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# ***Audit of Contracting Practices***

**Final Report**

**May 28, 2003**

Assurance Services  
Corporate Review Branch  
Department of Canadian Heritage

**Canada**



## TABLE OF CONTENTS

1.0	Background .....	1
2.0	Audit Objectives .....	2
3.0	Audit Scope .....	2
4.0	Approaches and Methodology .....	3
5.0	Conclusions .....	4
6.0	Observations and Recommendations .....	6
6.1	Management Control Framework .....	6
6.1.1	PCH Contracting Strategy .....	7
6.1.2	Contract Data Sheet .....	7
6.1.3	Training Activities .....	8
6.1.4	Contracting Activity Reports .....	9
6.1.5	Departmental Contract Policy and Monitoring Processes .....	10
6.1.6	File Maintenance .....	12
6.2	Compliance with Government Contracting Regulations and Policy .....	13
6.2.1	Appearance of Contract Splitting .....	13
6.2.2	Amendment Justification .....	13
6.2.3	Late or After-the-fact Contracting .....	14
6.2.4	Sole Source Contracts .....	14
6.2.5	Advance Contract Award Notification Mechanism (ACAN) .....	16



## 1.0 Background

As a result of a department-wide risk assessment, the 2002/03 audit plan of the Assurance Services Directorate, Corporate Review Branch (CRB) of the Department of Canadian Heritage (PCH) identified a requirement to conduct an audit of the contracting practices in the Department. The audit was conducted in August and September 2002.

The Departmental contracting activity above \$5,000 is centralized in the Materiel Management and Contracting Services Directorate (MMCSD) of the Finance Branch. MMCSD has functional responsibility for contracting in the Department and oversees the application of contracting regulations and policies.

The following represents the contracting activity within the Department for the period under review:

### Departmental Contracting Activity April 1, 2001-July 31, 2002

Contracting Activity	Number of Contracts	Value of Contracts	Percentage of Activity (#)	Percentage of Activity (\$)
Purchase Orders	10,997	20,471,000	74.5	21.7
PCH Contracts Below \$5,000	1,526	3,639,000	10.5	3.8
PCH Contracts \$5,000 to \$85,000	1,240	40,200,000	8.5	42.6
Call-ups (Standing Offers)	873	10,658,444	5.4	11.3
PWGSC	166	19,409,720	1.1	20.6
<b>TOTAL</b>	<b>14,582</b>	<b>94,378,164</b>	<b>100</b>	<b>100</b>



## **2.0 Audit Objectives**

The purpose of the audit was to provide the Department and the Financial Management Branch with assurance on the soundness of their contracting processes, to determine where the department is most exposed to risk, and to identify the appropriate mitigating strategies when appropriate. More specifically, the audit was to determine whether the following objectives have been met:

- the management control framework for the Departmental procurement function ensures compliance with Government Contract Regulations and that the Departmental processes and practices are effective, efficient, provide value for money and ensure financial integrity.
- the procurement activities undertaken by managers with contracting delegated authorities throughout the Department are in accordance with appropriate legislation, regulations, policies, directives and guidelines.

## **3.0 Audit Scope**

The audit covered the period from April 1, 2001 to July 31, 2002 and reviewed departmental contracting processes to procure goods and services for Headquarters. This included contracts awarded by the Department of Canadian Heritage (PCH) and through the Department of Public Works and Government Services Canada (PWGSC).

The scope included an examination of:

- contracting responsibilities in the Sectors;
- management and operational activities of the Materiel Management and Contracting Services Directorate (MMCSD) of the Finance Branch;
- contracts issued on a sole source basis and through a competitive process including consulting and professional services contracts; and

The following elements were excluded from the scope of the audit based on risk and our



knowledge of current practices. Some of the excluded elements are already provided for in our multi-year audit plan:

- regional contracts processed through local PWGSC offices;
- temporary help services for which the Materiel Management and Contracting Services Directorate (MMCSD) staff has little involvement;
- purchases below \$5,000 made through Local Purchase Orders (LPO) and Acquisition Cards (AC);
- contracts issued on behalf of Parks Canada for which PCH provides services.

