
REPORT ON THE AUDIT OF CONTRACTS

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EXECUTIVE SUMMARY

This audit reviewed the contract management practices in the Yukon government and assessed the extent to which desired results have been achieved and value for money obtained. The audit was government-wide in scope and included the examination of contracting processes in eleven departments. It included structured interviews with over twenty senior managers, a review and analysis of 136 contracts including such tests and other procedures as we considered necessary under the circumstances.

Our assessment covered both the operational responsibilities of departments for contracting and the functional responsibilities of Contract Services within the Department of Highways and Public Works. The audit examined the following aspects of the contracting process: consideration and definition of requirements; evaluation of potential suppliers; contractor selection; contract awarding; contract administration; contract performance and account verification; and post contract evaluation. Our assessment of the contracting process focused on three primary areas: the management control framework, compliance with authorities and value for money.

Management Control Framework

Opportunities exist to strengthen various elements of the government's contracting management framework and promote value for money. First, there is a need to re-examine the roles and responsibilities of departments and central agencies for contracting, in particular the roles played by Contract Services and the Legal Services branch of the Department of Justice. The current management framework does not promote consistency of contracting activities within departments or facilitate the monitoring of contracts with a focus on risk.

Second, most senior managers agree that there is a need to revamp the government's Contract Regulations and the Contracting Directive. The current authorities are antiquated and do not provide sufficient guidance for managers as to how they should carry out their contracting activities.

Finally, it is our view that managers, administrative staff and finance officers who play major roles in the contracting process do so without necessarily having the benefit of adequate experience and expertise. While there is some contract procurement training available, the training offered is simply an overview of the contracting function and is not nearly as comprehensive as it might be.

Compliance with Contracting Rules

Departmental contracting activities do not always satisfy the requirements of the Yukon government's Contracting Regulations or Contract Directive. Of 136 contracts reviewed we found very few cases where contracts had clearly fulfilled all of the compliance requirements under the existing rules. Many were signed and approved after their stated commencement dates, had incomplete statements of work, did not contain standard terms or conditions, or where the standard terms and conditions existed, they were not enforced.

Change orders also raised serious issues in our audit, as more than 40% of those we examined were of a questionable nature and not fully justified in the file documentation. While most contract files were properly authorized, we noted some instances where authorities were circumvented.

Existing contracting practices need to be seriously strengthened and improved to ensure that all procurement activities are carried out in an open, fair, consistent, efficient and competitive manner. To make this happen, we recommend protocols be established to involve Contract Services and the Department of Justice in reviewing high risk contracts before they are signed and approved. The nature or dollar value assigned to the contract would determine the appropriate level of risk.

We also recommend Highways and Public Works take the role and responsibility for monitoring the contracting activities in departments. By creating a watchdog and monitoring enforcement program that focuses on risk there is better assurance that departments will comply with the contracting authorities.

Contracting for "Best Value"

It is our conclusion that the government is not making sufficient effort to ensure that its contracting activities serve the public interest in bringing value for money. There are many possible reasons for this such as a weak central agency focus on contracting as evidenced by the absence of appropriate policies and guidelines, lack of monitoring activities, and mandatory procurement training for managers. These reasons among others, say something about the compliance deficiencies noted, but they also help explain why questions should be raised about whether the government is getting value for money from its contracting activities. Of 136 contracts reviewed, 36 contracts could not clearly demonstrate value for money. More attention should be given to training on contract justification, best practices in contracting and value for money concepts that will encourage departments to carry out their contracting activities in a cost effective manner.

INTRODUCTION

WHY THE AUDIT WAS CALLED

The audit of contracts forms part of the approved Internal Audit Plan for 2006-07, which was passed by the Audit Committee on April 6, 2006. This area was selected for audit for four reasons:

1. Contracts play a significant part in the overall spending activities of government.
2. The option of using contracts as a vehicle to deliver programs and services was deemed by senior management to be an important risk factor.
3. Internal audits and reviews performed since 2002 had shown many deficiencies in the way contracts are issued, managed and controlled, raising some general concerns as to whether departments were adhering to the contracting authorities.
4. The contracting process and directive on contracting had not changed since 1997. It was determined that an audit could lead to some improvements in policy and contracting practices in departments.

THE NATURE OF CONTRACTS

A contract is an agreement between a contracting authority and contractor (*person or firm*) to provide goods, perform services, construct public works, or lease real property for consideration (*Yukon Contract Regulations*). Where work specifications become part of a contract they are defined in terms of clear outputs or performance requirements. All contract work is subject to government audit. Market principles are brought to bear on the delivery of services in the belief that greater efficiency, economy and choice will result.

TYPES OF CONTRACTS

There are three major types of contracts under current government policy:

Competitive Award – where the contracting authority has selected a winning contractor from a public tender where bids and proposals were invited and opened to all parties.

Invitational Award - where the contracting authority has selected a winning contractor where bids and proposals were invited from a number of identified bidders or proponents.

Sole source contracts – where the contracting authority has entered into a contract or standing offer agreement directly with a proponent.

SPENDING ON CONTRACTS

According to the contract registry, 4,245 contracts valued at \$374 million were awarded in 2006-07. These contracts represented over 58% of forecasted expenditures for the year. In the previous year, 4,605 contracts were awarded for a total value exceeding \$396 million.

Tables 1, 2 and 3 below provide an overview of the value and number of service, construction and consulting contracts issued by department, type and range of value, respectively for the period from April 1, 2006 to March 31, 2007.

Table 1 – Contracts by Department

| Department | Contract Values | Number of Contracts |
|-----------------------------|------------------------|----------------------------|
| Elections Office | \$24,657 | 5 |
| Legislative Assembly | 1,368,240 | 33 |
| Community Services | 59,682,373 | 563 |
| Economic Development | 2,160,763 | 146 |
| Education | 7,458,365 | 200 |
| Energy, Mines and Resources | 11,601,135 | 320 |
| Environment | 3,609,393 | 348 |
| Executive Council Office | 1,244,470 | 54 |
| Finance | 19,157 | 3 |
| Health and Social Services | 50,501,521 | 501 |
| Highways and Public Works | 164,562,599 | 865 |
| Justice | 2,959,417 | 192 |
| Property Management Agency | 60,953,827 | 592 |
| Public Service Commission | 3,652,570 | 164 |
| Tourism and Culture | 4,495,454 | 254 |
| Women's Directorate | 27,592 | 5 |
| | \$374,321,533 | 4,245 |

Table 2 – Contracts by Type

| Type | Contract Values | Number of Contracts |
|---------------------|------------------------|----------------------------|
| Invitational Tender | \$23,676,262 | 445 |
| Public Tender | 217,341,561 | 708 |
| Sole Source | 133,303,710 | 3,092 |
| | \$374,321,533 | 4,245 |

Table 3 – Contracts by Range of Values

| Value Ranges | Values | Number of Contracts |
|----------------------------|----------------------|----------------------------|
| Under \$10,000 | \$11,734,405 | 2,686 |
| \$10,000 to \$24,999 | \$12,565,789 | 742 |
| \$25,000 to \$49,999 | 11,396,000 | 324 |
| \$50,000 to \$249,999 | 35,816,061 | 323 |
| \$250,000 to \$499,999 | 25,973,284 | 74 |
| \$500,000 to \$999,999 | 30,057,931 | 43 |
| \$1,000,000 to \$4,999,999 | 78,040,312 | 39 |
| Over \$5 million | 168,737,751 | 14 |
| | <u>\$374,321,533</u> | <u>4,245</u> |

Of the 3,092 sole-source contracts issued in 2006-07, a total of 351 contracts valued at \$114 million were issued above the \$25,000 sole-source threshold limit. Health and Social Services accounted for 102 of these 351 sole source contracts. We were informed that many of them were arguably contribution agreements which will be treated as transfer payments in future years under the new policy.

ROLES AND RESPONSIBILITIES

Legislative authority to contract is derived through the Financial Administration Act (FAA). Management Board is responsible for issuing policies and procedures for government contracting. Departments and Crown Corporations are responsible for ensuring that these policies and procedures are followed, and that staff with delegated contracting authority exercise it with prudence and integrity.

The Department of Finance, which is established under the FAA, is the principal central agency involved in the financial management of government. Its primary mandate is to ensure that the financial resources of the Yukon government are managed in a manner that meets government priorities and complies with statutes. The Department of Finance provides accounting direction and advice to departments.

