



1999-640 Final Report

Settlements Made by PWGSC

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Executive Summary

Authority for the Project

The project was approved by the Department of Public Works and Government Services Canada's (PWGSC) Audit and Review Committee as part of the 1999/2000 Audit and Review Plan.

Objectives

To review the adequacy of the management control framework in support of settlements made by PWGSC. The intent of the Preliminary Survey Phase of the audit was to:

- determine, to the extent possible, what settlements are being made by PWGSC;
- assess the extent to which formal processes for such settlements are in place; and
- identify any possible areas of risk to the Department which may require further study.

Scope

In 1995/1996, a comprehensive study entitled the "Evaluation of Contract Dispute Resolution Mechanisms in PWGSC" was undertaken. Given the department's interest in Alternative Dispute Resolution (ADR) techniques, the objective was to examine its contract dispute resolution mechanisms to identify possible issues. The scope included the Contract Claims Resolution Board (CCRB), which is comprised of the Contract Dispute Advisory Board (CDAB) - primarily used for Real Property Services cases, and the Contracts Settlement Board (CSB) - used for Supply Operations Services cases. It also included a review of all mechanisms dealing with contract disputes concerning financial claims which were not resolved by contracting staff in Supply Operations Services (SOS) Branch or by project management staff in Real Property Services (RPS) Branch.

The purpose of the current review was to explore settlements made by PWGSC which fall outside the CSB and CDAB processes. Such settlements may arise from: claims against the Crown, court orders, negotiations out-of-court, Canadian International Trade Tribunal (CITT) complaints, pre-contractual disputes, and contractual disputes. The review included the Department's major business lines - Supply Operations Service, Real Property Services, Government Operational Service, Government Telecommunications and Informatics Services, as well as the Human Resources Branch. The Regions and National Capital Area were included; Special Operating Agencies were not, although settlement data obtained from the Public Accounts reflect the department in its entirety. Costs associated with Terminations for Convenience, and claims made by the Crown, were not included.

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Approach and Methodology

The Preliminary Survey was based on: a review of previous studies, policies, authorities and other documentation related to settlements; interviews with 28 key departmental executives and staff, as identified by the Audit and Review Branch, departmental senior management and through the conduct of the assignment; and analysis of the limited financial data available and other related information.

Background

The 1995/1996 review identified a variety of issues related to the management control of contractual disputes, and the need for action to address key concerns such as organizational alignment, policy development, authorities and management information. The Action Plan addressing the study's recommendations entailed a co-ordinated intra-departmental effort, and implementation is underway.

A departmental Dispute Resolution Policy has been drafted, under the leadership of the Assistant Deputy Minister, Supply Operations Service, and is currently undergoing consideration by senior management. In addition, development of a Litigation Information System (LIS), to provide PWGSC branches and regions with early warnings of potential disputes and litigation cases, is scheduled to resume following renewed funding availability.

PWGSC's continuing interest in the extent and type of its settlement activity has more recently been prompted by changes, announced in August 1999, to Treasury Board's policy regarding the source of funding for court judgements against the Crown. Under the previous policy, such judgements had been payable from the Consolidated Revenue Fund rather than from departmental appropriations. Over the next five years, departments will assume increasing responsibility for funding court judgements, and by year five will be *fully* responsible.

Key Findings

There is no common definition or understanding across PWGSC of what constitutes a dispute or a settlement. To the extent that this contributes to: an inability to fully identify, track and monitor dispute and settlement activity; possible inconsistent treatment of disputes and settlements across the department; or possible misapprehensions as to which policies and procedures apply in particular circumstances, the department, and particularly Supply Operations Service, may wish to further examine the situation.

The problems of definition undermine the ability to construct a statistical profile of settlements made by PWGSC. Further, there is no information available to indicate the scope of

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non-monetary settlements, or settlements which may have been achieved through contract amendments and change orders.

The limited data available through the Public Accounts of Canada is restricted to financial settlements. The Public Accounts for PWGSC for the period FY1994/95 through FY1998/99, indicate that 673 formal, monetary settlements were paid by the department over the five year period, for a total cost of under \$43M. Compared to an *annual* business volume of \$8B for the department's acquisitions business line alone, this figure is very low. Payments of Claims Against the Crown accounted for 83% of the financial settlements by number and 97% by value. Ex Gratia Payments constituted 16% by number and 1% by value; and Court Awards, of which there were only 10, accounted for 2% of the total cost.

