



## OFFICE OF THE PROCUREMENT OMBUDSMAN



### **PROCUREMENT PRACTICES REVIEW**

### ***DIRECTED CONTRACTS UNDER \$25,000 – A RISK-BASED STUDY***

OTTAWA  
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STRENGTHENING THE CONFIDENCE OF CANADIANS IN PUBLIC PROCUREMENT

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## Executive Summary

1.1 The Government Contracts Regulations set out the conditions for entering into contracts. Although competition is the norm, there are certain exceptions to this rule. One of these exceptions is that bids do not have to be solicited for goods and services when the estimated value is below \$25,000.

1.2 This study examined the perceived risks to balancing efficiency and effectiveness with fairness, openness and transparency of contracts under \$25,000 that are awarded to a preselected supplier – also referred to as a non-competitive, a sole source or, in the case of this study, a directed contract.

1.3 In 1995–96, the House of Commons Standing Committee on Government Operations (now called Government Operations and Estimates and referred to in this study as the Parliamentary Committee) found that “there is an over-proportionate volume of awards of sole source contracts by departments and agencies, thereby reducing competition in the private sector for government business.” As a result, the directed contracting threshold was reduced from \$30,000 to \$25,000 where it remains today.

1.4 When the Procurement Ombudsman appeared before the Parliamentary Committee in December of 2009, the members voiced a number of concerns about directed contracts under \$25,000, including who audits the reason for sole sourcing (going to a specific supplier), how fairness is ensured when there is a comfort zone of using a specific supplier, how that \$25,000 is justified, and how these procurement opportunities are publicized so others know they exist.

1.5 In response, the Procurement Ombudsman stated, “The bottom line is really that these are the issues that are not resolved through additional regulation. These are issues that are resolved when you have a culture that says we have to be accountable for our actions and ethical considerations are just as important as legal considerations in procurement.”

1.6 In 2008, 91% of all federal government contracts were below \$25,000, which is consistent with statistics over the last ten years. While some of these contracts are competed, in 2008 more than 200,000 (roughly 60%) of them were awarded to a preselected supplier without competition. When more than half of all contracts are not open to competition, it is important that Canadians have confidence that the transparency of this category of contracts be strengthened.

1.7 Government policy emphasizes that departments treat all suppliers equally and not deal only with suppliers they already know or prefer, as this would not be fair to other suppliers.

1.8 During the course of the study, we reviewed literature, as well as the results of other work carried out by our Office. We also examined various policy documents and solicited the views of four departments, one professional association and three supplier

associations on this topic. A number of messages – risks as well as benefits – emerged from our findings.

1.9 Departments have different interpretations of the messages in policy documents, and it may be diminishing efficiency for both departments and suppliers. The result is inconsistent application by departments and extra work for suppliers because they have to adjust to different practices, which increases the risks to fairness, openness and transparency of the procurement system. While taking a customized approach may be appropriate in some cases depending on the context in which the goods or services are being purchased, inconsistent practices may jeopardize fairness and openness.

1.10 Although the wording in the various contracting policies could be strengthened and better aligned with other guidance, there is no doubt that public servants have an obligation to document decisions and actions taken – a key transparency measure. Directed contracts reduce access for all qualified suppliers so this is to be offset with enhanced transparency. Lack of essential documentation has continued to be a long-standing issue and it raises questions about the integrity of the procurement process. As stated in our 2009/10 Annual Report, many questions could be avoided or quickly answered with proper documentation.

1.11 Another key measure to strengthen transparency is providing information that facilitates public scrutiny of contracts awarded by the government. If information were reported in accordance with the TB guidance on proactive disclosure, it may meet the minimum requirements. However, at least from the suppliers' perspective, it does not seem to be meeting the spirit of the transparency measure. Although government information systems have limitations, without timely and useful information suppliers have no way of knowing about opportunities and how to access them.

1.12 There are mixed views about whether directed contracts under \$25,000 promote increased access for SMEs to government business. One of the benefits is that suppliers can participate without incurring the expenses associated with submitting bids for open competitions – this would be true for SMEs, as well as larger companies. On the other hand, access is diminished if contracts under \$25,000 go only to suppliers that are already known to the department.

1.13 Information collected by PWGSC over the past four years from departmental financial systems indicates that the number of suppliers to the federal government has decreased by roughly 12%. If the volume of directed contracts remains high and the shortcomings in file documentation and proactive disclosure are not addressed, our concerns for diminished access and transparency remain.

1.14 Although value and/or savings may be achieved by working with known suppliers, there are also risks to the efficiency and effectiveness of program delivery and the principles of fairness, openness and transparency, including reducing the scope of requirements to stay under the threshold for competition, repeatedly using the same suppliers, providing the chosen supplier with a future competitive advantage, and contract splitting. Departments and supplier associations suggested training and taking a risk-based approach to monitoring as measures to mitigate these risks.

1.15 Procurement and materiel management specialists are receiving basic training, but there appears to be a gap when it comes to others involved in the procurement process – responsibility centre managers and departmental oversight personnel. The government is facing a resource challenge as a large percentage of the workforce retires; the need to train those involved in procurement to ensure and maintain a knowledgeable workforce is more critical than has been the case in previous years.

1.16 With regard to strategic monitoring and management of procurement activity, departments are already recording information for producing a variety of reports required by the government. Analysis of this information can be used to identify and mitigate risks such as perceived favouritism for a specific supplier and contract splitting, as well as being useful input to departmental procurement plans and training plans.