The Department of Highways and Public Works is the lead department responsible for the administration and maintenance of the Contract Regulations and Contracting Directive. Acting on behalf of the Deputy Minister, Contract Services of the Department of Highways and Public Works offers advice to departments on the regulations and directive; administers the tendering process; maintains the contract registry and open source lists; and is responsible for engaging in a variety of advisory/educational roles, providing support to contracting authorities through the provision of contracting expertise.

POLICY DIRECTION

The Contract Regulations fall under the government's Financial Administration Act (FAA) and provide the framework for establishing common rules governing contracts that must be adhered to by all departments and agencies. Pursuant to the Regulations, there is also the General Administration Manual (GAM) Policy 2.6, Contracting Directive, which was issued in October 1998. This document expresses the process by which government will select contractors to supply goods and services. The objectives of this directive are to ensure that government contracting activities are carried out in a fair, fiscally responsible, accountable, open and competitive manner.

Supplementing the Contracting Directive are other policies that are linked to contracting such as the government policies on purchasing, Yukon hire, conflict of interest and Financial Administration Manual.

AUDIT OBJECTIVES AND SCOPE

AUDIT OBJECTIVES

The purpose of the audit was to provide the Yukon government with assurance on the soundness of their contracting processes, determine where departments are most exposed to risk, and identify the appropriate mitigating strategies, where necessary. In this regard, we assessed whether the contracting practices and activities in departments:

- were governed by an adequate management control framework;
- complied with the Contract Regulations, Contracting Directive and other related policies and directives as promulgated by Management Board; and
- achieved desired results with due regard to efficiency and cost effectiveness.

Typically, the management control framework for contracting and purchasing consists of the plans and objectives, policies and standards, people, accountability and reporting mechanisms used to manage the function.

SCOPE AND APPROACH

Our examination was conducted across eleven departments of government where contracts had been selected for testing. It involved information gathering, structured interviews with managers and staff responsible for contracting, testing of contracts and a review of the Contract Services operations of the Department of Highways and Public Works. We also relied on the project files, records and documents necessary to fulfil the audit objectives and established audit criteria. Where appropriate, we conducted research on specific areas of contracting to analyze and provide advice on best management practices as they exist in other jurisdictions.

Where appropriate we carried out tests on the systems, processes and controls adopted for effectively managing contracts. In this regard, the procurement planning phase of the contracting process was excluded from our examination of the contracting process. This is the phase, which, as a precursor to beginning any procurement process, assesses the business case or rationale for contracting for the activity in the first place. The requirement to justify a contracting action is not currently covered by the Contracting Directive.

The period of examination was from April 1, 2005 to September 30, 2006. The audit focused specifically on service contracts such as consulting, professional service, rental, lease, maintenance, and construction contracts. Excluded from our tests were:

- contracts issued by agencies and commissions reporting to the Legislative Assembly and Crown corporations such as Yukon Housing and Yukon Liquor;
- contracts issued by the Justice Department for outside legal services. Such contracts are not governed by the Yukon's Contracting Directive;
- contracts where costs are partly or fully recoverable from outside government agencies where agreements with those agencies require independent audits (*e.g., the Shakwak Construction Project*);
- purchase orders involving the procurement of goods; and
- contracts previously audited by the Office of the Auditor General or areas that they intended to audit (*e.g., Canada Winter Games*).

The audit was conducted in accordance with the Yukon government's policy on Internal Audit Services and Activities and the Standards for the Professional Practice of Internal Audit.

The audit criteria used to assess the government's performance against the audit objectives were based on an Audit Plan reviewed and approved by the Highways and Public Works and Finance departments. Audit criteria are those conditions that we expect departments to meet with respect to the management and administration of contracts.

OBSERVATIONS AND RECOMMENDATIONS

SECTION 1 MANAGEMENT CONTROL FRAMEWORK

IN BRIEF

Our first objective in the audit was to examine and evaluate the extent to which contracting practices and activities in departments are governed by an adequate management control framework. The framework elements that we expected to find for contracting included the following:

- defined and understood roles and responsibilities;
- proper delegation of contracting authority;
- the existence of a policy and guidelines;
- an effective monitoring program;
- a procurement training program; and
- communication of contracting related information.

FINDINGS AND ANALYSIS

It is our conclusion that the Yukon government's management control framework over the administration of contracts is not working effectively or in a way that holds managers accountable for their contracting activities. The existing framework has so many deficiencies that it fails to promote sound practices in contracting which could result in the circumvention of the contract rules.

So what are these deficiencies that we consider problematic? To begin with, the roles and responsibilities over contracting are not well understood or documented. Insufficient effort has been made in the last ten years to improve the policy framework. The tools and techniques meant to guide and help managers and staff through the contracting process are not current. The training offered by Contract Services is not sufficient in meeting the needs and demands for more comprehensive training. There is no requirement for managers to evaluate contractor performance and there is little or no monitoring of any contracting activities in departments. The main weaknesses we identified in our review of the management control framework are as follows:

ROLES AND RESPONSIBILITIES

The prime responsibility for contracting in departments resides with managers and officers who have delegated contracting authority, as determined by the Minister. Managers are responsible for ensuring that contracting is properly carried out and that value for money is obtained through good contract management processes.

Departments are responsible for ensuring that the Contract Regulations and Contracting Directive are followed and that staff with delegated contracting authority exercise it with prudence and probity.

Roles of Ministers

While a broad understanding of the roles and responsibilities for contracting are generally known, the Contracting Directive does not include a section that would clearly describe the specific roles and responsibilities of the key players who delegate or help set the rules over contracting, that is, Management Board, the Department of Highways and Public Works minister and Finance minister.

To illustrate this point, the Contracting Authority, as defined in the Contract Regulations and Contracting Directive, is any government body or government employee having authority under the FAA to enter into a contract on behalf of the Government of Yukon. In some other jurisdictions, the authority and responsibility for contracting within a department or agency resides with a minister and not simply “anyone with contract signing authority.” A change in the definition of the contracting authority would make it clear that the minister is responsible for the administrative and contracting processes within his or her department.

Role of Justice

The Legal Services branch of the Department of Justice has three full-time solicitors that can provide legal advice specific to contracts. However, for the most part, this branch sees only a fraction of contracts issued by departments, and these may not be the “right” contracts that they should be looking at. There is no policy requirement for departments to seek out the advice from Justice prior to entering into a contract. There is no risk management framework designed to advise departments that they should seek legal advice from Justice.

The Legal Services branch may be underutilized in areas where they can sometimes be of help to departments or Contract Services with their contracting issues. Departments sometimes use their prerogative of obtaining outside legal advice (*e.g., Athletes Village project*) rather than going to Legal Services. We believe the Department of Justice needs to be more actively involved in the contracting process.

Role of Contract Services

According to their web-page, Contract Services offers information and services to Yukon government departments on the tendering process, contract rules, preparation of tender packages and request for proposals, and in reviewing tender documents. Such information and services include developing training material

and presenting training sessions on contracting processes and activities to departments.

Our examination of the role of Contract Services shows that this unit does not serve all the needs of departments. The principal areas needing improvement are:

- monitoring the appropriateness of government-wide tendering and contract administration practices and documents;
- developing and/or updating the Contracting Regulations and Directive;
- engaging in research to develop better contracting tools and guidelines; and
- developing and updating training materials and presenting formal and informal orientation and training sessions on contracting processes and activities for clients, contracting authorities, other governments and external groups.

We noted most managers were generally satisfied with the public tendering process as administered by Contract Services and the unit was also found to be responsive to requests for advice or orientation sessions on contracting. Where frustration was expressed, it had more to do with their complaints about the Contracting Directive, the inefficiencies of the contracting process and the inability of Contract Services to give consistent and clear guidance on contracting. There is a strong sentiment, clearly evident from our interviews, that Contract Services simply does not have the “muscle”, the “teeth”, the authority or strategic vision to lead the contracting process to a state of excellence.

In order to strengthen the role of Contract Services, we believe it will become necessary for Highways and Public Works to assess the structure and reporting relationship of the unit and the resources assigned to it. Currently, this unit reports to Finance within the Corporate Services branch. If it is to remain a central service to departments this reporting relationship needs to be re-examined with the goal of giving it a higher profile, as is the case with Supply Services and other central agency functions.

On the resource side, if Contract Services is required to play a leading role in serving the needs of departments, maintaining and developing contracting guidelines and procedures, monitoring contracting activities across government or in developing and providing training sessions to managers and staff in departments, additional resources may be required in order for the unit to adequately fulfill these responsibilities.