Figures from the Public Accounts indicate that, for PWGSC, the cost of formal monetary settlements, including Court Awards, has traditionally been very low. Should this be altered by the provisions of the new Treasury Board policy, either directly or through financial pressures created on client departments, PWGSC may have to explore funding options beyond those it has relied on in the past. Further, under the provisions of accrual accounting now being introduced across the federal government, there are implications for how and when settlements, and anticipated settlements, are reported in the Public Accounts, as well as for the adequacy of the funding which may be available.

Despite the small numbers and low relative cost of formal monetary settlements paid by PWGSC, the Preliminary Survey identified concerns regarding the policies, procedures, accountabilities and levels of authority that should apply in dispute and settlement cases. More specific guidance would appear to be beneficial regarding the point at which particular types of expertise and authority should be sought.

Decisions remain pending in regard to a Dispute Resolution Policy for the department. Work is also underway to develop a Litigation Information System and a Risk Management Framework for the department, and to advance the implementation of accrual accounting across the federal government. It is possible that the concerns and observations raised in the current study, as well as those noted in the 1995/1996 evaluation of contract dispute resolution mechanisms in PWGSC, could be addressed in the context of these initiatives.

Recommendations

It is recommended that:

- 1. Considering the limited number and cost of formal monetary settlements made by PWGSC, the processes currently in place, the issues at stake, and the work already undertaken or underway by the Department to address them, the Audit and Review Branch conduct no further audit work at this time;*

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2. *The Assistant Deputy Minister, Supply Operations Service, as the designated lead for the development of a departmental Dispute Resolution Policy, undertake to examine, in consultation with other departmental stakeholders, how the observations raised in this review, and in the 1995/1996 evaluation of contract dispute resolution mechanisms within PWGSC, might be addressed in the context of the policy's development. In particular, issues related to the definition of settlements, management information, and approval authorities deserve attention; and*

3. *The Assistant Deputy Minister, Government Operational Service, as designated lead for the development of the department's Risk Management Framework, and in his capacity as Senior Financial Officer (SFO) for PWGSC and Assistant Deputy Minister responsible for the Receiver General function and thereby responsible for preparation of the Public Accounts, examine, in consultation with other stakeholders, the implications of accounting and budgeting issues raised by the current study.*

1 Introduction

1.1 Authority for the Project

The project was approved by the Department of Public Works and Government Services Canada's (PWGSC) Audit and Review Committee as part of the 1999/2000 Audit and Review Plan.

1.2 Objectives

The objective of the audit was to review the adequacy of the management control framework in support of settlements made by PWGSC. The intent of the Preliminary Survey Phase of the audit was to:

- determine, to the extent possible, what settlements are being made by PWGSC;
- assess the extent to which formal processes for such settlements are in place; and
- identify any possible areas of risk to the Department which may require further study.

1.3 Scope

In 1995/1996, a comprehensive study entitled the "Evaluation of Contract Dispute Resolution Mechanisms in PWGSC" was undertaken. Given the department's interest in Alternative Dispute Resolution (ADR) techniques, the objective was to examine its contract dispute resolution mechanisms to identify possible issues. The scope included the Contract Claims Resolution Board (CCRB), which is comprised of the Contract Dispute Advisory Board (CDAB) - primarily used for Real Property Services cases, and the Contracts Settlement Board (CSB) - used for Supply Operations Services cases. It also included a review of all mechanisms dealing with contract disputes concerning financial claims which were not resolved by contracting staff in Supply Operations Services (SOS) Branch or by project management staff in Real Property Services (RPS) Branch.

The purpose of the current review was to explore settlements made by PWGSC which fall outside the CSB and CDAB processes. Such settlements may arise from: claims against the Crown, court orders, negotiations out-of-court, Canadian International Trade Tribunal (CITT) complaints, pre-contractual disputes, and contractual disputes. The review included the Department's major business lines - Supply Operations Service, Real Property Services, Government Operational Service, Government Telecommunications and Informatics Services, as well as the Human Resources Branch. The Regions and National Capital Area were included; Special Operating Agencies were not, although settlement data obtained from the Public Accounts reflect the department in its entirety. Costs associated with Terminations for Convenience, and claims made by the Crown, were not included.

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1.4 Background

The 1995/1996 study identified a variety of issues related to the management control of contractual disputes, and the need for action to address key concerns such as organizational alignment, policy development, authorities and management information. The Action Plan addressing the study's recommendations entailed a co-ordinated intra-departmental effort, and implementation is underway.