#### **4.0 Approaches and Methodology**

The audit was conducted in August and September 2002 and examined all aspects of the contracting process including requirements definition, proposal evaluation, contractor selection and contract award.

Contracts from the period from April 1, 2001 to July 31, 2002 were selected for review from the commitment data information provided by MMCDS from the Department's financial system. A detailed review of 77 contract files from a total population of 2279 was conducted. This represents a value of approximately \$ 9.1M or 13% (\$70,2M) of the estimated total expenditure for contracting during that period. Sample selection was based the following:

- Known risk areas such as recurring use of suppliers frequent amendments and sole source contracts;
- Key program areas;
- Volume and/or dollar value of transactions; and
- Transaction types, i.e., non-competitive (sole source), open bidding (processed through the government electronic bidding system), traditional competitive (invited bidders) and Advance Contract Award Notification (ACAN).



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The audit coverage achieved is outlined below:



**File Review - Departmental Contracting Activity April 1, 2001-July 31, 2002**

<b>Contracting Activity</b>	<b>Number of Files Audited</b>	<b>Value of Files Audited</b>	<b>Percentage of Files Audited</b>	<b>Percentage of Value Audited</b>
<b>PCH Contracts \$5,000 to \$85,000</b>	59	5,253,184	4.8	13.1
<b>Call-ups (Standing Offers)</b>	7	1,034,664	0.8	9.7
<b>PWGSC</b>	11	2,841,462	6.6	14.6
<b>TOTAL</b>	<b>77</b>	<b>9,129,310</b>	<b>3.4</b>	<b>12.9</b>

The audit methodology also included interviews with MMCDS personnel in Headquarters and examinations of program processes, procedures, and practices in support of a comprehensive management control framework, including a review of departmental contracting policies, procedures, guides, practices.

As the sampling methodology used focused primarily on known high risk areas, the conclusions reached cannot be extended to the entire PCH contract population but are limited to the contracts reviewed.

## **5.0 Conclusions**

The Financial Management Branch has recently developed a Contracting Strategy to address areas of ongoing risk. The strategy addresses significant initiatives underway to improve PCH processes and practices related to contract management by developing a due diligence framework that will build awareness of proper practices and provide managers with better feedback on their contracting strategies and obligations. The proposed contracting strategy outlines activities that, if fully implemented, could address the audit recommendations.



The management control framework in place for the departmental procurement function requires improvement to adequately ensure compliance with Government Contract Regulations and to ensure that departmental processes and practices are effective, efficient, provide value for money and ensure financial integrity.

The management control framework currently consists of a combination of mechanisms and activities that serve to ensure completeness and standardized contracting information. It should promulgate up-to-date contracting information and practical training, reasonable reporting information, ongoing contracting analysis and monitoring function and development of policies and procedures. However, the audit revealed that:

- MMCS D did not fully monitor and appropriately assess PCH contracting activity risk;
- strategic guidance on contracting alternatives was not integral to the departmental training material;
- timely or reliable contract management information was not made available to managers; and
- there was no established risk-based diligence mechanism.

Procurement activities undertaken by managers with contracting delegated authorities were not always in accordance with Government Contracting Regulations or with the principles of the government contracting policy. The audit revealed that there was an appearance of contract splitting, that some contract amendments were not adequately justified and that there was evidence of some after-the-fact contracting.

PCH makes extensive use of sole-source contracts for work with a value of less than \$25,000. Although the audit could find no significant issues arising from the use of the sole-source contracts, MMCS D needs to monitor this type contracting activity to ensure ongoing value-for-money given the presence of frequent amendments and the use of recurring service contractors.

The audit also revealed that while the use of the Advance Contract Award Mechanism (ACAN) in the department was technically in accordance with the TB Regulations, there were instances where the use of the ACAN by managers with delegated authority was not consistent with the contracting principles of an open and transparent process.





