the retail and wholesale price at the same time with the supplier. SLGA will input the supplier's retail price into the fixed mark-up model to determine the wholesale price it will pay for the liquor product. If the supplier does not agree with the resulting wholesale price then SLGA will negotiate the retail price until the supplier and SLGA are both satisfied. A similar negotiation will occur periodically when the supplier wants to change the retail price of listed product.

Suppliers are aware of the retail prices of competing products that SLGA stocks. Suppliers want their products competitively priced to entice customers to purchase them over their competitor's products.

When SLGA chooses to stock a product, it signs a purchase order agreement with the related supplier outlining each party's responsibilities. SLGA continues to buy the product from the supplier as long as the product meets the minimum sales quotas as set out in policy. If the product falls below the quota, SLGA will delist the product. SLGA then asks the supplier to either buy back the remaining inventory or pay a rebate in the form of a 25% reduction of the retail price on the remaining inventory.

## 4.0 AUDIT OBJECTIVE, CRITERIA, AND CONCLUSION

The objective of this audit was to assess the effectiveness of SLGA's liquor procurement processes for the year ended February 29, 2012.

To conduct this audit, we followed the *Standards for Assurance Engagements* published in the *CICA Handbook - Assurance*. To evaluate SLGA's processes, we used criteria based on the work of other auditors and current literature listed in the selected references. SLGA's management agreed with the criteria (see Figure 2).

**Figure 2—Audit Criteria**

To have effective processes to procure liquor, SLGA should:

- 1. Define the need and specifications for products**
  - 1.1 Define the need in sufficient detail for understanding (e.g., customer demand, gross profits for liquor products, cost and SLGA's plans)
  - 1.2 Define specifications to encourage open and effective competition
  - 1.3 Use specifications that support the law and government policy
- 2. Obtain supplier proposals fairly**
  - 2.1 Identify and document feasible sources of products needed
  - 2.2 Obtain authorization to initiate proposals
  - 2.3 Give equal and fair treatment to potential suppliers
  - 2.4 Make available to all potential suppliers the procurement process, including timing
- 3. Select suppliers for products**
  - 3.1 Evaluate all proposals for new products against defined specifications established by SLGA in assessing best value
  - 3.2 Evaluate change requests for continued best value and require all agreed upon changes in writing
  - 3.3 Obtain appropriate approval to buy products
  - 3.4 Document decision justification
  - 3.5 Inform bidders of purchase decision
  - 3.6 Obtain written contractual agreements

**4. Monitor performance of products and suppliers**

- 4.1 Obtain timely feedback and information on sales performance, purchase price and selling price
- 4.2 Monitor feedback against sales targets, contract terms and conditions, and any requirements under law
- 4.3 Set and use guidelines on the nature and timing of action to be taken for an underperforming supplier or product
- 4.4 Conduct regular reviews and comparisons to other jurisdictions
- 4.5 Document and report problems to suppliers and apply for any remedy under the contract

**We concluded that, for the year ended February 29, 2012, SLGA's processes to procure liquor were effective except in the following areas. SLGA needs to:**

- › **Document what it uses and how it uses the information it has to ensure the product selection meets its customer needs**
- › **Develop written procedures for staff to use to objectively select all liquor purchases**
- › **Keep minutes for its Listing Committee to support the Committee's decisions on product listings and delistings**
- › **Formally evaluate new liquor products and share written results of these evaluations with unsuccessful suppliers**
- › **Obtain formal assurance that liquor products sold in Saskatchewan are safe to drink and contain their stated alcohol content**
- › **Develop and use written procedures for monitoring performance regarding sales targets, quotas, and product quality**

A documented proactive customer-focused procurement strategy will serve as a clear communication tool evidencing that the SLGA is aware of customers emerging tastes in Canada generally, and in Saskatchewan specifically. A documented procurement strategy will provide a source of reference for the listing and delisting of products and will provide both suppliers and customers with information on the direction SLGA is taking on product mix in the future. It is prudent for the SLGA to maintain documentation supporting their listing and delisting decisions so that their decisions can be defended if called into question. In addition, sales targets, quotas, and product quality can be assessed in comparison to a customer-focused procurement strategy and can provide timely information on product procurement decisions.

Obtaining formal assurance that liquor products sold in Saskatchewan are safe to drink and contain their stated alcohol content will reduce the risk that products may be either unsafe or misrepresented as to content.

## **5.0 KEY FINDINGS AND RECOMMENDATIONS**

In this section, we set out expectations (in italics), key findings and related recommendations.