A departmental Dispute Resolution Policy has been drafted, under the leadership of the Assistant Deputy Minister, Supply Operations Service, and is currently undergoing consideration by senior management. In addition, development of a Litigation Information System (LIS), to provide PWGSC branches and regions with early warnings of potential disputes and litigation cases, is scheduled to resume following renewed funding availability.

PWGSC's continuing interest in the extent and type of its settlement activity has more recently been prompted by changes, announced in August 1999, to Treasury Board's policy regarding the source of funding for court judgements against the Crown. Previously, such judgements had been payable from the Consolidated Revenue Fund rather than from departmental appropriations. However, it was thought that this arrangement encouraged departments to pursue litigation rather than to solve disputes and claims through less costly and less time consuming alternatives. Under the new policy, departments will, over the next five years, assume increasing responsibility for funding court judgements, and by year five will be fully responsible¹.

¹ Over the next three years, departments will become responsible for funding court judgements up to \$1 million or one percent of their operating budgets, whichever is less. Central sources will cover costs over and above that amount. In year four, central sources will fund one half of any judgements awarded in excess of \$1 million. Thereafter, departments will be responsible for fully funding both judgements and settlements. There will, however, be some possibility of relief on a case by case basis depending on the impact such costs may have on a department's ability to maintain the integrity of its programming.

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2 Results of the Preliminary Survey Phase

2.1 Work Performed

The Preliminary Survey included the following:

- review of previous studies, policies, authorities and other documentation related to settlements;
- interviews with 28 selected departmental Headquarters and Regional executives and staff, as identified by the Audit and Review Branch, departmental senior management and through the conduct of the assignment; and

analysis of the limited financial data available, and other information related to settlements made by PWGSC.

2.2 Profile of the Entity

2.2.1 Description

The *Treasury Board Policy on Claims and Ex Gratia Payments* states that “a normal part of risk management is dealing with claims that arise between a department and other entities after a harmful incident has occurred”. It describes a claim as the amount due, or alleged to be due, or the action taken regarding damages sustained by the Crown or a claimant. It notes that a ‘settlement’ is the adjustment process whereby an agreement is reached through negotiation, or other means, between the respective parties, whereas a ‘payment’ is the actual disbursement of monies². Further, the *Policy* distinguishes between claims in contract, which must be dealt with according to the contract’s terms and the applicable law, and claims in tort (i.e. non-contractual claims), for which there is no form of written, oral or implied contractual agreement between the Crown and claimants.

The *Public Accounts of Canada* is the report of the Government of Canada prepared each fiscal year by the Receiver General, as required by section 64 of the *Financial Administration Act*³. Included in the Public Accounts is a section entitled “Payments of Claims Against the Crown”. It itemizes payments by the government which are the result of: Claims Against the Crown, Ex Gratia Payments, and Court Awards. The data is presented department by department, according to which department was the actual ‘payee’.

² Definitions for “claims”, “ex gratia payments”, “judgements”, and “settlements” as defined in the *Policy* are included in Appendix A.

³ The report covers the fiscal year of the Government, which ends on March 31, and is prepared from data contained in the accounts of Canada and from more detailed records maintained in departments and agencies. Each department and agency is responsible for reconciling its accounts to the control accounts of the Receiver General, and for maintaining detailed records of the transactions in their accounts.

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2.3 Preliminary Findings

2.3.1 Issue of Definition

The 1995/1996 "Evaluation of Contract Dispute Resolution Mechanisms in PWGSC"⁴ identified the lack of a common definition as to what constituted a 'dispute' as being a key policy issue. It noted that disputes are defined differently in the Supply Manual and the Architectural and Engineering Service's Policy and Procedures Manual. Interviewees defined disputes as everything ranging from 'a difference of opinion' to 'an issue that cannot be resolved at a given level in the organization' to 'a disagreement over time/ cost/ performance of a contract, which requires the intervention of a third party'. The study concluded that "the lack of a common definition and a common understanding becomes a concern if management wishes to discuss, track, and monitor dispute resolution within the Department."

Given that the resolution of disputes by any of the above definitions would require discussion, negotiation and other possible remedies to 'settle' the matter, and that this could occur at any point in the life cycle of a transaction or a relationship, the same problem of definition became apparent for the current study's examination of 'settlements'. There was, throughout, an evident difference in whether the individuals interviewed, and the documents reviewed, spoke of settlements in a formal sense (i.e. 'Settlements' arising from formal dispute resolution mechanisms and which would appear as such in the Public Accounts), or in a more general sense reflective of day-to-day negotiations and adjustments related to the normal contract administration and project management responsibilities of departmental officials in their common service agent capacity.