Recommendations

- 1.1. Roles and responsibilities of all key players involved in the contracting process should be clearly described and communicated within the Contracting Directive.
- 1.2. A review should be conducted to evaluate the structure, resources assigned, efficiency and effectiveness of the Contract Services operation including an assessment of service needs for improving the contracting process across government.

Management Comments

For both recommendations on this page: Agreed. Highways and Public Works will lead these initiatives in conjunction with the recently initiated review of the Contract Regulations and Directive, and present options to Management Board and Cabinet on the structure and resourcing of the procurement and contract management functions in government.

POLICY AND GUIDELINES

Most policies are broad statements used for decision-making when people face recurring problems. They do not deal with particular situations; rather they are used as “guideposts” for solving repetitive types of problems. A sound policy in the area of contracting would ensure that contracts are managed in a manner sensitive to risks, complexity, accountability for results and economical use of public resources.

Management Board last amended the Contract Regulations and Contracting Directive in 1998. We examined these two documents to determine whether they provide adequate direction to departments as to how they should establish, approve, account, monitor, and report on contracts. The issues we identified from our examination are as follows:

Contract Regulations

Regulations set the tone for how government behaviour is to be conducted, and in so doing, influence how policies and practices are established and enacted upon. According to Section 2 of the Yukon government Contract Regulations, the objectives of government are to ensure that contracting activities are carried out in a fair, fiscally responsible, accountable, open and competitive manner, and that they benefit Yukon residents and Yukon businesses where applicable. Where there may be exceptions to the competitive bidding process, these are described under Section 20 of the Contracting Directive. Presently, there are eight exceptions where requests for bids or proposals are not required.

In our view, the exemptions allowed under Section 20 of the Contracting Directive are poorly articulated. In some cases they contribute to misunderstanding and subsequent improper application by managers who initiate contracts without seeking a bid or proposal. We also believe that any allowable exemptions to the contracting rules should be embedded in the government's Contract Regulations rather than in its policy. In this way there is greater assurance that the contract policy is subservient to the contracting principles, as established under regulation. This is the case with the Canadian government Contract Regulations. Section 6 of the said regulations states that there are only three exceptions where a competitive bid is not required when the amount is greater than \$25,000. These are where: the need is one of pressing emergency in which delay would be injurious to the public interest; the nature of the work is such that it would not be in the public interest to solicit bids; and only one person is capable of performing the contract.

Recommendation

- 1.3 The Contract Regulations should be reviewed and amended to reflect a sound governance and accountability framework for contracting. Exemptions to the contracting rules should be simplified and embedded in these regulations.

Management Comments

Agreed.

Contracting Directive

Government direction on contracting over the last nine years has not adapted well to changing circumstances or the commitment to continual improvement. Some of the more obvious shortcomings are: limited policy guidance on the responsibilities of key players in contracting, as discussed above, the directive's particular focus on rules which apply mostly to construction contracts and lack of focus on other types of contracts; the insufficient guidance on Standing Offer Agreements; and distinctions that add confusion rather than adding value, such as that between price-driven and value-driven contracts. The more prominent issues we found with the directive are as follows:

Policy excludes mention of a key intergovernmental agreement. The Government of Yukon may enter into a contract subject to Management Board's Contracting Directive, the Financial Administration Act, Contracting Regulations and various trade agreements. One of the most important trade agreements is the Agreement on Internal Trade (AIT). This agreement includes various threshold limits for procurement and service contracts which establish when a public tender is required. For example, it states that for procurement contracts over \$25,000, service contracts over \$100,000, and construction contracts over \$100,000, the government must go to public tender.

Care must be taken to ensure that the rules of such trade agreements are followed. We found that the Contracting Directive makes no mention of this agreement and managers who are responsible for contracting have no idea what is contained in it or the thresholds that apply to the Yukon when contracting. Any circumstances in which contracting does not follow the rules of this trade agreement could result in a challenge by a provincial government, individuals or the private sector through the AIT's dispute resolution provisions.

The sole-sourcing thresholds, as prescribed in policy, sometimes lead to poor management practices. Section 18 of the Contracting Directive establishes sourcing thresholds for three types of contracts: price-driven, value-driven and goods procurement contracts. We found that most managers are not fully cognizant of the rules that apply to a value or price-driven contract and no guidance exists to clarify what these terms mean. The sole-source contracts we reviewed tended to be value-driven because of the higher threshold value assigned to this type of contract. Decisions to label a contract as value-driven could not always be justified. In our view, the need to identify and distinguish price versus value-driven contracts in policy is questionable. Contract Services agrees that the sole-sourcing thresholds as defined in the directive are impractical.

Open source lists are not maintained and kept current. Section 28 of the Contract Directive requires Highways and Public Works to maintain a current register of all open and qualified source lists. Any firm or local business can apply to be included in the government's open source list. This idea came about many years ago as an economic initiative to try to promote local contractors to do business with the Yukon government. The source list is meant to be used whenever a contracting authority invites or goes out to public tender for certain types of goods or services. In more recent times, some contracting authorities have ignored the open source list for good reason. It provides little value in helping departments select suppliers. Many firms which are no longer in business still appear on the open source list. Firms do not need to meet any pre-qualification or basic requirements to be listed. As a result, departments are discouraged from putting too much emphasis on the quality of the suppliers listed on the source list. In our view, the rationale behind the open source list needs to be rethought.

Contracting authorities do not adequately pre-qualify bidders or proponents. The concept of pre-qualifying potential contractors has not been explored to any great extent. The governing rules for pre-qualifying of bidders or proponents under Sections 32 to 36 of the Contracting Directive are not supported by any available guidelines or tools that would enable departments to apply the appropriate industry standards or rigour that one would expect when performing a due diligence check on a contractor's qualifications. In British Columbia, for example, if a contractor wants to do business with the government in construction,

information technology, advertising, and consultancy services, certain pre-qualification standards and pricing ranges and rates must be met in each of these industry sectors. These are often established when issuing standing offer agreements for recurring services or supply procurements.

If the pre-qualifying or screening process is weak, inconsistent, inefficient and done in half-measures, then the risk is that Yukon government will be doing business with contractors that do not meet some fundamental performance requirements.

Definitions and use of tools and templates need to be consistently applied. There is a clear need to clarify how various legal instruments are defined and used by departments, for example, contributions versus contracts. The definitions contained within the contract regulations and contracting directive should also be aligned with the definitions that form part of the Financial Administration Act, and other government policies including the Financial Administration Manual.

There is a need to review the use of contract templates that some departments are using and the terms and conditions that become part of a contract. Some are too generic and do not work for all contracting situations. We have seen cases where the terms and conditions that form part of a Request for Proposal were altered or omitted from an actual contract. This can create a legal risk.

Standing Offer Agreements are mentioned in the Contracting Directive, but no guidelines are provided as to how they should be used. From our observations and discussions, we believe that there is not a good understanding of the purpose and advantages of setting up a Standing offer Agreement (SOA) for service contracts. Although Supply Services in the Department of Highways and Public Works has had a long history in the use and application of SOAs over goods procurements, this has not been the case with the contracting for services. The result is that this option is, on the whole, underutilized or sometimes used inappropriately. We believe there are a large number of sole-sourced service contracts that could lend themselves to being brought under an SOA. This would promote competition and reduce the unacceptably high number of sole-sourced contracts. Wherever there is a routine, repeated job to be done, it may be an opportunity to set up an SOA.

Another anomaly is that under current practice the SOAs we have examined allow the contractor to charge whatever prices they submitted. This means that the contract manager can choose any vendor from the SOA list without regard to how their rates match up to the other vendors on the list. Under the normal usage of an SOA, one screens out some of the vendors and one gets them to commit to a competitive pricing structure. The Yukon government has tended to apply the

granting of an SOA to all vendors who can deliver the service, and the accepted rate is whatever they quoted. If one is neither ranking, nor pursuing a competitive rate, then one loses the main purpose and advantage of the SOA.

The Contracting Directive does not adequately address the issue of change orders. Section 63 of the Contracting Directive says: "*Contracting authorities may issue change orders to accommodate changes in the scope, schedule or price of the contract that could not have been reasonably foreseen when the request for bids or proposals was issued.*" This does not amount to useful guidance, because it immediately begs the question: "What if we have a case that doesn't fit this definition?"