## **6.0 Observations and Recommendations**

### **6.1 Management Control Framework**

The Department is responsible for implementing a management control framework which includes monitoring processes that will ensure compliance with Treasury Board Secretariat (TBS), the Financial Administration Act (FAA) and departmental policies, procedures and processes. MMCSO carries out the functional role for contracting within the Department and is responsible for overseeing the application of contracting regulations and policies.

In order to be effective MMCSO requires a management control framework which establishes, monitors and communicates contracting processes and procedures, identifies and reinforces values and ethics to be followed by managers with delegated authority, ensures reliable information is available for decision-making and reporting, establishes and communicates roles and responsibilities for all parties involved in contracting processes, and that provides managers with appropriate training and management tools.

The current management control framework for the departmental procurement function can be improved in the following areas to ensure increased compliance with Government Contract Regulations or that departmental processes and practices are effective, efficient, provide value for money and ensure financial integrity:

#### **6.1.1 PCH Contracting Strategy**

MMCSO has developed a draft contracting strategy aimed at improving contract management in PCH. An important element of the strategy is to develop a risk-based diligence framework that will build awareness of proper contracting practices and provide managers with better feedback on their contracting strategies and obligations. The strategy also includes other initiatives to improve contracting practices in PCH. The strategy generally proposes activities that, if fully implemented, could effectively address the audit recommendations.

#### **Recommendations to the Director General, Financial Management Branch:**

- 6.1.1.1      Submit the contracting strategy developed by MMCSO to PCH executive management for approval.**



- 6.1.1.2      Ensure that MMCS D develop a practical and phased implementation plan for the contracting strategy that places early emphasis on clarifying roles and responsibilities for delegated managers, training for delegated managers and increased diligence activities by MMCS D.**

### **Management Responses**

**6.1.1.1 Agreed. The Contracting Strategy was presented for the consideration and support of the Departmental Issues Management Committee (DIMC) on April 7, 2003. It's recommended next steps were accepted and received approval by the Deputy Minister.**

**6.1.1.2 Agreed. The Contracting Strategy does provide for a phased in implementation which focuses on building a due diligence regime aimed at improving awareness among contracting administrators and decision makers, enhanced monitoring and tools, the provision of timely and accurate reports and finally, a more balanced Delegation Instrument for the Department. The implementation plan for the Contracting Strategy will be part of the Financial Management Branch and MMCS D Business Plans and Accountability Accords over the next three years.**

### **6.1.2 Contract Data Sheet**

The contract data sheet is a document which contains contracting information intended to ensure completeness and standardized contracting information across the Department. It must be completed prior to processing their contracting service request through MMCS D. The contract data sheet is included in each contracting file. The audit revealed that the contract data sheet is a good tool for monitoring contracting activities, however, its use could be expanded to improve the analysis of compliance with TB contracting policy principles of access, fairness, transparency and best value which could result in increased capacity to monitor contract activities. Additional elements of the contract data sheet could include, as examples, the last use of vendor and the nature of



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## **Recommendations to the Director, MMCSD:**

- 6.1.2.1**      **Ensure that the contract data sheet is modified to improve monitoring of the contracting process at the approval stage.**

## **Management Responses**

- 6.1.2.1 Agreed. The Contract Data sheet has been modified in accordance with recommendations of this audit.**

## **6.1.3 Training Activities**

As part of its functional role, MMCSD offers training and related documentation to all managers with contracting authority and individuals involved in contract administration. Although MMCSD offers contracting training, it is ultimately the responsibility of managers with delegated authority to familiarize themselves with the requirements of the Government Contracting Regulations, the responsibilities incumbent with their delegated authority, and to ensure individuals administering contracts on their behalf are properly trained.

The audit revealed that the contracting training currently provided focuses mainly on administrative and procedural requirements. Consequently, the core of procurement and contracting training is generally provided to administrative staff instead of the managers with delegated authority or officers with contract management responsibilities. As a result, the training provided does not address contracting issues such as the appropriate use of varied contracting mechanisms, the development of scope of work or adequate criteria for selection, or ensuring value-for-money. Furthermore, procurement and contracting training is not mandatory for managers with delegated authority.