2.3.2 Data on Settlements Made by PWGSC

The issue of definition created fundamental difficulties for the audit team in attempting to develop a statistical profile of settlements made by PWGSC. The annual Public Accounts of Canada⁵, by way of itemizing Payments of Claims Against the Crown, Ex Gratia Payments and Court Awards, do provide information regarding formal, monetary settlements paid by the department. However, they do not reflect settlements which may have been achieved through non-monetary means⁶, or settlements which may have taken place through contract amendments and change orders. The extent of this latter activity is unknown⁷ but such action would be in

⁴ By the Audit and Review Branch, PWGSC, January 1996.

⁵ Section 10, Volume II, Part II.

⁶ Such as reducing the scope of work to be accomplished under fixed-price contracts.

⁷ Although there are indications that it could be extensive. For example, a draft document entitled "Construction Contract Claims Prevention and Resolution" by RPS's Integrated Support Centre, states that over 90% of disputes are settled through written clarification or through the issuance of change orders, with the remainder of cases potentially resulting in a formal claim. It should be noted, however, that RPS's Project Management Practice Standard defines a 'dispute' as "any difference of opinion between a contractor or consultant and the department regarding the carrying out of work under their contracts".

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keeping with both Treasury Board and departmental policy, which favour negotiation and management within the contract wherever possible and justifiable.

Table 1
Monetary Settlements Made by PWGSC by Number of Cases and Dollar Value
FY1994/95 through FY1998/99

Settlement Type	1994/95 through 1998/99			
	Cases (n)	%	Amount: (\$)	%
Claims Against the Crown	558	83	41,497,122.	97
Court Awards	10	1	824,420.	2
Ex-Gratia Payments	105	16	446,478.	1
Total	673	100	42,768,020.	100

Source: Public Accounts of Canada, Volume II, Part II, Section 10 - for PWGSC

Recognizing the limitations of the Public Accounts data for the purposes of the current study, the above profile of settlements paid by PWGSC nevertheless emerges (Table 1). Over the five year period FY1994/95 through FY1998/99, 673 formal, monetary settlements were paid for by the department, for a total cost of under \$43M. Compared to an *annual* business volume of \$8B for the department's acquisitions business line alone, this figure is very low. Payments of Claims Against the Crown accounted for 83% of the settlements by number, and 97% by value. Ex Gratia Payments accounted for 16% by number and 1% by value. Court Awards, of which there were only 10 paid by PWGSC over the period, accounted for 2% of the total cost.

2.3.3 Formal Processes in Place

Policies and procedures governing the management of disputes and settlements exist at both the government-wide and departmental level and form part of the management control framework. Some focus specifically on settlements, while others apply more broadly.

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2.3.3.1 Treasury Board of Canada

The *Treasury Board Contracting Policy*, Section 12.8, indicates that the expeditious handling of disputes is of paramount importance in order to avoid performance delays and delayed payments to contractors. It also points out that since the bidding process can be challenged at the Canadian International Trade Tribunal (CITT), and since decisions of the contracting authority made after contract award are challengeable in court, it is important that legal advisers be consulted, and that actions taken and decisions made be fully defensible.

The *Policy* states that efforts should first be made to resolve disputes through negotiation. If negotiation is unsuccessful, mediation or binding arbitration may be used, if acceptable to both sides. Except in the case of binding arbitration, the parties also retain a right to litigation. The policy indicates the circumstances under which an arbitral award can simply be made by amending the contract. It also indicates that the Minister of Justice has committed to working with departments to introduce Dispute Resolution (DR) clauses into Government contracts, that senior Justice officials must be involved in certain types of dispute resolution, and stipulates the circumstances under which extra payments may be made.

The *Treasury Board Policy on Claims and Ex Gratia Payments* addresses non-contractual claims and ex gratia payments which are not covered by other authorities, governing instruments or policies⁸. It also emphasizes the need for adequate and timely settlement and payment, and gives deputy heads the authority to resolve most non-contractual claims and to make ex gratia payments provided that legal advice is sought for claims greater than \$25,000. The policy stipulates that only the deputy head may approve ex gratia payments over \$2,000.⁹

The *Treasury Board Policy on the Indemnification of and Legal Assistance for Crown Servants* is also relevant to the subject of claims against the Crown. The policy reflects the Crown's recognition that it should indemnify its servants and protect them from certain financial costs arising from the performance of their duties. The policy has specified procedures for application.

Under accrual accounting, the Treasury Board will assess *contingent liabilities* annually, based on the likelihood of the event occurring and the ability to estimate a settlement amount, and will book a blanket provision for the Government of Canada as a whole.