1.17 Most departments and supplier associations stated that directed contracts are less costly, simpler and administratively efficient in meeting program requirements. The government has not, however, analysed the cost associated with directing contracts under \$25,000 to determine whether there are sufficient gains in efficiency to offset fairness and openness. The costs may actually be increased if departments assess the full organization-wide effort (i.e. involvement of responsibility centre managers and the oversight function related to reviewing individual transactions under \$25,000) associated with contracts under \$25,000 as a category.

1.18 Mandatory use of standing offers and supply arrangements for repetitively purchased goods and services can mitigate the risks to fairness and openness. These tools can increase efficiency because contracts can be issued quickly. Despite the fact that using these tools is mandatory and only specialized requirements should be contracted outside them, the volume of directed contracts remains high and raises the question as to why. To date, the government has not completed an assessment of the impact of these mandatory tools.

1.19 In addition to directed contracts or standing offers and supply arrangements, there are other means of contracting that can be considered in certain circumstances. These include using simpler forms of competition such as requests for quotation, telephone buys and invitations to tender. These other means would promote fairness, openness and transparency and have a number of other benefits for departments and suppliers.

1.20 While soliciting bids is the norm, we recognize that there are times when the government needs to be able to direct contracts under \$25,000. Fourteen years ago, the threshold for competition was lowered in an effort to increase competition. Whether the threshold should be changed or not is a decision for policy makers and the government has committed to the Parliamentary Committee to investigate this. Under the current threshold, there are already a number of risks to fairness, openness and transparency to be considered to find the balance with efficiency and effectiveness.

## Introduction

1.21 Part of the mandate of the Office of the Procurement Ombudsman (OPO) is to review departmental practices for the acquisition of materiel and services to assess their fairness, openness and transparency and make any appropriate recommendations for improvement.

1.22 The review of procurement practices includes the conduct of research as well as studies on specific topics. The objectives of our studies are to ensure that the procurement community has a balanced understanding of the interests and concerns of government, suppliers and parliamentarians, and to publicize best practices with the aim of strengthening the federal government procurement process. Although the reports do not contain recommendations for improvement, the results may stimulate discussion about the evolution of the government's procurement practices.

## Purpose

1.23 The *Government Contracts Regulations* (GCRs) provide an exception to the need for competition when the dollar value of the contract is under \$25,000. OPO initiated this study to draw attention to the risks and benefits associated with these directed contracts.

1.24 We examined fairness, openness and transparency of the procurement process in relation to how these are balanced with efficiency and effectiveness, how perceived risks are currently being mitigated, and whether the risk mitigation measures are contributing to fairness, openness and transparency.

1.25 The study focussed on contracts for goods and services only, not construction contracts. Directed contracts under \$25,000, also known as low dollar value contracts, affect many commodities and many industries with very different business environments. In future work, this office may examine other elements of contracts under \$25,000 and their effects on fairness, openness and transparency.

## Description

1.26 A “directed contract” is a contract awarded to a preselected supplier where the contracting authority has justifiably set aside the requirement to solicit bids under the provision of one or more of the exceptions stated in the GCRs. It is sometimes referred to as “sole source” or “non-competitive”.

1.27 “Fairness” is the practice of providing equal treatment to all current and potential suppliers.

1.28 “Openness” is the practice of providing to all potential suppliers the opportunity to submit bids for government procurement.

1.29 “Transparency” is the practice of providing information to Canadians in a timely manner that facilitates public scrutiny of the decisions made and actions undertaken.

## Background

### Legal, regulatory and policy framework

1.30 The *Financial Administration Act* codifies the government's commitment to "taking appropriate measures to promote fairness, openness and transparency in the bidding process" for goods, services and construction contracts.

1.31 Arising from the *Financial Administration Act* is the principal regulatory instrument governing government contracting, the *Government Contracts Regulations* (GCRs). The GCRs prescribe the conditions for entering into contracts, chief among these being that bids should be solicited before entering into a contract, unless specific exceptions apply. One of these exceptions is that the estimated value of the proposed goods or services contract is less than \$25,000.

1.32 In 1995-96, in a review of government contracting, the House of Commons Standing Committee on Government Operations (now called Government Operations and Estimates, and referred to in this report as the Parliamentary Committee) found that "there is an over-proportionate volume of awards of sole source contracts by departments and agencies, thereby reducing competition in the private sector for government business." As a result, the Committee's recommendation to reduce the directed contracting threshold from \$30,000 to \$25,000 was implemented through an amendment to the *Government Contracts Regulations*. The threshold remains at \$25,000 today.

1.33 When the estimated value of the goods or services required is below \$25,000, the procurement is not subject to any national or international trade agreements. It may, however, be subject to the Comprehensive Land Claims Agreements that the Government of Canada has entered into with Aboriginal peoples. Many agreements include provisions dealing with economic and social development benefits affecting contracting in land claim areas.

1.34 As stated in the Treasury Board (TB) Contracting Policy, the objective of government procurement is "to acquire goods and services and to carry out construction in a manner that enhances access, competition and fairness and results in best value or, if appropriate, the optimal balance of overall benefits to the Crown and the Canadian people." One of the principles that dictate how government contracting will be done is that it will "stand the test of public scrutiny in matters of prudence and probity, ...and reflect fairness in the spending of public funds."

1.35 Under the TB Common Services Policy, Public Works and Government Services Canada (PWGSC) provides some mandatory common services for federal government procurement. Notwithstanding, departments have received contracting authority to do some contracting on their own, from either TB or PWGSC. As of April 1, 2010, PWGSC is encouraging departments and agencies to use their own authority for contracts under \$25,000, instead of sending them to PWGSC. PWGSC will focus on the more complex procurement, continue to focus on developing improved standardized tools for

government-wide purchasing of common goods and services, and departments will be able to leverage PWGSC's expertise.