We saw some cases where a change order was indeed anticipated. The examples of this are contracts that were extended to the next phase, which could be viewed as contract splitting, to contracts that were renewed on a quarterly or six-monthly basis. There is divided opinion on whether a change order should be compulsory to wrap up any contract where the final cost is either higher or lower than the contract value. In other words, "Should a change order be the source document to de-commit funds?" The directive does not address this issue.

Efforts are needed to improve the information and advice provided to First Nations under the Contracting Directive. Section 40 of the Contracting Directive reflects the general commitments the Yukon government has made in First Nation Final Agreements to assist First Nations with respect to contracting opportunities. It requires the Deputy Head of the Department of Highways and Public Works, or delegate, to provide information on publicly advertised requests for bids or proposals, as well as regular information on contracts awarded that were not publicly tendered. Information on public tenders is communicated to the First Nations by Contract Services. However, for other types of contracts exceeding \$50,000 where a competitive bid was not requested for work intended to be carried out in a First Nation territory we are not certain whether departments regularly notify the First Nations of these contracts.

The provisions included under Section 40 also require government to provide First Nations and corporations, upon request, with information on how to compete for contracts and give them full opportunity to be registered on open and qualified source lists. We found very few First Nations corporations on the government source lists and rarely are requests made by First Nations to help them compete for contracts or standing offer agreements.

We also noted from our observations and discussions with managers that they had limited knowledge of what they should be doing to support government commitments to First Nations with regard to contracting. In our view government

needs to examine the actions it takes with respect to Section 40 to determine how it can improve efforts to ensure First Nations have the information and advice they want in the area of contracting.

Recommendation

- 1.4 The Department of Highways and Public Works through consultation with the Departments of Justice, Finance and other departments, the contracting community and First Nations should develop a new Management Board directive on contracting. A series of new contracting guidelines, tools and techniques should also be developed in support of the new directive.

Management Comments

Agreed. A review of the current Contract Regulations and Directive is currently underway and will include consultation with all government departments and with external stakeholders as well. Highways and Public Works will work with the departments identified, as well as the Public Service Commission, to build appropriate supports for the regulations and directive once revised.

MONITORING OF CONTRACTS

Contract monitoring is critical to ensuring that contractors fulfill their legal obligations and the Yukon government receives appropriate value for money it spends for a service. Monitoring of service contracts is an important function that can be used to identify: recurring problems; inappropriate use of delegated authority; specific contracting areas to address in training sessions; staff training needs; requirements for changes to delegated authorities, contracting policies and guidelines, and so on. A functioning monitoring system provides the opportunity to report to senior management instances of continued abuse of delegated authority and other irregularities.

The audit noted that most monitoring activities serve a limited purpose. While senior managers may be monitoring contracts within their own departments for financial control purposes, the central government—does not monitor the service contracting activities that occur within departments. As a result, there is no monitoring activity that is designed to capture information on high risk contracts or non-compliance issues across government.

There have been no reviews undertaken of high risk contracts, contract splitting and sole-source contracting. The reason cited was that Contract Services does not have the resources to undertake this kind of activity. As well, it is not certain whether Highways and Public Works has the authority to monitor contracts in other departments since the Contracting Directive does not specifically cite this responsibility.

A formal monitoring program over contracts would go a long way in ensuring departments comply with the contracting authorities. Assuming Contract Services establishes this program, it could also serve as a means for departments to report results including identified weaknesses and to improve the contracting process.

Recommendation

- 1.5 A comprehensive monitoring program led by the Department of Highways and Public Works in cooperation with other departments should be established which includes statistical sampling, periodic assessments of contracting practices in departments including assessments of internal financial controls, and the post review of contract performance from a lessons learned perspective.

Management Comments:

Highways and Public Works agrees a comprehensive monitoring program would improve internal controls and provide useful information on contracting practices in departments. HPW is prepared to work with other departments to develop options for a monitoring activity that would address this need.

CONTRACT TRAINING

An important aspect of the management of the procurement process is ensuring that all those involved in the contracting process have received appropriate training. Contract Services presently assumes this responsibility by developing training modules and delivering the training on contracting to departments on a demand basis. Of the five training modules developed by the unit, only one is currently offered: An Overview of Contracting in Yukon government. We were told the other four modules: Writing and Organizing the Tender Documents; Evaluation Criteria; Insurance and Other Securities; and Managing the Contract have not been given in years as the materials are outdated.

As the title suggests, the overview is not meant to be a comprehensive course on every aspect of contracting. It is designed as an introduction to the contracting function in Yukon government. Most of the discussion, handouts and materials in the overview course are already available on the web.

The training currently offered by Contract Services is not designed as a professionally laid-out training program. There are no learning objectives to the training being offered. The training does not target the unique training needs of managers, project officers, finance officers or administrative staff across government. Because the contracting function carries such a low profile across government, there is no mandatory requirement for managers or staff involved in contracting to undertake training.

Contract Services agrees that emphasis should be made to update training and far better training is required and that all the training modules need to be completely re-engineered.

Recommendation

1.6 The Public Service Commission, in consultation with the Department of Highways and Public Works, should work with other departments to identify needs, develop and deliver appropriate training for staff involved in the contracting process.

Management Comments:

The Staff Development branch of the Public Service Commission will work with the Department of Highways and Public Works and other departments to develop appropriate learning tools and processes to assist staff involved in the contracting process.

COMMUNICATING RESULTS

The contract registry serves as the primary source in disseminating information on service contracts. Departments are required to report to Contract Services all contracts over \$2,000. When this is done a contract number is issued and the contract gets recorded in the contract registry. The registry can be accessed internally and externally by the public.

External Reporting on Contracts

Twice a year Highways and Public Works produces a Contracting Summary Report (*Summary Report*) which gets tabled in the Legislative Assembly. Most of the information on service contracts contained in this report is derived from the contract registry. Other information relating to supply procurements is derived from other systems including the commitment system.

Although the *Summary Report* serves partly as a vehicle for reporting contracts to the Legislative Assembly, we believe its purpose and usefulness should be re-evaluated. It is a hefty document that requires significant resources to produce, which may be greater than the benefits derived from it. For example, on the supply side, it lists every purchase order issued by government whether the purchase order is \$10 in value or \$100,000. Reporting of this nature does not provide useful information. Moreover, the contract registry which is accessible to the public provides the kind of detailed information that anyone one can get from the *Summary Report*, at least when it comes to services contracts. This report would better serve the public if it contained summary information and statistics on the government's contracting activities, priorities and achievement of objectives.

Recommendation

- 1.7 Highways and Public Works should assess the need and justification of the Contracting Summary Report. Where there is a need identified, the content of the report should be reviewed so that it contains useful and relevant information that can be used by the Legislative Assembly to assess the Yukon government's contracting performance.

Management Comments:

Agreed.

Internal Reporting on Contracts

Another issue is the ability of Contract Services to report on high risk contracts or transactions that deviate from standard contracting and financial practices. While the Contract Registry is able to provide information on the history of the government's contracting activity and every contract issued by type of contract (*competitive, invitational and sole-source*), community location, amount and name of contractor, it was not designed to flag contracts that could pose a risk or out of compliance condition. If, for example, more than two change orders are issued on a contract, it would be a useful feature to have a system that could flag or signal a warning about this level of activity. Or, if a non-competitive contract was issued significantly above the sole-sourcing threshold, this too could be flagged either for management control, reporting or monitoring purposes. The nature of the flag could assist Contract Services, if they were given the appropriate authority, to monitor contracts in departments.

It is our understanding that a new system is being developed by the Department of Finance in consultation with Highways and Public Works with the capability to report on the progress of all active contracts with flags that would trigger high risk transactions or out of compliance conditions.

Recommendation

- 1.8 Highways and Public Works, in consultation with the Finance department should develop a strategy that would improve the future reporting capabilities on contracts for internal management and monitoring purposes.

Management Comments:

Agreed. There have been a number of enhancements and improvements to the reporting capabilities of the Contract Registry in the past year and, as further needs are identified by users, additional enhancements may be implemented. In addition, the Department of Finance is currently beta testing a new "front-end" system that will enable Contract Services and other users to track and monitor the status of active contracts.

SECTION 2 COMPLIANCE WITH AUTHORITIES

IN BRIEF

Our second objective in the audit was to evaluate the extent to which contracting practices and activities in departments complied with the contracting authorities. Based on our initial assessment of the management control framework over contracting, we selected two samples of competitive and sole-source service contracts for testing. Using a representative sampling method we selected 101 contracts at random from the Contract Summary Report using ACL as our audit tool, as shown in Table 4, below. Each selected item had a contract value of \$10,000 or greater and a starting date beginning after April 1, 2005.