2.3.3.2 Department of Justice Canada

Under the *Department of Justice Act*, the Attorney General for Canada is responsible for the regulation and conduct of all litigation on behalf of or against the Crown. Legal Counsel, assigned by the Department of Justice to each federal department, provides advice and guidance,

⁸ For example, it does not apply to the relocation of household property and travel claims, or to the traditional remedies for settling bidding or contract performance disputes. These are treated in *Treasury Board's Relocation Directive*, *Travel Directive*, and *Contracting Policy*.

⁹ The policy is silent on who may make payments below that amount.

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including assessments of the Crown's liability as it may relate to disputes, settlements and litigation. The Department of Justice's "*Directive Concerning the Use of Dispute Resolution Clauses in Contracts*" was issued to advise client departments and to help in the preparation of contracts. Every effort must now be made to include dispute resolution clauses, where appropriate. When a formal settlement is made, a *Settlement and Release Form* is prepared for the Contractor's signature to indicate closure and to prevent the submission of further claims.

Legal Services is reported to be frequently involved in dispute resolution cases, although their role and level of involvement is said to be understandably varied, and information on the proportion of cases in which they participate is not available. There appear to be no clear guidelines on the conditions under which Legal Services should be involved when a dispute arises.

2.3.3.3 Public Works and Government Services Canada

PWGSC's *Litigation Committee* is a subcommittee of the department's Business Board¹⁰. The Committee's mandate includes the provision of input to the Department of Justice in regard to dispute resolution and/or litigation strategies for cases involving PWGSC.

The *Contract Claims Resolution Board (CCRB)* acts as an appeal/review agency within PWGSC for all procurement-related disputes and claims arising from commercial, construction and consulting contracts. The CCRB administers the *Contracts Settlement Board (CSB)* and the *Contract Dispute Advisory Board (CDAB)*. PWGSC's Delegation of Authorities¹¹ provides the Chair of the Contracts Settlement Board (CSB) and the Director General, Audit and Review Branch, with unique authority for settlements. As a matter of practice, however, the CSB does not act unilaterally.

Within PWGSC, and throughout the federal government, disputes and settlements related to *Human Resources* issues benefit from an extensive management framework which includes: Public Service legislation; Treasury Board policies and procedures; Workers' Compensation legislation; the *Canada Labour Code*; the *Canadian Human Rights Act, Commission and Tribunal*; common law; and the provisions of specific collective agreements.

*Real Property Services' Project Management Practice Standard (PMPS)*¹² provides detailed guidance to RPS Project Managers regarding (i) their roles and responsibilities, and (ii) the proper procedures, for managing disputes and claims in Consultants' Agreements and construction contracts. Negotiations must take place quickly to settle as many issues as possible and to identify those which cannot be resolved at the Project Manager level. Project Managers are instructed on what to do if negotiations are not successful. This includes referral to the

¹⁰The Litigation Committee is chaired by the Assistant Deputy Minister, Supply Operations Service. Members include the Assistant Deputy Minister, Government Operational Service; the Assistant Deputy Minister, Real Property Services; the Assistant Deputy Minister, Human Resources; the Director General, Audit and Review Branch; and the Senior General Counsel.

¹¹Column 60 of the Administrative Authorities section.

¹²Chapter 4, Section 4.5

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Contract Disputes Advisory Board, Alternate Disputes Resolution (arbitration, mediation, etc.), or to the courts.

The Architectural and Engineering Service, within RPS's National Capital Area, has established the *Integrated Support Centre (ISC)* to address disputes that can be settled by way of contract change orders. The Centre's Claims Prevention and Management Unit facilitates claims management and issues a quarterly report on the status of claims greater than \$5000.¹³ which are monitored by it. The Centre's Contract Management unit handles change orders. The ISC is currently drafting a best practices document entitled "Construction Contract Claims Prevention and Resolution", which provides an extensive overview of claims, and by extension settlements, within A&ES/RPS. In conjunction with SOSB, RPS has also established a mechanism called the *Pre-Approved Amount for Anticipated Amendments (PAAA)* to provide specific contract amendment approval authority in relation to a given contract. The PAAA is part of a larger management framework for change orders/contract amendments, which includes the PWGSC Supply Manual.