### Context

1.36 In June 2009, the Parliamentary Committee produced a report titled *In Pursuit of Balance: Assisting Small and Medium Enterprises in Accessing Federal Procurement* after having studied the conditions surrounding small and medium sized enterprises' (SMEs') access to federal contracts. Some of the issues raised by suppliers were: it is impossible to get information on business opportunities; it is often difficult to understand what a department's real need is; it is difficult to get on the bid list for contracts; the selection process seems to favour insiders; and decision making seems arbitrary. Among several recommendations, the Committee recommended that a system of fairness to encourage departments to use SMEs be established.

1.37 The government presented its response to the Committee in October 2009. In response to that particular recommendation, it stated that it would investigate the possibility of increasing the directed contracting threshold for service contracts through consultations with SMEs, industry associations and the Treasury Board Secretariat.

1.38 Subsequently, the Parliamentary Committee members discussed a number of concerns about directed contracts under \$25,000 with the Procurement Ombudsman when he appeared before them at a December 2009 meeting. The Chair of the Committee stated, "I think the question around the table, in listening to everybody, is that the sole-sourcing under \$25,000 is a critical issue. You've stated that a person has to write down the reason for sole-sourcing, but who goes in and audits that reason? Who goes and spot-checks the reason? I have been in the procurement business in government and I know it's the comfort zone of utilizing that person, so how do we go about ensuring fairness? Because the small and medium-sized enterprises that are creators of jobs need that. How do you justify that \$25,000?" The Committee also wondered about how the under-\$25,000 procurement opportunities are publicized so that everybody has a chance to know they exist.

1.39 In response, the Procurement Ombudsman stated, "The bottom line is really that these are the issues that are not resolved through additional regulation. These are issues that are resolved when you have a culture that says we have to be accountable for our actions and ethical considerations are just as important as legal considerations in procurement."

1.40 Under the Values and Ethics Code for the Public Service, two of the professional values to be exemplified in the behaviours and actions of public servants are:

- how ends are achieved should be as important as the achievements themselves; and
- striving to ensure that the value of transparency in government is upheld while respecting their duties of confidentiality under the law.



## Why it Matters

1.41 In 2008, the government awarded a total of 368,849 goods and services contracts (including amendments) having a dollar value in excess of \$15.5B. Of these, 337,302 contracts or 91% are below \$25,000, which is consistent with statistics over the last ten years. While some of these contracts are competed, in 2008 more than 200,000 (roughly 60%) of the contracts under \$25,000 were awarded, either directly or using an Advance Contract Award Notice (ACAN), to a preselected supplier without competition, broken down as follows:

	Number of Contracts	Dollar Value
Goods	118,559	\$239M
Services	<u>81,464</u>	<u>\$356M</u>
Total	200,023	\$595M

1.42 According to the TB Purchasing Activity Report, directed contracts account for only about 3.8% of the total value of all contracts, and 56.8% of the total value of contracts under \$25,000. Although this may not represent a significant risk in terms of taxpayer dollars at stake, when more than half of all contracts are not open to competition, it is important that Canadians have confidence that this category of contracts is handled in a fair, open and transparent manner.

1.43 It is also important that departments treat all suppliers equally and not deal only with suppliers they already know or prefer, as this would not be fair to other suppliers.

1.44 Since 2005, unverified information collected by PWGSC from departmental financial systems indicates that the number of suppliers doing business with the government has been steadily decreasing, as indicated in the chart below.

Fiscal Year (April 1 to March 31)	Number of Suppliers
2005–06	305,000
2006–07	300,000
2007–08	272,000
2008–09	269,000

Data source: PWGSC "Spend Cube" – June 2010

Note: The Spend Cube is a collection of departmental financial systems. This system collects data voluntarily from departments and represents approximately 85% of Government of Canada spend.

1.45 As huge contributors to employment, innovation and the Canadian economy, suppliers should be treated equally and have access to government business.

1.46 As directed contracts, by their very nature, are not open to competition and, consequently, result in greatly reduced access to all qualified suppliers, enhanced transparency is required to compensate for this. Two key transparency measures are the TB policy requirements to justify and document decisions and to disclose information on contracts and amendments over \$10,000 after they have been awarded.

1.47 These measures are critical to meeting the government's commitment to transparency, supporting cases of administrative or judicial challenge, monitoring the use of public funds and holding public servants to account.

## Approach

1.48 We reviewed literature as well as the results of previous work carried out by our Office. We examined relevant policy and other guidance documents, and analysed feedback from a survey of four government departments, one professional association and three supplier associations.

1.49 Government participants included the Treasury Board Secretariat as a central agency, as well as Public Works and Government Services Canada as a common service organization.

1.50 Additional government participants included two program departments: Correctional Service of Canada (CSC), as it awards the most contracts under \$25,000 in the government, and Passport Canada as a small organization. We asked for responses from the following three distinct functional groups: departmental oversight; program managers with responsibility for a budget, i.e. responsibility centre managers; and materiel managers.

1.51 The Purchasing Management Association of Canada (PMAC) was asked to participate on a voluntary basis, as it is a national professional association for supply chain management professionals with more than 40,000 members and program participants working in all sectors of the Canadian economy.

1.52 Finally, three supplier associations were asked to voluntarily participate, principally because their memberships largely comprise small businesses. CABINET is an association of independent information technology consulting firms in the National Capital Region representing approximately fifteen companies and over 1,200 IT consulting resources. The Canadian Federation of Independent Business (CFIB) is a national association of 105,000 small business owners in virtually all economic sectors. The Canadian Association of Management Consultants (CMC) is a national association with approximately 3,000 members that administers the Certified Management Consultant designation in Canada and advances the practice and profile of management consulting in Canada.