## **Recommendations to the Director, MMCSD:**

- 6.1.3.1**      **Make training on contracting mandatory for all delegated managers.**



- 6.1.3.2**      **Develop a training program for contracting directed to delegated managers and another directed to administrative staff.**

### **Management Responses**

- 6.1.3.1**      **Agreed. Mandatory training has been suggested to and supported by the DIMC. It has now received approval by the DM as part of the DIMC recommendations on implementation of the Contracting Strategy.**
- 6.1.3.2**      **Agreed. Although various contracting and procurement courses are provided to delegated managers and administrators, by the end of this fiscal year, they will be reviewed and updated to more clearly focus on the distinct roles of these two target communities.**

### **6.1.4 Contracting Activity Reports**

Fundamental to the success of MMCS D's provision of contracting services and ensuring adequate diligence, is accurate, relevant and timely information. Information for decision making and reporting is not routinely produced or reviewed by senior management in order to control the ongoing performance of contracting processes or practices.

MMCS D has recently begun producing and sharing contracting activity reports with delegated managers. The production of contract activity reports is challenging as it requires staff to manually extract information from multiple data bases to produce the required information. This initiative is a valuable early step in ensuring departmental managers have the information needed on the ongoing performance of contracting processes, but continued effort and investment is required.

### **Recommendations to the Director, MMCS D:**

- 6.1.4.1**      **Continue production, distribution, analysis and review of contract activity reports with delegated managers.**



- 6.1.4.2** As part of the contracting strategy, propose to PCH senior management a performance measurement strategy for departmental contracting activities.

#### **Management Responses**

- 6.1.4.1** Agreed. A number of new monthly, quarterly and ad-hoc reports were presented to and accepted by the departmental executive. They are now being made available for senior managers at the sector and branch levels. They will be distributed and refined on an ongoing basis.
- 6.1.4.2** Agreed. Accountability of managers continues to play an important role at PCH. The two aspects requiring consideration are, compliance with proper contracting practices and effective management of public funds through contracting. The first aspect will be assessed via the regular reporting and analysis function. Senior managers will get feedback on a quarterly basis. This will be in place in the first quarter of this fiscal year. The latter however, requires an assessment of effective contract management in ensuring value for money and achievement of expected results. Driven by the Department's business planning initiative, MMCSO will participate actively in the development of Executive Information Reporting and performance measurement approaches. Although there is support for the principle of having contracting practices affecting Senior Manager's performance evaluations, this initiative will take time. Working with Senior Managers and Human Resource specialists, we will study how to best develop and implement such a performance measurement approach.

#### **6.1.5 Departmental Contract Policy and Monitoring Processes**

The Government Contracting Regulations and related policies provide the



broader management framework for the department's contracting activities. The audit revealed that only limited internal documentation is available to provide additional guidance to PCH managers. The documentation available focuses on contracting processing information and MMCSO service standards, but does not provide important information on roles and responsibilities of parties involved in contracting processes, key processes such as the completion of the contract data sheet, and the due diligence processes in place within the department. An effective internal contracting policy should provide this important information to managers, help ensure that PCH contracting processes are in-line with Government Contracting Regulations, as well as serve as a useful communication and training tool.

The audit also found that PCH did not have an established monitoring system that was being used effectively by MMCSO to provide timely feedback on compliance and the performance of contracting processes to PCH managers. The monitoring system would be used by MMCSO to provide feedback to delegated managers on their performance in meeting their responsibilities as well as feedback to senior management on the compliance of departmental contracting processes with Government Contracting Regulations.