Table 4 – Random Audit Sample

| | Contract Values | Number of Contracts |
|-----------------------------|----------------------------|--------------------------------|
| Department | | |
| Community Services | 715,753 | 13 |
| Economic Development | 80,800 | 3 |
| Education | 22,000 | 2 |
| Energy, Mines and Resources | 353,894 | 13 |
| Environment | 159,431 | 9 |
| Executive Council Office | \$30,000 | 1 |
| Health and Social Services | 640,446 | 14 |
| Highways and Public Works | 1,379,859 | 30 |
| Justice | 182,390 | 5 |
| Public Service Commission | 341,112 | 6 |
| Tourism and Culture | 513,950 | 5 |
| | \$4,419,635 | 101 |
| Type | | |
| Invitational Tender | \$723,251 | 14 |
| Public Tender | 1,815,955 | 26 |
| Sole Source | 1,880,429 | 61 |
| | \$4,419,635 | 101 |
| Value Range | | |
| \$10,000 - \$24,999 | 864,176 | 56 |
| \$25,000 - \$49,999 | 835,576 | 25 |
| \$50,000 - \$249,999 | 1,616,206 | 17 |
| \$250,000 - \$499,999 | 1,103,677 | 3 |
| \$500,000 and over | 0 | 0 |
| | \$4,419,635 | 101 |

Our second sample included 35 contracts selected on our understanding of risks within the population of contracts reported in the Contract Summary Report. Table 5 below presents an overview of the high risk population and the breakdown of our audit sample.

Table 5 – Risk Based Audit Sample

| Department | High Risk Population | Contract Values | Number of Contracts |
|--|-----------------------------|------------------------|----------------------------|
| Sole-source contracts \$25,000 - \$250,000 | 402 | \$1,277,001 | 23 |
| Sole-source contracts over \$250,000 | 33 | 2,998,587 | 5 |
| Invitational bids over \$50,000 | 47 | 591,021 | 4 |
| Contracts over \$1,000,000 | 36 | 5,350,615 | 3 |
| | | \$10,217,224 | 35 |

Our analysis of the random and risk-based audit samples relative to the total contract population for the eighteen month period is as follows:

Table 6 – Combined Audit Samples

| Total Value and Number of Contracts from Selected Population | Value and Number of Random Sample | Value and Number of Risk Sample | Total Value and Number of Random and Risk Samples | Sample Percentage of Total Population |
|---|--|--|--|--|
| \$293,291,092 | \$4,419,635 | \$10,217,224 | \$14,636,859 | 5.0% |
| 6,060 | 101 | 35 | 136 | 2.2% |

In addition to the two audit samples described above, we carried out some general auditing procedures on the contracting population to identify and analyze any service contracts that could be deemed as employment contracts; contracts with firms that have more than one operating name; sole-source contracts with vendors who appear to be getting an excessive amount of business; and situations that indicate contract splitting, conflict of interest or a history of complaints.

The contracts examined in our audit were assessed against the following criteria for compliance:

- A competitive bidding process is being followed except for the proper exclusions permitted under the Contract Regulations and Directive.
- The selection and awarding of contracts can stand up to public scrutiny.

- The terms and conditions of contracts including the Statement of Work are clear, relevant, and complete. They enable departments to mitigate risks in situations where there is non-conformance.
- Amendments and changes to contracts are properly justified.
- Clear evidence exists that services were rendered.
- Payments are duly supported, accounted for and appropriately approved.

FINDINGS AND ANALYSIS

It is our conclusion that the fundamentals of the current contracting process are not designed to encourage competition, fairness or transparency in the process. We found very few instances where contracts had clearly fulfilled the requirements of the criteria mentioned above, as demonstrated by our summary of findings as shown in Table 7, below:

Table 7 – Summary Analysis of Contracts and Supporting Transactions

| Nature of Deviation | Contract Sample | Number of Deviations | % of Sample |
|--|------------------------|-----------------------------|--------------------|
| <p>Questions regarding the reason for exemption from competitive bidding such as:</p> <ul style="list-style-type: none"> • Reason for exemption not described in sufficient detail; • Validity of the described reason for exemption not supported by existing contract rules; and • Exemption not formally authorized. | 40 | 12 | 30% |
| Selection process for competitive bids not properly documented or supported. | 40 | 13 | 32.5% |
| Statement of Work was insufficient to enable an independent party to verify tasks or deliverables. | 136 | 21 | 15.4% |
| Standard terms and conditions such as insurance requirements, business license or workers compensation were not followed up to verify compliance. | 136 | 25 | 18.4% |
| The distinction between a cost that would be eligible, versus a cost that was ineligible, or already included, was not articulated in a manner that would enable an independent party to verify the validity of invoiced charges. | 136 | 24 | 17.6% |

Table 7 – Summary Analysis of Contracts and Supporting Transactions
(continued)

| Nature of Deviation | Contract Sample | Number of Deviations | % of Sample |
|--|------------------------|-----------------------------|--------------------|
| Change orders did not fit the definition that the contract policy allows as valid circumstances for a change order. | 46 | 20 | 43.5% |
| Insufficient evidence in the contract file to show confirmation that the job was completed to contract specifications | 136 | 11 | 8.1% |
| Contracts signed after the stated commencement dates. | 136 | 72 | 52.3% |
| The contract or an invoice within the contract was signed off by a person who did not have appropriate spending or payment authority for that transaction. | 136 | 5 | 3.4% |

Overall, 65% of all the sampled service contracts issued by the government did not meet one or more of the compliance requirements, as stated in policy. Some of the more prominent issues encountered during our examination of contracts and other supporting documents were as follows:

Exemptions from the Competitive Bidding Process

We reviewed 40 contracts that should have been subject to competitive bidding under normal circumstances. As indicated in table, we identified 12 contracts where we were concerned about the defensibility of the exemptions from competitive bidding that were given to these contracts.

One of the misconceptions which became evident during the audit was the opinion that one could claim exemption under Section 20(f) of the Contracting Directive without providing a documented, convincing argument as to why the claimed exemption was warranted. This section reads as follows: “*The contracting authority may enter into a contract or standing offer agreement directly with a bidder or proponent: (f) in special cases authorized by the Minister of the contracting authority.*” The occurrence of claimed exemptions without full ministerial justification continued to occur despite a letter issued on April 12, 2005 by the Chair, Audit Committee to the Deputy Ministers Review Committee requesting that departments give justification through ministerial approval rather than just claim exemption. One area, in particular, that seems to exercise the frequent use of Section 20(f) is the contracting for information technology

services. Many of the contracts we encountered whose purpose was to upgrade and maintain software systems could not be completely justified for sole-sourcing. Typically, the program or project manager would claim that there was only one possible supplier.

Another section of the directive that is often used incorrectly is Section 20(d) which states “*where a contract is to extend the existing occupancy of substantially the same real property leased by the contracting authority.*” This section appears to allow for extending the lease of real property, but we assume that the intention is not to allow the continued sole-sourcing over an unlimited period.

To break away from the principle of competitive bidding is not something that should be done without careful thought. The principle of fair competition is designed to give businesses the opportunity to bid openly for government contracting services and to ensure that government receives the best value for money from its public spending. The easy circumvention of this principle erodes the contracting process and the government’s objectives that underlie the contracting policy.

Recommendation

- 2.1 Highways and Public Works should establish guidelines on the use of any exceptions to the bidding requirement, as established under the Contract Regulations and Contracting Directive. In cases where there is a high risk involved in issuing a sole-source contract that has been exempted from the competitive bidding process, departments should be required to have the contract reviewed by Contract Services and the Department of Justice prior to its issuance.

Management Comments

Highways and Public Works will undertake, as part of the current review of the Contract Regulations and directive, to establish guidelines on the use of exceptions to competitive procurement processes and the definition and review of high risk contracts.

Pre-qualifying contractors

We noted three cases where the contractor had either been struck off the Corporate Registry list or never registered. The Department of Community Services, for example, has a qualified source list for their well-drilling program, but we have serious concerns about this list. The well-drillers put themselves onto the qualified source list by filling in the form and agreeing to abide by the guideline. There is no requirement to prove that they have insurance, a business license or that they have certified drillers on their staff. In the case of contractors in the medical field,

we were told that there is some resistance to checking of the credentials of medical practitioners. In the case of contracts with Youth Care Facilities, we found that the contracts would typically express the requirement for the facility to carry insurance and a license. There was, however, no insistence that the contractor submit proof, and there was no other checking of credentials. We also found a case where the name of the contractor was incorrect. The contract was in the commonly used name of the owner, not the proper business name, and not even the proper name of the proprietor.