1.53 It should be noted that we did not study the use of departmental acquisition cards (credit cards) to purchase low dollar value goods and services, nor review procurement files, investigate whether existing measures were effective in terms of mitigating risks to fairness, openness and transparency, or review other elements of contracts under \$25,000.

1.54 We also did not study the question of delegations of contracting authority within and among departments. Nor did we study the specific question of whether the threshold for competition should be changed, as the government committed to the Parliamentary Committee that it is looking into this matter.

## Observations and Analysis

1.55 In total, we received comments from 3 supplier associations, and 12 government respondents, including PMAC, which canvassed some of its members engaged in the federal government materiel management function. For that reason, their views have been included with the responses from the government respondents in this report.

### Policies and Practices may Jeopardize Fairness and Openness

1.56 According to section 5 of the *Government Contracts Regulations* (GCRs), soliciting bids through competition is the norm. Section 6, however, contains the following four main exceptions that permit the setting aside of the requirement to solicit bids:

- a. The need is one of pressing emergency in which delay would be injurious to the public interest;
- b. The estimated expenditure does not exceed \$25,000;
- c. The nature of the work is such that it would not be in the public interest to solicit bids; and
- d. Only one person is capable of performing the contract.

1.57 Federal employees work within a policy framework that sets out the requirements for contracting, including use of any of the GCRs exceptions to competition. When the estimated value of the contract is under \$25,000, examples of the guidance are as follows:

	TB Contracting Policy	TB Contracting Policy Notice 2007-04	PWGSC Supply Manual
<b>Procurement Strategy</b>	Call for bids whenever it is cost effective to do so.	The high cost of awarding a contract far outweighs any economic advantage associated with competing goods and services contracts under \$25,000.	Contracting officers must procure requirements below \$25,000 using the most efficient and cost effective approach to select a contractor, either by soliciting bids or by directing the requirement to a sole supplier when it is not cost effective to solicit bids.
	As of April 1, 2005, for specific commodities where PWGSC has developed standing offers in support of these commodities, the use of those standing offers is mandatory.	Continue using the standing offers and supply arrangements for those commodities that have been identified as mandatory, regardless of the dollar value of the requirement.	Some commodities are available via standing offers, and these must be used unless there is a valid reason to deviate.

1.58 Comments from departments and supplier associations suggested that ambiguity in the policy framework is resulting in inconsistent application. One supplier association stated: “Consistency between departments is an issue. Rules are not followed.” They also stated that another risk is “how the department interprets the rules (there seems quite a variation among departments).” These differences are creating frustrations in the supplier community, as they are required to adjust their approach depending on the department they are dealing with.

1.59 In OPO’s 2009/10 review of practices related to Procurement Strategies, the findings were similar. The practices review looked specifically at graphic design services and found that for the vast majority of these contracts, the dollar value is well below \$25,000. The supplying industry is almost entirely made up of SMEs, and they do expect to be provided with the opportunity to bid on government requirements. That review also found that the differences in the practices among the departments (some departments compete their requirements; others do not) resulted in confusion and additional work on the part of suppliers.

1.60 Depending on the context in which the goods or services are being purchased, different procurement strategies may be justified. Nonetheless, departments are interpreting and applying the policy guidance differently – which may be attributable to the wording used – and, consequently, they have developed inconsistent practices, which may jeopardize fairness and openness.

### **Documentation Standards Not Being Met**

1.61 Good documentation of the reasons for a decision is at the heart of the government’s transparency obligation; it is the key measure for ensuring transparency, particularly where contracts are not competed.

1.62 One department and one supplier association expressed concern about the process for approving directed contract requests under \$25,000. They cited onerous rules, extensive justifications and other controls such as senior level approvals as risks to the efficiency, effectiveness, simplicity and timeliness of the process.

1.63 Once a decision has been made to direct a contract, we would expect at least three key decisions to be justified and documented before contract award:

- 1) Why the contract was not competed, as this is an exception to the norm;
- 2) Why the contract is being directed to a particular supplier; and
- 3) Why the price is considered fair and reasonable in the absence of competition.

1.64 In the practice reviews and investigations carried out by our Office, we have repeatedly observed the lack of essential documentation to explain and support the decisions made and actions undertaken. As noted in our 2009/10 Annual Report, despite the requirements of the TB Contracting Policy, the duty to keep accurate records under the North American Free Trade Agreement, as well as departmental

manuals and the numerous calls for proper documentation of files by internal audits, the Auditor General and the Gomery Commission, this problem persists and it is troubling.

1.65 In 2010, the Office of the Comptroller General carried out the *Horizontal Internal Audit of Contracting for Professional, Technical and Temporary Help Services in Small Departments and Agencies*. Of the 19 organizations audited, they found that contracts entered into through sole sourcing were not sufficiently justified, that there was a lack of analysis to determine whether alternatives to contracting or to the choice of contracting tools had been considered; and that greater rigour was required to mitigate possible risks from improper use of sole sourcing and standing offers.

1.66 The policy guidance which sets out the framework to justify and document contract files includes:

	TB Contracting Policy	TB Contracting Policy Notice 2007-04	PWGSC Supply Manual
<b>Justify and document files</b>	Any use of the four exceptions to the bidding requirement should be fully justified on the contract file.	Any use of the four GCRs exceptions to competitive bidding should be fully justified by the contracting authority, with appropriate documentation placed on the contract file.	The rationale for any exception to competitive procurement must be provided and adequately supported; use of any of the GCRs exceptions must be fully justified by the contracting officer with appropriate documentation placed on the contract file.
	In some circumstances, it may be appropriate to direct a contract to a particular firm without any competition as permitted by section 6 of the <i>Government Contracts Regulations</i> . Contracting authorities shall fully document the circumstances in each case that justify using this selection method.		Contracting officers must document the procurement file with the rationale to support the procurement strategy, and must also document the basis on which the estimated value of the contract, that is, below \$25,000, was established.