## 5.1 Needs Better Documentation of Procurement Process Linked to a Proactive Customer-Focused Approach

*We expected SLGA to have procurement processes to define the need and specifications for products. We expected SLGA would:*

- › *Define the need in sufficient detail for understanding (e.g., customer demand, gross profits for liquor products, costs and SLGA's plans)*
- › *Define specifications to encourage open and effective competition*
- › *Use specifications that support the law and government policy*

By law, SLGA can purchase, import, possess, and sell liquor. SLGA's strategic plan provides broad guidance for liquor operations but does not provide specific objectives related to liquor procurement or liquor sales.

SLGA's strategic plan and its Retail Operations Division's work plan did not set any specific objectives related to product mix (the number and type of liquor products SLGA sells) or assess customer demand. SLGA does not have a formal process to gather and analyze customer demand data or to assess it against the current product mix. Staff told us they informally use CALJ sales data from other jurisdictions or recent customer special order requests as a means of determining customer demand for product categories (e.g., Canadian wines) or specific products. However, we did not find evidence that they used this information to assess the overall product mix.

We also looked at SLGA's financial plan for guidance on the types of liquor products it expects to sell. Annually, SLGA establishes a financial plan for all of its operations including liquor sales. The financial plan sets revenue and expense budgets for liquor. SLGA does not set out how much (i.e., the number of litres by category) liquor it expects to sell, its anticipated customer demand, or any other non-financial objectives in its financial plan. The financial plan does not provide staff with any further estimate on the types of liquor products SLGA expects to sell to meet net income.

SLGA's Listing Policy states that new products chosen should be "consistent with contemporary market demand" but does not further describe what this means. SLGA has not set any specific objectives in terms of the number and type of liquor products (product mix) that would further define this statement. The Listing Policy also lists new product selection criteria. SLGA's new product selection criteria are: product quality, suppliers' marketing and promotional plans, anticipated consumer acceptance, SLGA's product portfolio (complementing existing product offerings), unique characteristics, container and packaging, suppliers' orders and shipping logistics, deferred payment proposals, and product shelf life. However, SLGA does not provide any guidance to staff as to how to apply the criteria in an objective way.

As we noted earlier, SLGA implemented a policy setting the minimum retail price it will charge for liquor. SLGA does not have any further policies to guide staff on the number, types, sizes, and price ranges of products it should carry. Nor does SLGA set sales targets (versus minimum sales quotas) for individual products or product categories that it would expect them to achieve.

Management told us they undertake activities to monitor customer demand. These activities include conducting periodic customer satisfaction surveys, analyzing sales data, receiving supplier driven research, and operating the special order desk. Although we agree that these initiatives are useful to understand customer demand, SLGA should have an overall documented strategy to align its liquor procurement with customer demand.

**2. We recommend that Saskatchewan Liquor and Gaming Authority document what it uses and how it uses the information it has to ensure the product selection meets its customers' needs.**

SLGA sets out other general product specifications for suppliers in its Listing Policy, e.g., product standards and labelling must conform to *Canadian Food and Drug Act and Regulations* (Canada) and *Consumer Packaging and Labelling Act* (Canada).

## 5.2 Product Procurement Reactive to Supplier Proposals

*We expected SLGA to have procurement processes to obtain supplier proposals fairly. We expected SLGA would:*

- › *Identify and document feasible sources of products needed*
- › *Obtain authorization to initiate proposals*
- › *Give equal and fair treatment to potential suppliers*
- › *Make available to all potential suppliers the procurement process, including timing*

SLGA has not defined its product needs based on solicited customer demand information (e.g., surveys). SLGA chooses not to initiate proposals for liquor products for its retail stores as they receive new product applications throughout the year. By not defining product needs using a customer-focused approach, SLGA may not provide Saskatchewan citizens with liquor products that best meet their demand.

SLGA receives suppliers' applications for new products throughout the year from any supplier who wants to sell their product in Saskatchewan. Monthly, SLGA reviews new products according to the pre-determined schedule for listing applications, e.g., review new Canadian wine every February.

SLGA sets out its new product selection criteria, pricing policy and listing application schedule in several documents. These documents are available to any supplier upon request but are not otherwise available publicly. The Listing Policy outlines the process that suppliers should follow to submit a new product for consideration and SLGA's selection criteria.



All suppliers are required to complete a standard application and submit a product sample to SLGA. The application requires information such as the product type and size, container type, shelf life, and the supplier's marketing plan for the first year.