Recommendation

2.2 Highways and Public Works should develop guidelines and standards for pre-qualifying contractors for various types of service contracts, especially where there may be common and recurring contracting activities that would lead to the creation of Standing Offer Agreements.

Management Comments

Highways and Public Works will review the standards for pre-qualifying contractors as part of the contract regulations review currently underway.

Selection and Awarding of Competitive Bid Contracts

The selection of contractors and awarding of contracts under the Contracting Directive includes bid solicitation, bid receiving and opening, and the establishment of appropriate and fair evaluation criteria. Of the 40 competitive bids reviewed, it appears that contract and project managers had done their selection with due diligence, but sometimes failed to appreciate the importance of leaving documented evidence of their evaluation. They had not considered that their efforts might, one day, be subjected to public scrutiny and that their inadequate documentary evidence would undermine all their good work undertaken during the bid evaluation process.

Thirteen of the 40 bids reviewed failed to leave an adequate audit trail that would prove the selection of the winning bid was carried out with due diligence. The risk of not providing this level of assurance could undermine the contracting process leaving the government open to public criticism. In other matters touching on the awarding of contracts we noted the following instances where the contracting rules should not have been applied:

Contracts that are grants or contributions

We found four contracts that were clearly intended as grants or contributions, but apparently these had been put into a commercial contract format. In one case there was not even an invoice from the recipient, and payment was released on the basis of an e mail rather than the receipt of an invoice.

The decision to use a commercial contract format for what appears to be a grant or contribution agreement was the result of inadequate information and poor guidance. The lack of good guidance is linked to the following factors: the Contracting Directive has not been kept up to date; the expertise of Justice has been underutilized; and Contract Services is unlikely to be aware of the contracting activity and has not been given a clear mandate to deal proactively with a case like this, where the program or project manager has chosen an inappropriate option.

The inappropriate use of the commercial contract format for grants and contributions does not in itself create a risk per se. However, it does cause confusion and inconsistency because we now have a commercial contract that carries with it obligations to prove delivery of service. Obviously, there cannot be the same proof of delivery that applies to a normal commercial contract, so an exception is created. Exceptions like this tend to dilute the internal control environment over the contracting process.

Employment Contracts

Departments are required to follow certain rules to avoid entering into employer-employee contracts. The employer, as represented by ministries, is governed by the Canada Customs and Revenue Agency rules regarding who must be considered an employee. The Yukon Workers' Compensation Health and Safety Board (WCH&SB) may also consider a contractor to be an employee under certain circumstances. Departments must also follow the collective agreements established for union staff.

In our review we found five contracts that could be deemed as employment contracts. While there is a policy that establishes terms and conditions of employment for persons who provide contractual services to the Yukon government which include an employer-employee relationship (*GAM Policy 3.41*), it does not provide guidance on what to do before you hire to determine whether the situation is one of a service or employment contract. This may be part of the reason why contracting authorities have not been aware of their responsibility to challenge their service contracts against an employer-employee relationship.

An employee-employer relationship exists when an organization or department has the ultimate right to direct and control an individual in the way he/she works both as to the final results and as to the details of when, where, and how the work is to be performed. The department does not need to actually exercise control; it is sufficient that the respective department has the right to do so.

If Yukon government employs staff under a service agreement, when the law deems the relationship to be an employment contract, then there will be obvious

repercussions for breaking the law including fines and penalties imposed by the federal tax authorities.

Recommendation

- 2.3 Highways and Public Works should develop standards and guidelines that would assist departments to maintain proper contract files and records that demonstrate fairness and transparency in the tendering process and the evaluation, selection and awarding of contracts.

Management Comments

As part of the process of establishing and clarifying mandates related to contract management and monitoring, Highways and Public Works will work with other Departments and Management Board to ensure roles and responsibilities for providing guidelines and managing contract files and records are addressed.

Recommendation

- 2.4 Highways and Public Works, in consultation with the Finance department, should develop guidelines that can help explain the nature of contracts versus grants or contributions. This recommendation is currently being looked at by the Department of Finance as a result of the audit on contributions.

Management Comments

Agreed.

Recommendation

- 2.5 The Public Service Commission should revise GAM Policy 3.41, Contract Employees Terms and Conditions of Employment, or create another policy that provides direction on employer-employee relationships and the use of employment contracts.

Management Comments

This policy was identified as needing “major revision” during the 2004 Policy Round-up – a government-wide consultation with the human resource community to address changes to policies in GAM 3. The review of Policy 3.41 is in the initial revision stage and the Staff Relations branch is developing an Application Guideline as the policy instrument that will address the direction of the audit recommendation until the full review of Policy 3.41 is completed.

Contract Certification (Section 24 FAA)

Section 24 of the FAA states that contracts shall not be entered into unless there is sufficient money in the vote or fund from which the payments are to be made. This authority is exercised when decisions are made to obtain goods or services that will result in the eventual expenditure of funds, such as the decision to hire staff, requisition supplies or services, to authorize travel, or to enter into some other arrangement for program purposes. Before a manager can commit to the spending of funds under Section 24 FAA, there needs to be assurance that there is a sufficient unencumbered balance available out of the relevant appropriation or item included in the Main Estimates to discharge such commitment. Therefore, work should not commence before a contract has been entered into and work should not commence prior to authorization pursuant to Section 24.

Of the 136 sample contracts reviewed, 72 (or 53%) of these were signed only after the stated commencement date. The delay between the signing date of the contracts and effective dates of service ranged from one day to over six months, with an average of 38 days. Of the 72 exceptions, we found that six of these showed evidence that work started before a valid contract was in place. None of these six exceptions were emergency situations which demanded quick reaction without the opportunity to draw up a contract.

When an important step is not completed on time we assume this is caused by poor planning, a cumbersome approval process or poor discipline and sense of urgency. In exceptional circumstances, there may be an emergency situation where the job must be done immediately and there is obvious justification for not having a signed contract in place before work commences. However, if for no other valid reason a contractor begins delivery without a valid contract in place, then this undermines the whole purpose of having a formal agreement, which is to avoid disputes and the possibility of future litigation. It also increases the risk that services could be delivered where there were insufficient funds for ensuing payments.

Recommendation

- 2.6 All contracts (whether new or renewal) should be completed pursuant to Section 24 of the FAA prior to a contractor commencing delivery of services. Highways and Public Works through its active monitoring program and work with managers should ensure that contracts are signed before the contract start date.

Management Comments

Highways and Public Works is committed to establishing tools and processes to ensure appropriate documentation of approvals are in place prior to work commencing on a contract and will work to ensure any monitoring, compliance and

training/support functions that are established in the Yukon government support this requirement.

Amendments and Changes to Contracts

Forty-six contracts we sampled involved change orders. Twenty of these did not satisfactorily meet the conditions that could reasonably support a change order. Apart from the Directive being rather weak on the subject of change orders, we noted following discrepancies in the way they are handled and executed:

- Six failed to explain the reasons for the increases in cost. One of these gave the reason "additional hours required."
- Two were created to extend the deadline for contract completion, but were signed off after the new deadline.
- Five resulted in changes to the scope and cost of the service contract that had not been pre-approved, but rather authorized much later.
- Four related to a totally different job. These change orders should have been set-up as whole new contracts.
- Three clearly did not meet the requirements as described in the Contract Regulations, insofar as the additional work was foreseen. If the contractor gives a proposal for two phases choosing to make a contract for phase one and using a change order to add phase two, then our change order is certainly not for an unforeseen event.

While some change orders clearly indicated some form of contract splitting, there appeared to be an acceptance, on one hand, that contract splitting was a circumvention of the rules and had negative connotations and was to be avoided. On the other hand, we were told that it was the official mandate of the Yukon government to give Yukon businesses a better chance at competing, and one way of achieving this, was to deliberately break a big project into smaller parts. We could not find any official proclamation of this mandate to split contracts in order to benefit local business.