1.67 In addition to the above, there are a number of other sources of guidance that must be observed. For example, the TB Policy on Information Management (2007) states that Deputy Heads are responsible for, among other things, “ensuring that decisions and decision-making processes are documented to account for and support the continuity of departmental operations, permit the reconstruction of the evolution of policies and programs, and allow for independent evaluation, audit, and review.” Consequences for non-compliance can include:

- “informal follow-ups and requests from the Treasury Board of Canada Secretariat, external audits, or formal direction on corrective measures”; and
- “any measure allowed by the *Financial Administration Act* that the Treasury Board would determine as appropriate and acceptable in the circumstances.”

1.68 To strengthen the transparency aspect of directed contracts, in the early 1990s, the government introduced a mechanism known as an Advance Contract Award Notice (ACAN), which publishes a department's intention to award a directed contract. The TB Contracting Policy indicates that departments should, whenever possible, use ACANs even if a proposed directed contract qualifies using one of the four exceptions provided by the GCRs. One case of particular sensitivity for which an ACAN is recommended, even when the dollar value is under \$25,000, is contracting with former public servants.

1.69 However, as noted in our 2008/09 review of procurement practices related to ACANs, we found a number of deficiencies with implementation. This included the majority of files containing inadequate documentation to support decisions made. If transparency obligations are not fulfilled, this measure does not compensate for diminished fairness and openness of federal government procurement.

1.70 Lack of essential documentation on files weakens transparency. It also raises questions about the integrity of the procurement process. When the Procurement Ombudsman appeared before the Parliamentary Committee in December 2009, he stated, "Let me just say that this is not a new issue. For 30 years, almost any audited [sic] report that I've read has raised exactly that issue with government procurement: lack of documentation." He further stated, "What we did this year was try to find out why it is happening. There were two explanations we got this year. One was resource constraints. People said they didn't have enough time to do the transaction [contract] and asked, 'Where do we find the time to do the file?' The second one was on the issue of technology. As you know, with the use of technology, information management is raising a whole series of new issues. How do we translate that into the paper file?...People need some training in this, but there's no time to give them training because everybody's doing transactions [contracts]."

1.71 Respecting the Values and Ethics Code for the Public Service, which includes ensuring the value of transparency is upheld, is a condition of employment for all public servants.<sup>1</sup> It falls to the responsibility centre managers, procurement personnel and those responsible for oversight to contribute good written information to support decisions made during a procurement process.

### **Comfort Zone of Working with Known or Preferred Suppliers**

1.72 Departments and supplier associations both indicated value and/or savings can be achieved by working with known suppliers that have known track records. They also perceived increased efficiencies because a known supplier has familiarity with the department's mandate and ways of doing business.

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<sup>1</sup> The Values and Ethics Code for the Public Service applies to all public servants subject to the *Public Service Labour Relations Act*.

1.73 However, they identified the following risks that may arise from this practice:

- Work being scoped to stay under the competition threshold. This may compromise the efficiency and effectiveness of program delivery if departments are contracting for something less than what they really need;
- Repeatedly using the same suppliers. In the TB Contracting Policy section that addresses consulting and professional services, it states: “Repeat commissioning of a firm or individual without competition should not become a practice, even if the value of the contract is under the mandatory threshold for the calling of bids.” This may diminish access for others, increasing the risk to fairness and equal treatment of all suppliers;
- Providing the selected supplier with an advantage in later competitions. One supplier association commented that directed contracting is used by all sizes of companies to further their competitive advantage for downstream opportunities;
- Contract splitting – contracting for a project in several smaller parts. This is a more serious issue as the TB Contracting Policy states that “contracting authorities must not split contracts or contract amendments in order to avoid obtaining either the approval required by statute, the Treasury Board Contracts Directive or appropriate management approval within the department or agency.”

1.74 The measures identified by departments that are currently being used to mitigate the risks to balancing efficiency and effectiveness with fairness, openness and transparency tended to be transaction-oriented, e.g. ensuring good price support, documenting the file well with good justifications, having all requests over \$10,000 reviewed by a contract review committee.

1.75 Suggestions made by departments and supplier associations for potential additional measures tended to be more holistic in nature, such as training and taking a risk-based approach to monitoring.

### Need for Proper Training

1.76 With respect to training, the Treasury Board Secretariat indicated that the government had determined that one of the most significant risks associated with procurement, not just directed contracts, is the training and experience of its procurement specialists. For that reason, a few years ago, a certification program for procurement personnel was introduced as a component of the federal government’s Professional Development and Certification Program for the Procurement, Materiel Management and Real Property Community.

1.77 Currently, there are over 3,200 procurement specialists in the federal government. This does not include the many other employees involved in procurement, such as materiel managers, responsibility centre managers, procurement oversight personnel, as well as administrative and technical staff. Estimates for these categories of employees range as high as 20,000 in total.

1.78 Since the Certification Program was launched in 2006, only 600 functional specialists in procurement and materiel management from 47 different departments and agencies have enrolled. Four years later, only 16 specialists in procurement, 1 specialist in materiel management, and 1 specialist in both have completed the first of three levels of their specific certification program. This is due to a number of challenges with implementation, such as lack of qualified instructors, insufficient number of participants to meet minimum class size; and the fact that certification is not mandatory. It can take three or more years to complete the first level of certification so, coupled with resource and budget constraints, this often leads to registered individuals abandoning their training plans.