### 5.3 Product Selection Procedures and Approval Documentation Needed

*We expected SLGA to have procurement processes to select suppliers for products. We expected SLGA would:*

- › *Evaluate all proposals for new products against defined specifications established by SLGA in assessing best value*
- › *Evaluate change requests for continued best value and require all agreed upon changes in writing*
- › *Obtain appropriate approval to buy products*
- › *Document decision justification*
- › *Inform bidders of purchase decision*
- › *Obtain written contractual agreements*

SLGA's Listing Policy provides staff and suppliers with new product selection criteria for regular listings. As noted previously, SLGA has selection criteria but it has not provided staff with guidance on how to apply them in an objective way. SLGA has not set a definition for "best value" as it has not set the minimum acceptable rating for each criterion. For example, the criterion related to product quality suggests chemical or organoleptic (taste, sight, and smell) examinations but does not set out the measurement tools and the minimum acceptable ratings.

Ad hoc purchases of products take place throughout the year. SLGA often makes ad hoc purchases for seasonal products or products that suppliers offer in limited supply. SLGA does not have written policies and procedures to help staff determine under what circumstances it is appropriate to purchase products on an ad hoc basis. It also does not set out the evaluation criteria or documentation requirements for making ad hoc purchase assessments. Staff told us they use some of the new product selection criteria to assess ad hoc products.

**3. We recommend that Saskatchewan Liquor and Gaming Authority develop written procedures for staff to use to objectively select all liquor purchases.**

SLGA's Listing Policy sets up a Listing Committee to objectively assess and approve new product listings, approve existing product listing changes (e.g., seasonal packaging and changes in retail prices), assess and approve ad hoc products listings, and to hear supplier appeals regarding listing and delisting decisions. The Listing Committee

consists of seven staff members from the Retail Operations Division. The Vice-President of Retail Operations Division chairs the Listing Committee.

SLGA staff pre-screens new products that they are considering for regular stock items for the Listing Committee. SLGA has no specific policy or procedures on pre-screening new products. Staff told us they use some of the new product selection criteria to pre-screen new products. Staff do not document their analysis of the product against the criteria. SLGA notifies, in writing, suppliers of products rejected but does not tell them why they were not selected.

The Listing Committee does not keep minutes of its meetings or its key decisions. A Listing Committee member documents the Committee's decisions on new products after each meeting. The Listing Committee does not formally verify that this documentation is an accurate reflection of its decisions. We found no evidence of the Listing Committee approving ad hoc product listings, products rejected in pre-screening, or existing product listing changes. Minutes are useful as support should listing decisions be challenged. They are also useful to ensure that decisions made are documented, understood by all members of the Committee, and are acted upon as agreed.

**4. We recommend that the Listing Committee of Saskatchewan Liquor and Gaming Authority keep minutes supporting its decisions on product listings and delistings.**

A SLGA staff member (who is also a member of the Listing Committee) makes a written and verbal presentation to the Listing Committee describing each new product. The written presentations include the supplier's product description, retail price, the supplier's anticipated sales of the product in Saskatchewan for the first year, the number of similar products SLGA currently stocks from that supplier and their sales, the related supplier's marketing plan for the first year, and a product sample. As the Listing Committee does not keep minutes, we could not determine if it assessed each new product against all of the new product selection criteria.

The Listing Committee reviews the information presented and conducts an organoleptic (taste, sight, and smell) evaluation, a label and container assessment, and holds a general discussion of the product selection criteria. We found no evidence that the Listing Committee formally scored submissions or that it formally evaluated marketing and sales information against the product selection criteria. In our sample of new product submissions, we found no documented rationale for most new products selected. However, when asked, SLGA staff were generally able to recall the rationale behind their selection decisions. Lack of formal evaluations and documented results make it difficult for staff and the Listing Committee to explain to a supplier why SLGA did not select their product.

Feedback provided to suppliers in rejection letters was generic across all unsuccessful applicants. The standard reasoning given was "the number of current category listings and the market situation in Saskatchewan".



**5. We recommend that Saskatchewan Liquor and Gaming Authority formally evaluate new liquor products and share written results of these evaluations with unsuccessful suppliers.**

SLGA does not conduct a chemical analysis on products to make certain all of the products it carries are safe to drink and contain their stated alcohol content. SLGA told us it relies on analysis done by other Canadian liquor boards as many of SLGA's products are also carried in other jurisdictions. Some jurisdictions perform regular testing on the products they carry. Other jurisdictions have written agreements with other Canadian liquor boards that perform product testing. These agreements provide assurance as to the safety and alcohol content of products tested. SLGA does not test its products and does not have an agreement with any other liquor board to supply product safety information. Management told us that they are reviewing options around ensuring the chemical analysis requirements are being achieved.