Signing Authorities (Sections 24, 29 and 30 FAA)

We found five instances where the signatories had exceeded their delegated authority limits as stipulated on their specimen signature cards. Three of these instances were cases where the Section 29 signatory had signed to approve an invoice that was beyond his or her authority limit. The fourth case involved a change order that had been signed for an amount greater than the Section 24 authority limit allowed. The fifth case involved a contract that required ministerial approval. The contract manager claimed to have ministerial approval, but the memo which the contract manager quoted, did not give approval.

If a signatory signs a contract, change order or cheque requisition for an amount greater than their authority limit, this could either be because they were unaware of their limit, or they did not perceive this as a serious breach of control. The setting of authority limits is a very basic internal control. If the control is ignored or if there is no effective checking, then the end result is that the control over spending has been eroded.

The current system is paper-based. We found examples where a department did not have a copy of the specimen signature card on file. From our discussions with staff we noted that the review of authority limits is an onerous task which tends to get neglected. Even when inconsistencies in signing limits were noted, or at least suspected, it became a long drawn-out process to review and update these authorities. We were given the impression that reliance is placed on the Finance department to provide a final check on signing limits. We also noted that there has been much movement of staff and that this contributes to the complexity of keeping control of signing authorities.

Without having a computerized database on hand it is very difficult to do a quick analytical review of signing authorities. Important internal control principles such as setting automatic expiry dates cannot be applied. In an antiquated system that relies on human intervention, it is inevitable that anomalies get overlooked.

While we believe a more modern method of validating financial signing authorities would improve internal control, we were informed by the Department of Finance that the introduction and use of electronic signature cards has been investigated and is not being considered at this time due to uncertainty regarding cost.

Contract Performance (Section 29 FAA)

Section 29 of the FAA requires an account verification process and a certification that the services have been performed as required prior to payment. The account verification process includes checking to ensure that the contractual terms including price, quantity and quality have been met and that all departmental, Management Board, central agency, legal and regulatory requirements have been satisfied.

Our review identified a number of instances that made it difficult to confirm contract performance. These included situations where:

- statements of work lack sufficient clarity as to what services are expected;
- service charges could not be clearly validated;
- contractual terms and conditions were not being enforced;
- evidence of inspections or validations of work done were missing; and

- validations of contract performance were left to the finance officer.

These types of non-compliance with the government's financial policies increase the risk that payments will be approved for services that were not rendered in full as per the contractual agreement.

Statements of work lack sufficient clarity as what services are expected

A common weakness in the contract statements of work which we examined is that the deliverables were often poorly described. Of our sample 136 contracts, we had concerns with 21 of these because the expected outcomes, milestones in the process, payment terms, standards, specifications and end product or vision of what the contract or project manager expected to achieve were poorly articulated. In cases where the contract was weak in its description of the expected deliverables, it appears that program and project managers had not considered the likelihood of a future dispute and neither had they deemed it necessary to engage the finance unit or Justice Department who would have pointed out the obvious consequences of not defining the deliverables properly.

If the expected outcomes of the contract are not well articulated, it creates the risk of dispute about whether the contract has been successfully completed. Under such circumstances there is unlikely to be assurance that fair value was delivered.

Service charges could not be validated

Most of the contracts examined were comprehensive in their description of what should be anticipated as charges on future invoices and the timing of invoices. However, we did find 24 contracts where it was not sufficiently clear what charges to expect. In these cases, if a contractor had added in an unusual and unanticipated charge, we would not have been able to resolve the dispute by referring back to the contract. An example of an unanticipated charge would be a 10% surcharge as an administration fee or incidental costs such as travel and disbursements that are not stipulated in the contract. An unusual charge would be costs that could not be validated to a standard. For example, the contracts we reviewed for helicopter services only mention dry cost and there is no agreement on what the basis is for the fuel charge.

To avoid disputes over what is an allowable extra cost and what is deemed to be part of the main quotation; the contract often needs to be more specific. It appears that in 24 exceptional cases, the contracting authorities had not given consideration to the worst case scenario where a charge on an invoice could not be legitimately supported.

Contractual terms and conditions were not being enforced

Our examination revealed a great inconsistency in the enforcement of standard terms and conditions within contracts. We found 25 contracts where there was no confirmation that the contractor had provided proof of insurance, business license and coverage under workers' compensation. Although for many of the selected contracts, the contracting authorities were insistent that contractors provide this kind of evidence, in almost 20% percent of the cases reviewed these standard conditions were overlooked.

As a tool, Contract Services has developed a template that has proven to be very useful in promoting consistency. The standard conditions are applicable to all contracts, except the clause relating to insurance. This clause requires the contractor to confirm commercial general liability insurance with the Yukon government as additional insured. It is questionable whether this requirement should be a standard condition as there may be contracts where this is not applicable. What we found is that this condition was not consistently enforced. We also did not get assurance that the Yukon government was named as additional insured. In testing for insurance, for example, there were cases of: - no checking at all - reserving the right to call for proof - verbal assurance from the contractor - getting a certificate of confirmation. In no instance did we see any contract manager insisting on seeing an insurance policy. We have one case where the insurance certificate of confirmation was obviously altered, but this was accepted without query. The only checking that meets the criteria of due diligence for high risk contracts is to demand at least a copy of the insurance policy.

There may be a tendency to pay little attention to standard clauses that are not applicable. There is also a lack of common understanding of the commitment of the Yukon government to support the City of Whitehorse with respect to business licenses and the requirements for workers' compensation, as required by the Yukon Workers' Compensation Health and Safety Board.

If we allow a precedent that allows program and project managers to ignore standard terms and conditions in contracts, then we send a message that we are not serious about enforcing contracts.

Evidence of inspection or validation of work done were missing

We found 11 contracts where we could not find an indication to assure us that there had been a meaningful inspection, or confirmation that the job was done to the satisfaction of the program or project manager. In certain cases a final inspection report was a stipulation of the contract, but this was never pursued. We also noted an ironic situation with painting contracts where the job specifications were exceptionally detailed, but the actual inspections appeared to be very superficial. The person sent to do the site inspections returned with reports that added no

value. This appeared to be little more than a drive-by observation and added nothing to the objective of quality control.

The task of doing inspections appeared to be delegated, in some cases, to junior staff and they had not been briefed to ensure that they knew what was expected of them when they did a site inspection. If there is no meaningful quality control for ensuring that job inspections get done properly by qualified inspectors then this undermines all previous efforts to document the job specifications.

Validation of contract performance was left to the finance officers

In nine of 11 departments audited, we found that finance officers were signing off Section 29. This was accepted practice on the grounds that the alternative was impractical and would delay the payment process. This alternative being: to send the cheque requisition to the program or project manager for his or her signature under Section 29. We acknowledge that finance officers insisted on an "OK to pay" from the contract manager which was usually an initial on the invoice. The problem with this practice is that it is contrary to the proper segregation of duties between program and finance officers. It is also unfair to expect a finance clerk to carry the burden that goes with Section 29 of the FAA. The mere initial of the program or project manager on an invoice does not signify that this person is verifying of what is required to give certification under Section 29.

Recommendation

2.7 Financial officers and clerks in departments should not be assigned spending authority under Section 29 of the Financial Administration Act unless that authority pertains to their own operations. The Department of Finance should review the Delegation of Financial Signing Authorities in all departments to ensure that this recommendation is implemented within a reasonable timeframe.

Management Comments

The Department of Finance agrees with this recommendation and has instructed departments to review the Section 29 signing authority delegation to financial officers. Finance will continue to monitor and work with departments in this area.

Recommendation

2.8 The finance units in departments should conduct random reviews and tests of the account verification procedures and controls that managers have in place to ensure that Section 29 of the FAA is being properly exercised over the administration and management of contracts.

Management Comments

The Department of Finance does conduct Section 29 tests through its accounts payable post-audit activity. In view of the findings in this audit of contracts, Finance plans to intensify its testing of Section 29 signing authorities.

Payment Approval (Section 30 FAA)

From our observations and interviews we found no evidence of finance officers doing a deliberate test on the quality of account verification done by the Section 29 signatory. Because the FAA imposes some onerous expectations on the finance officer, we questioned whether it was wise to sign off Section 30 without really knowing the control environment of the Section 29 signatory. When we queried this with finance officers we concluded from their responses that for the most part, they believed that as long as the contract manager had given the "OK to pay" they were comfortable signing off Section 30. Our concern is that, if this attitude is prevalent, the Section 30 sign off may be little more than a rubber-stamp.

Apart from the concern that any "rubber-stamping" exercise is not adding value and is not complying with the spirit of the FAA, there is the concern that finance officers put themselves at risk if they sign something without considering the consequences if something goes wrong, and they have not done their due diligence. This situation becomes even more serious when we find non-finance officers having Section 30 authority.