1.79 In 2006, the government also released the Directive on the Administration of Required Training which required departments to identify specialists in procurement, materiel management and real property. It is mandatory that these specialists take six basic training courses. The results here are much better; it is estimated that over 10,000 of those identified have completed the required training.

1.80 The Certification Program and the required training mentioned above, however, are not targeted at other employees who have procurement-related responsibilities – responsibility centre managers and departmental oversight personnel.

1.81 The Office of the Comptroller General's (OCG) *Horizontal Internal Audit of Contracting for Professional, Technical and Temporary Help Services in Small Departments and Agencies* (2010) found that many of the officials responsible for fulfilling the oversight role were not familiar with the intent of many of the contracting policies and regulations or the risks associated with contracting activities. The audit also pointed out that there was limited guidance for those performing the challenge function. Though the audit did not specifically recommend training, it did say that those responsible for oversight should be aware of the importance of their challenge function.

1.82 While procurement is a component of training on delegated financial authorities that new managers, supervisors and executives are required to take, this may be insufficient for their responsibilities – in particular, when awarding directed contracts under \$25,000. Departments specifically suggested additional training for responsibility centre managers as a risk mitigation measure. A number of courses are already available on-line – an accessible method for training large numbers of people without incurring course fees and travel costs.

1.83 When the Procurement Ombudsman appeared before the Parliamentary Committee in December 2009, he stated, “lately people have been thinking of training. I looked at some of the training plans, and everybody’s plan shows four or five days of training, but nobody gets more than a day or two simply because there are just too many transactions [contracts].”

1.84 The government is facing a resource challenge as a large percentage of the workforce retires; the need to train those involved in procurement to ensure and maintain a knowledgeable workforce is more critical than has been the case in previous



years. Without proper training, the risks to fairness, openness and transparency of the procurement process are increased.

### Strategic Monitoring and Management

1.85 With regard to taking a risk-based approach to monitoring, the OCG's *Horizontal Internal Audit of Large Departments and Agencies: Contracting Information Systems and Monitoring* concluded that "there is an opportunity to advance to a strategic based model of monitoring and risk management that would improve management effectiveness and apply the principles of active monitoring with regard to contracting activities." It found that the nine large departments and agencies audited have not defined the contracting information required to support risk management and decision making beyond the transactional level, although they do have the information in an information management system.

1.86 This begs the question whether this is also the case in the departments and agencies not included in the audit. We know that for purposes of the quarterly proactive disclosure report, the annual TB Purchasing Activity Report, as well as other reports required for project and financial purposes, they are already recording numerous data elements. What we do not know is whether they have an information system that will assist them with the analysis of this information.

1.87 Suggestions made by departments and supplier associations for useful information that should form elements of risk-based monitoring mirrored a number of the OCG's audit suggestions. These include contract awards by supplier over a period of time (total number, total dollar value, responsibility centre managers who are requesting them), proportion of directed contracts under \$25,000, and amendment analysis by supplier.

1.88 The Procurement Ombudsman, during his appearance before the Parliamentary Committee in December 2009, stated, "My understanding is that all internal audits are supposed to be done based on a risk-based plan. What are the risks to the organization? If they identify procurement under \$25,000 as a high-risk area, they should be doing internal audits in that area."

1.89 The necessary information exists to achieve more strategic monitoring and managing of departmental procurement activity. If the information is analysed, the results can be used to mitigate risks to fairness, openness and transparency such as perceived favouritism for a specific supplier and contract splitting. Analysis of contracting information can also be used to inform other departmental plans affecting procurement activity, such as procurement plans and training plans.

### **Effect on Access**

1.90 We asked departments and supplier associations whether directing contracts under \$25,000 promotes increased participation of SMEs in government procurement.

1.91 The majority of responses from departments agree and some commented that directed contracts for services provide a means for SMEs to participate in government procurement without incurring what is perceived to be the considerable expense associated with open competitions. They also stated that directed contracts provide an opportunity for SMEs and other suppliers to obtain government experience, which may, in turn, permit them to meet mandatory government experience requirements in the larger, open competitions.

1.92 The responses from all supplier associations indicated concern that directed contracts under \$25,000 generally go to suppliers that are already known to the department, so the supplier base is not expanded by directed contracting. If this were proven to be true, this would undermine access and fairness.

1.93 Two of the three supplier associations indicated that contracts under \$25,000 are likeliest where their members are participating, and that this category of contracting is well-suited to SMEs; the cost of bidding and resources needed to prepare the documentation required for open competitions were suggested as reasons.

1.94 Statistics provided by PWGSC and published in the Parliamentary Committee's report indicated that the total number of federal government contracts awarded to SMEs between 2004 and 2008 was between 64 and 68% of the total number of all contracts.

1.95 There is little support for treating under-\$25,000 contracts as a small business set-aside (i.e. designating that a percentage of all contracts would be awarded to SMEs). The majority of SMEs that were consulted during the Parliamentary Committee hearings on the federal procurement process indicated they were not supportive of small business set-asides. In the end, the Parliamentary Committee stated in its *In Pursuit of Balance: Assisting Small and Medium Enterprises in Accessing Federal Procurement* report that "set asides, though useful in other policy areas, are not the preferred system of fairness."

1.96 While it appears there is general agreement that it is likely easier and less costly for SMEs to participate, we are not aware of any publicly available analysis of the award of directed contracts under \$25,000 to SMEs versus large companies, nor are we aware of impediments to large companies accessing this business.