#### **Recommendation to the Director General, Financial Management Branch:**

- 6.1.5.1      Develop a departmental contracting policy which clearly identifies contracting roles and responsibilities for both MMCSO and delegated managers; explains key contract management processes; and establishes an effective monitoring process for contracts.**

#### **Management Response**

- 6.1.5.1      Agreed. The Contracting Strategy's awareness and monitoring approach will include the clear identification of roles and responsibilities of all stakeholders involved in the contracting process. Decision makers and administrators will understand the risks associated with their obligations and respective authority levels including the means for ensuring compliant practices. On an ongoing basis, policies and guidelines will be drafted, tested and promulgated establishing a more**



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**effective Management Accountability framework. A review of contracting policies will also be undertaken in light of the TBS central policy review.**





### 6.1.6 File Maintenance

Proper file maintenance is an essential part of the accountability process. It ensures that contract files are maintained in a way that provides a complete audit trail. The audit revealed that the files held in Materiel Management and at the Activity Centre generally failed to provide adequate documentation to ensure that the Government Contract Regulations criteria had been satisfied. These gaps in documentation included inadequate demonstration of bid solicitation when it was indicated that the open bidding process had been used and incomplete documentation on which to determine if the deliverables called for in the Statement of Work had been produced. This is of particular concern as the contact name in the file is not always available to complete the gaps in the history of the particular initiative. More than one manager interviewed felt that the essential documentation regarding requests for proposal and evaluations was on file in Materiel Management, when this was not the case.

#### Recommendation to the Director, MMCS D

- 6.1.6.1 Develop specific procedures for comprehensive contract file maintenance which include a clear definition of roles and responsibilities for file maintenance.**

#### Management Response

- 6.1.6.1 Agreed. File maintenance has long been a point of discussion between Materiel Management & Contracting Services Directorate, Accounting Operations Directorate and program staff. The Contracting Strategy includes the implementation of the “Rule of three”:**
- Files are complete**
  - Challenge role is exercised and respected**
  - Value for money & expected results are achieved**

**A checklist has been developed that outlines necessary steps involved in processing a contract file as well as what documents and information it should contain. It has been agreed that the most complete files should reside with the program. Nonetheless, MMCS D is now**



**implementing an automated process for filing of contract information within our Integrated Finance and Materiel System (IFMS) that will significantly improve file maintenance, completeness and access. Already being utilized within MMCS D, this will be available for program administrators this fiscal year.**

## **6.2 Compliance with Government Contracting Regulations and Policy**

The audit has identified instances where procurement activities undertaken by managers with contracting delegated authorities were not in accordance with Government Contracting Regulations.

The PCH contracting and procurement process needs to be conducted in a manner that stands the test of public scrutiny in matters of prudence, facilitation of access, encouragement of competition and should reflect fairness and best value in the spending of public funds.

Specifically, the audit revealed the following:

### **6.2.1 Appearance of Contract Splitting**

In 5 of 66 files reviewed, contracts of a similar nature with similar deliverables were issued. In these instances, there was an appearance of contract splitting which circumvents the delegation of authorities and the GCRs. There was no evidence on file of analysis having been conducted by MMCS D to determine whether contract splitting had occurred.

### **6.2.2 Amendment Justification**

10 of 66 files demonstrated insufficient evidence of amendment justification. The justifications presented to contract authorities were ambiguous, underestimated the nature and scope of the work required or did not specify the contractor's deliverables.

Contract amendments should be made in the best interest of the government. Work definitions should be carefully developed in order to reduce probable



amendments. Contracts should be properly administered to avoid unanticipated amendments, including adequate initial funding and adequate pre-planning.

### **6.2.3 Late or After-the-fact Contracting**

4 of 66 files demonstrated that PCH entered into oral contracts, with the formal written contracts only being signed when work was completed or near completion.

The terms and conditions of any contract issued must be in writing and the contract signed by the authorized departmental official and the representatives of the contractor prior to any commencement of work.

### **6.2.4 Sole Source Contracts**

Sole source contracts are used extensively as part of the PCH contracting activities. At the time of the audit, they represented 42.6 % of the value of PCH contracts. While the sole source contracts were initially issued in accordance with GCRs, some concerns were raised given the number of amendments to the sole source contracts, 155 out of 1240. Of these 155 amendments, 43 were amended to a final dollar value greater than \$25,000. A further ten were amended to a final dollar value greater than \$50,000.