Our audit testing revealed that, for the most part, finance officers had gone through the basic checklist: Is there money available? Has the invoice been approved by the Section 29 signatory and are they within their authority? Are the calculations correct? However, there were 31 contracts where we would not have paid the invoice, because of some deficiency such as contract terms not met or insufficient detail on the invoice. If we, as auditors, found good reason to raise some serious questions about the invoice, then we would expect finance officers to have raised the same query.

We would also expect financial officers to perform their duties with care and to implement internal controls to prevent invalid payments and fraud. As stated in FAM, Section 5.5.4.3 "*Payment authority should be delegated to financial officers, who are sufficiently senior to have the experience and judgment necessary for exercising payment authority.*" It goes on to say that "*Financial officers with payment authority should understand the principles of internal control. In addition to examining specific transactions, they should satisfy themselves that various administrative processes and approvals given to them provide sufficient segregation of duties and independence in order to preclude any likelihood of improper or inaccurate payments taking place.*"

Recommendation

2.9 The Department of Finance should plan a workshop and training session for all senior finance officers in departments that would address the responsibilities for account verification and the general procedures and controls that should apply to this process. This would enable the finance community to develop a common understanding of what is required of them in ensuring a high standard of probity in their payment functions and to share best practices.

Management Comments

Agreed. The Department of Finance has offered training and workshops to financial officers and will continue to do so.

Recommendation

2.10 The Department of Finance should periodically monitor and randomly conduct tests in departments to ensure that the financial practices and internal controls that govern Sections 29 and 30 under the Financial Administration Act are functioning adequately, and as intended.

Management Comments

Agreed. This is a current practice and will be continued by the Department of Finance.

Maintenance of Contract Files

According to the Canadian government Treasury Board Policy on contract documentation, “files should be established which will provide a complete audit trail containing details on matters such as options, decisions, approvals, amendments, if any, etc., and identifying the officials or authorities who made them.” The maintenance of a current contract file serves as a historical record in the event of a financial review, subsequent legal action or an official complaint. Current files are also important for anyone who may have to consult the file or assume responsibility for it at a later date.

Apart from isolated exceptions, the contract files we reviewed did not provide an accurate and complete audit trail. If we accept that a file should stand up to public scrutiny and provide convincing evidence of good management and monitoring, then the vast majority of files fell short in this regard. The most common omission was documented review or evaluation of contractor performance. We found no evidence that supervisors were inspecting contract files to gain assurance that their subordinates were managing their contracts to an acceptable standard. Some of the shortcomings we encountered were: poor filing discipline; decisions and thought

processes not documented; absence of confirmation of delivery; and no use of a checklist to check off all the steps in the process or the documents required.

Recommendations

2.11 Records management guidelines should be developed to assist program managers, finance officers and administrative staff to establish and maintain proper contract files and records.

Management Comments

Agreed.

SECTION 3 CONTRACTING FOR “BEST VALUE”

IN BRIEF

There are a multitude of qualities and circumstances which make up the concept of contracting for “Best Value” or “Value-for-Money”. The Australia, Commonwealth Procurement Guidelines, state that *“it is supported by the underpinning principles of: efficiency and effectiveness, accountability and transparency, ethics and industry standards. Officials buying goods and services need to be satisfied that the best possible outcome has been achieved, taking into account all relevant costs and benefits over the whole of the procurement cycle. Accepting the lowest price is not necessarily an indicator of best value for money. Value for money is a concept evaluated on a whole-of-life basis of the property or services being procured and is influenced by a number of factors: the procurement method adopted; market maturity; performance; financial considerations; and the anticipated price that could be obtained at the point of disposal.”*

It is essential that the principles of best value and open access to contract possibilities always be observed because these principles represent the cornerstone of the government’s contracting process. Over the last few years the Yukon government’s contracting practices have aroused considerable public interest. The great visibility around infrastructure projects, the high volume of sole-source contracts awarded, and the inherent risks in increasing the use of contracts as a means to deliver programs are significant risk factors.

FINDINGS AND ANALYSIS

It is our conclusion that sufficient effort is not being made to ensure that the government’s contracting activities bring value for money. In our audit testing we were looking for any circumstance that might undermine the principle of fair value for money. Of the 136 contracts sampled, 36 had some condition, or lack of evidence, which called into question whether fair value for money had been obtained.

Our conclusions on these 36 contracts were derived primarily from the results of our compliance testing and examination of supporting records and financial transactions, as described in the previous section of this report. We believe there is a strong correlation between meeting the compliance requirements of the Contracting Directive and the concept of value for money. In our view, if the rules on contracting are not followed or if the management practices over contracting are not sound then there is a strong likelihood that value for money will not be achieved. In other words, value for money in contracting is difficult to prove or unlikely to be achieved if:

- there is no substantial evidence that rates paid were competitive;
- there is lack of competition;
- statements of work have poorly articulated objectives, performance requirements or deliverables;
- there is insufficient evidence of contract monitoring or quality control; and
- time overruns or change orders are allowed without justification.

If program and project managers do not appreciate that they are, in fact, obligated to demonstrate value for money, then there may be a tendency to let contractors get away with sub-standard delivery. If the whole contracting cycle is not consciously focused on demonstrating value for money, then the government leaves itself open to public scrutiny and embarrassment.

Two of the most relevant value for money issues we encountered in our examination of contracts had to do with the competitive bidding process and the lack of contract performance reviews.

The Competitive Bidding Process

Our audit identified 12 contracts where we felt the lack of open competition had seriously undermined the contracting process. While we do not suggest any impropriety or bending of the rules, we do feel it necessary to place on record those situations which were subject to limitations on open competition and which need to be considered as opportunities for improvement.

Situation 1: The Yukon has a limited pool of information technology contractors. For example, once a vendor has secured the initial engagement to provide software programming expertise, they have a distinct advantage and are in a strong position to secure future contracts. A concern would arise if the project becomes a whole series of smaller, follow-up contracts that go on from year-to-year without any challenge or clear justification.

Situation 2: The procurement of advertising services is of an ongoing nature and should be contracted on a government wide basis to create a Standing Offer Agreement. During the audit we found only one contract that referred to an SOA on advertising led by the Executive Council Office. In other departments most advertising contracts selected in our sample were sole sourced without clear knowledge or thought that such contracts could be more efficiently administered at a lesser cost through a standing offer arrangement. It may be that in some cases an SOA exists, but it is not being utilized or the contracting authorities are not aware that it exists.

Situation 3: We did not see an established routine of monitoring warning flags that might indicate contract splitting and circumvention of the competitive bidding process.

It does appear that sufficient planning has not gone into addressing the risks and finding the best compromise, or the best ways to maintain control under challenging circumstances. It would appear that the concept of a standing offer agreement has not been adequately addressed in policy, and consequently, we find cases where an ongoing contract or multi-phase contracts are continually being sole sourced, whereas these should have been opened to competition under a Standing Offer Agreement.

The potential for creating standing offers for various types of services, such as advertising, information technology, transportation services, maintenance, etc., is far greater today than it was at the time the Contracting Directive was last changed. While standing offers and supply arrangements are not the solution for all needs, they often result in the availability of certain services at attractive prices. Furthermore, they are relatively easy to use and save on administration.

Recommendation

3.1 Highways and Public Works should review the government's contracting activity for service contracts for a suitable period (e.g., *perhaps over the past two years*) to determine if there are patterns that suggest there are opportunities for establishing standing offers.

Management Comments

Agreed.

Contractor Performance Review

In all the contracts selected for audit, there was no documented, formal evaluation of contractor performance. This gave us no assurance that there is a consequence for contractors who perform poorly. There appears to be a perception that there would be negative repercussions if a poor performer was excluded from future bidding. We did not see any cases where a contract manager had laid down objective measurement criteria for contract performance, and logged the post completion evaluation into a memory system.

Formal evaluation of contractor performance is overlooked because it is not a stated requirement in the Contracting Directive. There is no guideline to describe how to do an objective and factual evaluation. The Yukon government needs to learn from experience and the contractor deserves to receive feedback. Ultimately there should be consequences for poor performance.

Recommendations:

- 3.2 Departments should be required to undertake post-completion evaluations of the service contracts to assess project management, consultant performance, and lessons learned as part of continuous improvement.

Management Comments

Highways and Public Works will work with the Department of Finance and others to explore this question