#### Timely and Useful Information Needed

1.97 In 2004, the government implemented a series of measures to strengthen public sector management by enhancing transparency and oversight of public resources in the federal government. One of these measures introduced modern, real-time information systems to track spending and provide appropriate tools for effective scrutiny and decision-making. This includes the mandatory publication of contracts entered into by the Government of Canada for amounts over \$10,000. Proactive disclosure of information after contract award, like good file documentation to support decision making, is a key measure that supports transparency when suppliers are not provided with the opportunity to bid.

1.98 Transparency, however, was a particular concern for the supplier associations because they indicated that there is a lack of public knowledge about when directed contracts, in particular, are awarded. As government information systems have limitations, departments are required to publish their proactive disclosure reports quarterly.

1.99 Two supplier associations suggested that improving the utility and timeliness of contract reporting would be useful additional measures to mitigating risks to the balance between efficiency and effectiveness, on the one hand, and fairness, openness and transparency, on the other. One suggested a specific list of directed contracts should be published; the other stated that all contract awards, not just those over \$10,000, should be published. In addition, having contract award information in a timely manner would allow them to assess procurement trends by department.

1.100 In a 2009 survey carried out by the Canadian Federation of Independent Business on federal procurement, businesses indicated that one of the reasons they had not sold to the federal government in the last five years was because they have no means of determining what the federal government wants to purchase.

1.101 We reviewed the proactive disclosure websites of the departments participating in our study and found that not all departments are following the TB guidelines on proactive disclosure. Of the four departments, the Correctional Service of Canada is the only one that publishes all of the recommended information. In its present form, however, the information that is required to be provided is not detailed enough for conducting a meaningful analysis. For example, information is consolidated by department without indicating the geographic location or the sub-organization that made the purchase. Further, the differences in the existing formats make the data difficult to consolidate across departments. As a result, the information is not very useful to Canadians, which diminishes transparency.

1.102 We further note that the TB Purchasing Activity Report will not include government-wide data on the number and dollar value of contracts (call-ups) against standing offers and supply arrangements until 2012. Regardless of whether these contracts are competitive or directed, the current plan is to report an aggregate for all contracts under \$25,000; only contracts having dollar values over \$25,000 will be reported individually. Publishing of an aggregate report of contracts under \$25,000 along with the weaknesses in the proactive disclosure reporting will continue to be risks to transparency of the procurement process.

1.103 The current state of publicly available procurement data appears as an impediment to effective scrutiny and being able to assess procurement trends by department or across government, whether it is for purposes of deciding to pursue government business and how to access it, or whether it is so that people can properly prepare themselves if they want to participate in discussions on procurement practices.

1.104 The information provided to us by PWGSC indicates that, over the past four years, the number of suppliers that received government contracts has dropped from approximately 305,000 to 269,000 – a decrease of roughly 12%. Canadian Federation

of Independent Business comments in response to our survey also indicate the number of suppliers to the federal government is decreasing. While the government has not done an analysis and does not know if procurement policies and practices have affected access to government contracts, a large percentage of which are directed contracts under \$25,000, the above findings indicate risks to fairness, openness and transparency.

### **Do Efficiency Gains Offset Risks?**

1.105 Most departments and supplier associations stated that the process for awarding directed contracts under \$25,000 is less costly and simpler, both for departments and suppliers, than a competitive process. Two supplier associations are of the opinion that the efficiency benefits of directed contracts under \$25,000 offset whatever risks there may be to a fair, open and transparent procurement process.

1.106 Departments indicated that they view directed contracts under \$25,000 as essential, low risk, administratively efficient and effective in responding to operational needs. All three supplier associations were generally of the same view.

1.107 There was substantial divergence of viewpoints, however, about whether the government considers its administrative costs when determining the appropriate sourcing strategy. Administrative costs would include office wages, salaries and necessary administration and management expenses of all those involved in the procurement process.

1.108 All supplier associations and about one-third of the departments that responded indicated they do not believe that these costs are considered when determining whether to compete or direct a requirement under \$25,000. One of these respondents commented there is no specific data on this, which seems to support another comment that the government has little idea of its administrative costs.

1.109 The other two-thirds of the responses from departments indicated administrative costs are considered, but commented that there may not be an actual calculation, and these costs may not outweigh other factors in determining which method should be used.

1.110 The nature of the comments made by respondents from departments also suggested that they view time and effort from the perspective of their individual roles, rather than from a departmental perspective.

1.111 In departments where responsibility centre managers have the authority to approve contracts, it may be that they are responsible for the whole process in the case of directed contracts under \$25,000. As they are not typically specialists in procurement, there is a risk to fairness and transparency as well as efficiency as they have to prepare justifications for the non-competitive strategy and the selected supplier. In addition, where departments have decided that approval of directed contracts under \$25,000 is required from a higher level of authority or a contract review committee as a risk mitigation strategy, additional time and effort is required for the approving authority to review the request and document the decision. The responsibility centre manager may

also be required to modify the strategy if the approving authority provided either a conditional approval or rejected the request, which may further reduce efficiency.

1.112 We understand that these are low dollar value contracts and it may be efficient to direct them on an individual basis. The government has not, however, analysed the costs associated with directing contracts under \$25,000 to demonstrate sufficient gains in efficiency to offset risks to fairness, openness and transparency. In addition, there may be an even greater impact when the whole collection of directed contracts under \$25,000 is considered on an organization-wide basis.

### Mandatory use of Standing Offers and Supply Arrangements

1.113 Standing offers have existed since the early 1960s and were developed to reduce the number of solicitations and contract negotiations for repetitively ordered goods and services. The use of these tools for specific commodity groups became mandatory, government-wide, in April 2005 to ensure, among other things, that procurement is efficient and effective.