Within *Supply Operations Services*, Chapter 6 of the *Supply Manual* instructs procurement officers to seek advice from Legal Services with respect to "contracts to be placed with a supplier with whom disagreements are likely to be encountered ... (or) disputes arise after the contract has been awarded". Chapter 11 states that contractors may submit a formal statement and documentation of claim to the Contract Claims Resolution Board when any contract dispute cannot be resolved through negotiation. Other than this, little direction is provided to procurement personnel in SOSB and the regions as to the appropriate method or process for "settling" contract disputes. There is no organizational unit within SOSB specifically responsible for monitoring or tracking disputes, until parties outside the Branch become involved. As for RPS, the resolution of disputes often results in the need for a contract amendment or change order, although there is no way of determining how frequently this has occurred.

The 1995/1996 study of contract dispute resolution in PWGSC found that within SOSB the use of dispute resolution clauses was not standardized and took place on an ad hoc basis. At the time that study was conducted, such clauses were not included in the majority of standard goods and services contracts. This contrasted with the *mediation guidelines* and *standard Mediation Agreement* set out in RPS's Alternative Dispute Resolution (ADR) Pilot Project and with the *standard A&ES Agreement*, which contained a "*Resolution of Disputes*" clause permitting the mediation of disputes with consultants. The current study did not assess the extent to which SOSB's use of dispute resolution clauses may have changed in more recent years.

The *Government Operational Service (GOS)* monitors contingent liabilities related to litigation and on a quarterly basis reports to the Receiver General. Under the Financial Information Strategy (FIS) and full accrual accounting, it will become the department's responsibility to assess and account for likely settlements as a liability. With regard to settlements, GOS is of the view: that it is not possible to track settlements resulting from contract amendments; that

¹³Claims monitored by the Claims Prevention and Management Unit are those which come to the unit's attention by way of requests for assistance from the project officer or manager responsible, or through other means. The Unit's quarterly report should therefore not be taken to reflect all RPS claims resolution activity.

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disputes resolved through normal business practices (such as amending contracts) should not be included in the definition of settlements; and that settlements achieved through non-monetary means would appropriately have to be reported on outside of the financial system.

GOS management expressed particular concern with regard to the funding of settlements, especially high dollar cases. They see settlements as being negotiated on a case-by-case, often urgent, basis and without adequate consideration of the funds available. Their preference would be that a process be established which would require ADM-level pre-approval of maximum negotiable settlement amounts.

The *Government Telecommunications and Informatics Services (GTIS)* has little involvement with settlements. GTIS does its own contracting for transactions valued at less than \$25K, or up to \$72.6K (NAFTA limit) when using its database for informatics service providers. Above this, its contracting is managed by the Supply Operations Service. Nevertheless, GTIS's contracting officers recently received contract management training, including guidance related to dispute resolution, and a document entitled "*Introduction to Contract Management for GTIS*", which will outline prescribed contracting procedures and indicate where help can be obtained if required, is currently being drafted.

2.3.4 Potential Risk Areas

2.3.4.1 Definitions

As in the 1995/1996 study, which identified the lack of a commonly understood and applied definition of what constituted a 'dispute', the current study identified the lack of a commonly understood and applied definition of what constitutes a 'settlement'. To the extent that this contributes to: an inability to fully identify, track and monitor dispute resolution and settlement activity; possible inconsistent treatment of disputes and settlements across the department; or possible misapprehensions as to which policies and procedures apply in particular circumstances, the department, and particularly Supply Operations Service, may wish to further examine the situation.

2.3.4.2 Guidance

At a departmental level, without a common understanding of what constitutes a dispute or a settlement, it is difficult to discuss settlement activity, processes in place for handling settlements, and issues such as the appropriate approval authority for settlements. Questions such as the following inevitably arise: What is a settlement? What is a dispute? Are contracts/amendments which include a "release" clause considered settlements? Under what circumstances should "release clauses" be included? Is it a settlement if the amount paid was agreed, without dispute, after the work was completed? Is it a settlement if the amount paid was agreed, following a dispute, after the work was completed? Are amendments for settlements a form of ratification and should the "ratification" approval levels be used? Do all "settlements"

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require approval, as a minimum, at the Director level, as is the case with ratifications? At the time of contract approval, should dollar amounts be set aside for settlements of claims/disputes? Should the "Pre-Approved Amounts for Anticipated Amendments" (PAAA) process be amended to include settlements of claims/disputes?