**6. We recommend that Saskatchewan Liquor and Gaming Authority obtain formal assurance that liquor products sold in Saskatchewan are safe to drink and contain their stated alcohol content.**

When SLGA selects a product as a new regular stock item, it signs a purchase order agreement with the related supplier. Under its Listing Policy, SLGA continues to buy the product from the supplier as long as the product meets the minimum sales quotas as set out in the policy. The purchase order agreement and Listing Policy adequately outline the responsibilities of the supplier and SLGA.

## **5.4 Product Performance Monitoring and Documentation Needed**

*We expected SLGA to have procurement processes to monitor performance of products and suppliers. We expected SLGA would:*

- › *Obtain timely feedback and information on sales performance, purchase price and selling price*
- › *Monitor feedback against sales targets, contract terms and conditions, and any requirements under law*
- › *Set and use guidelines on the nature and timing of action to be taken for an underperforming supplier or product*
- › *Conduct regular reviews and comparisons to other jurisdictions*
- › *Document and report problems to suppliers and apply any remedy under the contract*

As noted earlier, SLGA has not defined its product needs in terms of product mix or provided other guidance on the types of liquor products it should buy. SLGA sets

minimum sales quotas for products but does not set sales targets for products or product categories. As a result, SLGA cannot monitor if its product mix is meeting customer demand or if liquor sales and wholesale purchases are meeting targets. We found limited evidence that SLGA monitors individual product or product category liquor sales and wholesale purchases.

SLGA's Listing Policy sets the minimum sales quotas that individual products must meet and requires an additional threshold for new products in their first year (expected to sell 40% of the stated annual minimum sales requirements within the first six months). When a product underperforms, SLGA's Listing Policy requires the Listing Committee to review the facts and decide if the product should be delisted. The Listing Committee is also responsible to hear supplier appeals regarding delisting decisions. As no minutes are kept from Listing Committee meetings, we found no evidence of the Listing Committee making these decisions.

SLGA is able to obtain information about how well different products are selling across Canada from CALJ. SLGA told us that staff may look at trends in other jurisdictions when making listing decisions but do not keep documentation.

SLGA's Listing Policy allows the Listing Committee to exempt a product from the minimum sales quota if it is deemed to be a unique product. Staff told us that the Listing Committee has exempted a few products under this rule, e.g., Kirsch. We found no documented evidence of the Listing Committee making these exemption decisions. We recommended earlier that the Listing Committee keep minutes supporting its decisions.

SLGA does not have any documented monitoring procedures for staff to follow. Staff told us each month they assess all products against quotas based on a rolling 13-period average. Staff do not document their assessments. SLGA gives suppliers access to real-time sales information for their products but does not provide alerts if a product is not meeting quota. Also, SLGA does not follow-up on suppliers' marketing plans submitted with new product applications. As a result, SLGA does not know if suppliers have carried out the marketing plans that were agreed to when the product was listed.

We reviewed a sample of delisted products and found no documented evidence why the product was delisted. Staff provide suppliers with a written notice that their product is being delisted due to poor sales.

When a product is delisted, SLGA's policy is to request the supplier either buy back the remaining inventory or provide a 25% reduction of the retail price in the form of a rebate on the remaining inventory. Once SLGA receives the rebates, it marks down the retail price of products at its stores.

Individual store managers or the warehouse manager deal directly with the suppliers on any individual product problems that may arise, e.g., wine products containing broken corks. SLGA does not have a system to track problems with products.

**7. We recommend that Saskatchewan Liquor and Gaming Authority develop and use written procedures for monitoring product performance regarding sales targets, quotas, and product quality.**



## 6.0 EXHIBIT

### 6.1 Components of Retail Prices for Liquor

Component	Explanation
Supplier quote	Price at which the supplier sells his or her product to the SLGA
x Exchange rate (if applicable)	Converts prices to Canadian dollars
+ Federal import duty	Applied only to imported goods; similar in structure to excise tax
+ Federal excise tax	A variable tax based on volume and alcohol content
+ Freight	Rate based on existing SLGA freight contracts
= Landed cost	
+ SLGA markup	Variable rate applied according to the type of product (to a maximum for certain categories)
+ High alcohol beer surcharge (if applicable)	Applied to high alcohol beer products at a fixed rate of \$40 per litre of pure alcohol above 6.5%
+ Cost of service charge	Applied to import products and SLGA distributed beer at a fixed rate per units/case
+ Environment charge	Applied to all non-refillable products at a fixed rate per litre
= Base price (round up to nearest cent)	
+ Goods & Service Tax (GST)	Fixed rate of 5% applied to the basic price
+ Liquor Consumption tax (LCT)	Fixed rate of 10% applied to the basic price
+ Container deposit	Amount varies depending on volume of container (up to \$0.40)
= Retail price	

Source: Saskatchewan Liquor and Gaming Authority Pricing Structure & Policy – April 2011.

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