Of 1240 sole sourced contracts, 642 were awarded to fewer than 116 suppliers who had multiple contracts (four or more amendments and/or distinct contracts), indicating a high degree of incumbency.

Within PCH there were numerous cases where suppliers were repeatedly used for work of a similar nature with almost unbroken service. This kind of incumbency makes it difficult for other suppliers to bid successfully on those relatively few occasions that bids are called for.

Frequent amendments and the use of recurring service contractors are often indicators that the department may be at risk with respect to the application of the sole source contracting rules. The audit revealed that MMCSO did not have in place a mechanism to mitigate this kind of risk.

### **Recommendation to the Director, MMCSO**



**6.2.4.1 Establish a risk-based monitoring process for all contracting activities to ensure compliance with GCRs and TBS policy, specifically that:**

- **contracts of a similar nature with similar deliverables are identified in order to mitigate against the appearance of contract splitting,**
- **contracting amendments are properly justified,**
- **contracts are signed by the authorized departmental official and the representatives of the contractor prior to service delivery, and**
- **amendments to sole source contracts which exceed the \$25,000 limit and the repeated use of the same vendors for multiple contracts are justified.**

### **Management Response**

**6.2.4.1 Agreed. Enhanced monitoring practices are being implemented in accordance with the Contracting Strategy. Due diligence efforts will ensure that inherent risks will be targeted, assessed and minimized to the greatest extent possible.**

- **The recently revised Contract Data Sheet will identify occurrences of contracts with similar suppliers for similar work.**
- **Contracting specialists will be advised to be more vigilant in their review and acceptance of amendment justifications.**
- **Mandatory training for all staff will emphasize the importance of not allowing work to be performed prior to the signature of proper contract documents.**
- **The DM has agreed that Assistant Deputy Ministers will approve:**
  - ✓ **All sole source contracts (including amendments) with a cumulative value exceeding \$25K,**
  - ✓ **Temporary Help Call-Ups longer than 6 months,**
  - ✓ **The use of “Ministerial Exclusions”, and**



- ✓ **Requirements deemed a high risk by the Financial Management Branch.**

### **6.2.5 Advance Contract Award Notification Mechanism (ACAN)**

PWGSC's Advance Contract Award Notification (ACAN) mechanism is used by a department to notify the public of its intention to let a contract with a pre-selected contractor. The mechanism allows potential bidders to challenge the Department's intention to tender through the ACAN mechanism. While the use of the ACAN mechanism was technically in accordance with the Treasury Board *Contracting Policy*, certain practices observed were not fully in accordance with an open and transparent contracting process.

Five ACAN files worth approximately \$2.5 million were reviewed. The review indicated some instances of inadequate substantiation, documentation and justification by managers with delegated contracting authority. In one instance, an ACAN was issued. Several challenges were received, one of which was accepted. The standard practice to proceed with a formal Request for Proposal process was not pursued and the originally-proposed supplier was enlisted to make changes to the scope of work. The ACAN was then re-issued. In the opinion of the team, the extent of scope change did not warrant the issuance of a new ACAN.

In a second instance, an ACAN was posted for procurement of services. The rationale for the ACAN was that the work required was based on proprietary theory developed by the supplier under a contract valued at \$75,000. Subsequent scope changes and contract amendments increased the project value to \$500,000. In addition, an intellectual property clause was not negotiated before proceeding with the ACAN; amendments were not directly linked to the proprietary aspect of previous work and could have been acquired competitively as stand-alone contracts; and the complete scope of the project was not disclosed in the original ACAN.

### **Recommendation to the Director, MMCS**



- 6.2.5.1** Review the use of the ACAN mechanism, improve appropriate controls and exercise increased due diligence where significant amendments are made to ACANs.

**Management Response**

- 6.2.5.1** Partially agree. ACAN's at PCH are utilized only when there is a clear expectation that only one source of supply exists for any given requirement. Monitoring is being enhanced to ensure appropriate controls. We will continue to advise managers on the proper use of ACANS and will reiterate this in our mandatory training efforts as well as our day to day practices. Issues relating to improper use will be escalated to higher levels of management.