As illustrated by the above questions, it is notably difficult to establish clear parameters for dealing with all types of settlements and claims faced by PWGSC. However, this Preliminary Survey suggests that some elements of the framework surrounding disputes, claims and settlements would benefit from greater formalization. For example, no specific and objective criteria were found that would establish when Contract or Project Officers would inform or seek the guidance of Management, Legal Services, the Contract Claims Resolution Board, or A&ES's Integrated Support Centre. The proposed department-wide Dispute Resolution Policy, which could help bring greater clarity and consistency to the manner in which disputes, claims and settlements are managed across PWGSC, remains in draft form. In the absence of a departmental position, the principles which underlie dispute resolution and settlement are left to the interpretation of procurement officers and project managers as they attempt to balance sometimes competing objectives such as: upholding the terms and conditions of contracts, protecting the financial interests of the Crown, avoiding litigation, saving taxpayers' money, and preserving business relationships.

2.3.4.3 Funding

The intent of the new Treasury Board policy regarding sources of funding for court judgements is to make it increasingly difficult for departments to obtain central funding for such costs. Figures from the Public Accounts indicate that, for PWGSC, the cost of formal monetary settlements, including Court Awards, has traditionally been very low. Should this be altered by the provisions of the new policy, either directly or through financial pressures created on client departments, PWGSC may have to explore funding options beyond those it has used in the past. This might include, as suggested by GOS, ADM pre-approval of maximum negotiable amounts. The outstanding concern is that efforts are required to forestall possible disconnects between negotiations and the source of funds, as this can create significant funding pressures for the department in a context in which resources are already limited.

The federal government's move to accrual accounting will have implications for when expenditures are reported in the Public Accounts. Under accrual accounting, liabilities are recorded at the time they are recognized as legal obligations. This may be different from the time when the actual transfer of monies occurs. Further, generally accepted accounting principles call for the disclosure of contingent liabilities, if they are judged to be of sufficient materiality. As noted in Section 2.2.1. above, Treasury Board Policy distinguishes between 'settlements' and 'payments'¹⁴. This distinction is shared by the Public Accounts, which currently reports monetary settlements on a cash basis (i.e. when they are actually paid¹⁵), and not simply when they are recognized as obligations. The government's move to accrual accounting may therefore

¹⁴A 'settlement' is the adjustment process whereby an agreement is reached through negotiation, or other means, between the respective parties, whereas a 'payment' is the actual disbursement of monies.

¹⁵i.e. Payments made of claims against the Crown, as per Public Accounts of Canada, Volume II, Part II, Section 10.

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require a realignment of how settlements are funded. There are also implications for the identification of contingent liabilities, including how they are recognized and valued, how accurate the assessments underlying them prove to be, and the level of risk to the department's budget in any one year if the disbursement of monies must be made from a budget which did not anticipate them as part of the current year's expenditures.

2.3.4.4 Management Information

Consideration by the department of two information sources (the LIS and A&ES's quarterly report) are indications of a requirement by stakeholders for more comprehensive information pertaining to the nature and disposition of disputes, claims and settlements than has previously been available within the Department. Further, without the resolution of outstanding issues concerning the operational definition of 'disputes' and 'settlements', the department will remain unable to fully identify and monitor the extent and type of dispute resolution and settlement activity, and its implications. There may also be implications, due to the introduction of accrual accounting, for the time at which settlements are reported in the Public Accounts and how related expenditures are budgeted for.

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3 Conclusions and Recommendations

The materiality of formal, monetary settlements made by PWGSC, as reported in the Public Accounts, was very low over the review period. This does not, however, take into consideration non-monetary settlements or settlement actions which may have occurred through contract amendments and change orders. The negotiation and resolution of disputes within the context of existing contracts could not be quantified. However, such resolution is encouraged by Treasury Board and departmental policy. Nevertheless, to the extent that a lack of clear definition of what constitutes a settlement may contribute to inconsistent treatment of such cases across the department, or to misapprehensions as to which policies and procedures apply in particular circumstances, the department, and particularly Supply Operations Service, may wish to further examine the situation.

Decisions remain pending in regard to a Dispute Resolution Policy for the department. Work is also underway to develop a Litigation Information System and a Risk Management Framework for the department, and to advance the implementation of accrual accounting across the federal government. It is possible that the concerns and observations raised in the current study, as well as those noted in the 1995/1996 evaluation of contract dispute resolution mechanisms in PWGSC, could be addressed in the context of these initiatives.

It is therefore recommended that:

1. *Considering the limited number and cost of formal monetary settlements made by PWGSC, the processes currently in place, the issues at stake, and the work already undertaken or underway by the Department to address them, the Audit and Review Branch conduct no further audit work at this time;*
2. *The Assistant Deputy Minister, Supply Operations Service, as the designated lead for the development of a departmental Dispute Resolution Policy, undertake to examine, in consultation with other departmental stakeholders, how the observations raised in this review, and in the 1995/1996 evaluation of contract dispute resolution mechanisms within PWGSC, might be addressed in the context of the policy's development. In particular, issues related to the definition of settlements, management information, and approval authorities deserve attention; and*
3. *The Assistant Deputy Minister, Government Operational Service, as designated lead for the development of the department's Risk Management Framework, and in his capacity as Senior Financial Officer (SFO) for PWGSC and Assistant Deputy Minister responsible for the Receiver General function and thereby responsible for preparation of the Public Accounts, examine, in consultation with other stakeholders, the implications of accounting and budgeting issues raised by the current study.*

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4 Appendix A

Settlement:

(1) An agreement reached through negotiation between respective parties to resolve a claim. (*TB Policy on Claims and Ex gratia Payments*).

(2) An Out-of-Court procedure whereby one of the parties to an impending court action agrees to pay certain sums of money or do certain things in return for a waiver by the other party of all rights arising from the grievance. (*Smyth & Soberman, The Law and Business Administration in Canada, 2nd Ed., p. 62*).

Claim:

(1) Request for compensation to cover losses, expenditures or damages sustained by the Crown or a claimant, including requests or suggestions that the Crown make an ex gratia payment. Claims can be settled in or out of court. (*TB Policy on Claims and Ex gratia Payments*).

Ex-Gratia Payment:

(1) A benevolent payment made by the Crown under the authority of the Governor in Council. The payment is made to anyone in the public interest for loss or expenditure incurred for which there is no legal liability on the part of the Crown. An ex gratia payment is an exceptional vehicle used only when there is no statutory, regulatory or policy vehicle to make the payment. (*TB Policy on Claims and Ex gratia Payments*).

(2) A discretionary payment, made as an act of benevolence in the public interest, free of any legal obligation, whether or not any value or service has been received. (*Public Accounts of Canada, 1997-98*).

(3) A payment made pursuant to the Ex gratia Payments Order, 1991, P.C. 1991-8/1695 dated September 5, 1991. (Treasury Board Manual) A payment made to anyone in the public interest for loss or expenditure incurred for which there is no legal liability on the part of the Crown (23/06/94) (*PWGSC Supply Manual, Amend. 98-3, p. 12-25*).

Judgement:

(1) A decision rendered by the courts to resolve a claim between respective parties. (*TB Policy on Claims and Ex gratia Payments*).

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5 Action Plan

Recommendation

It is recommended that:

1. *considering the limited number and cost of formal monetary settlements made by PWGSC, the processes currently in place, the issues at stake, and the work already undertaken or underway by the Department to address them, the Audit and Review Branch conduct no further audit work at this time.*

Action Plan

No action required.

Recommendation

It is recommended that the Assistant Deputy Minister, Supply Operations Service:

2. *as the designated lead for the development of a departmental Dispute Resolution Policy, undertake to examine, in consultation with other departmental stakeholders, how the observations raised in this review, and in the 1995/1996 evaluation of contract dispute resolution mechanisms within PWGSC, might be addressed in the context of the policy's development. In particular, issues related to the definition of settlements, management information, and approval authorities deserve attention.*

Action Plan

The Departmental Dispute Resolution Policy is under review. The review will address the issues related to the definition of settlements, management information and approval authorities.

Management of the Dispute Resolution process within PWGSC will be reviewed with the Deputy Minister in the Fall of 2000. A detailed plan will be developed subsequently.

Recommendation

It is recommended that:

3. *the Assistant Deputy Minister, Government Operational Service, as designated lead for the development of the department's Risk Management Framework, and in his capacity as Senior Financial Officer (SFO) for PWGSC and Assistant Deputy Minister responsible for the Receiver General function and thereby responsible for preparation of the Public Accounts, examine, in consultation with other stakeholders, the implications of accounting and budgeting issues raised by the current study.*

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Action Plan

a) Budgeting and funding issues

The department cannot budget for these costs without endangering program delivery since it is not appropriated for judgements and settlements costs.

(Exclusion under subsection 69(1) of the
Access to Information Act.)

GOS will continue to help the departments negotiate funding of high value settlements which could impair the delivery of the department's programs.

In addition, GOS will work closely with all PWGSC stakeholders in establishing a departmental process to secure funding before the final settlement is agreed to.

Implementation Timetable: The process should be identified by March 31, 2001.

b) Accounting Issues

GOS will continue to report contingent liabilities quarterly and through the annual publication of the Public Accounts. Furthermore, any additional reporting requirements which could be needed under accrual accounting will be implemented as identified.

Implementation Timetable: For fiscal year 2000-01.