1.114 One of the supplier associations pointed out that the need for directed contracting should be limited because, for common goods and services, standing offers and supply arrangements have been put in place by PWGSC.

1.115 Most standing offers have already been competed, and the supply arrangements serve as lists of pre-qualified suppliers with the added efficiency that most of the terms and conditions of any resulting contract have already been established. As pointed out by one of the supplier associations, these tools can minimize the effort required to award a contract, which would increase efficiencies. For example, in the case of supply arrangements, competitions can typically be closed in five to ten business days.

1.116 In fact, the TB Contracting Policy Notice on Non-Competitive Contracting states that departments and agencies are required to continue using the standing offers and supply arrangements for the following commodity groups that have been identified as mandatory, regardless of the dollar value of the requirement:

- Information Processing and Related Telecom Services
- Professional, Administrative and Management Support Services
- Ground Effect Vehicles, Motor Vehicles, Trailers, and Cycles
- Telecommunications Equipment and Accessories
- General Purpose Automatic Data Processing Equipment (including Firmware), Software, Supplies and Support Equipment
- Furniture
- Office Machines, text processing systems and visible recording equipment
- Office Supplies and Devices

- Clothing, Accessories and Insignia
- Fuels, Lubricants, Oils and Waxes

1.117 In theory, few requirements should fall outside these commodity groups. In 2009, PWGSC-Acquisitions Branch carried out a client satisfaction survey. Of the 375 respondents, 86% said they use standing offers and supply arrangements. This raises the question as to why, in 2008, there were still more than 200,000 directed contracts under \$25,000 awarded without following the TB Contracting Policy to use the mandatory tools – is it because procurement personnel and/or responsibility centre managers are not aware of, or have not been properly trained on the procurement tools available to them?

1.118 As stated in our 2009/10 Study on Methods of Supply (Standing Offers and Supply Arrangements), the government is refocusing its efforts to support better commodity management and procurement tools. It is, therefore, too early to determine that this effort will address the balance between efficiency, effectiveness and fairness, openness and transparency.

#### Other Means of Contracting

1.119 When there is no standing offer or supply arrangement in place for a particular good or service, there are means other than directed contracting that would be more fair, open and transparent; different strategies may also be appropriate, depending on the context. These include the following:

- Requests for Quotation (these documents may not contain all of the terms and conditions that are typically used to form a contract; bids may be evaluated and compared on the basis of price and delivery);
- Telephone buys, which are a form of Requests for Quotation (bids are solicited verbally (in-person or over the phone)); and
- Invitations to Tender (these documents may not contain all of the terms and conditions that are typically used to form a contract, but selection is based on lowest price only).

1.120 Both the volume of directed contracts and comments made by departments and supplier associations regarding competitive contracting raise questions about whether alternatives to the use of open bidding are considered in sourcing decisions. In the main, they indicated that the time and effort associated with competition are excessive.

1.121 The Correctional Service of Canada, however, indicated that most of its regional operations request three quotes before awarding a low dollar value contract. It also provided information indicating that over a four-year period, more than 80% of the under-\$25,000 service contracts issued by its national headquarters office were issued to a different supplier. As the department reporting, by far, the most contracts in the under-\$25,000 category in government, it would appear that other means of contracting

are workable and are also effective in mitigating the risk of repeat contracting with known suppliers by being fair and open.

1.122 Passport Canada and one supplier association indicated an interest in pursuing the use of pre-qualification lists and source lists, particularly in the case of service requirements. This is based on the perception that there are many excellent SMEs that are not on standing offers because they do not have the resources to compete in open competitions or have opted out of competitive processes because they consider their chances of winning a standing offer to be slim when competing with large suppliers. In our view, these lists could serve as the starting point for any one of the other means of contracting described above.

1.123 The TB Contracting Policy provides some guidance in this area that may be useful at a departmental level where it discusses processes for consulting and professional services; it advises the following:

“Representative and up-to-date inventories or source lists of firms that provide consulting and professional services and wish to do business with the federal government should be maintained for consistency, economy, effectiveness and fairness in selecting and procuring best value. These inventories should be consulted before inviting bids or proposals or recommending a non-competitive selection.”

1.124 The TB Contracting Policy further states that consulting and professional services can be chosen using competitive bidding in several ways and mentions having an inventory that could be used to produce a short list of enough suppliers to produce competition, and competitive proposals could then be invited from the suppliers on the short list.

1.125 If departments were to pursue pre-qualification lists or sources lists, care would need to be taken to ensure no duplication with the standing offers and supply arrangements that are already in place and that have been declared mandatory for departments to use; care would also need to be taken to ensure that there is consistency in the terms and procedures used by departments.

1.126 Not only would other means of contracting alleviate challenges to the principles of fairness, openness and transparency, they can have the following benefits: (a) the involvement of responsibility centre managers could be more efficient, reducing administrative costs; (b) the effort associated with the process for obtaining higher level or contract review committee approval of the procurement strategy could be removed from processing time which should result in increased efficiency; and (c) contract review committees would be able to spend time reviewing the collection of contracts under \$25,000 from a more strategic perspective, which should lead to greater assurance that fairness, openness and transparency concerns are being addressed.

1.127 In addition, other means of contracting could mitigate the risk of repeatedly contracting with known suppliers; expand the supplier base; and engage suppliers who do not compete in larger competitive processes.

## Conclusion

1.128 We know from the 2009 report titled *In Pursuit of Balance: Assisting Small and Medium Enterprises in Accessing Federal Procurement* that the list of issues with government procurement heard by the Parliamentary Committee in 1995 is largely the same today, at least for contracts under \$25,000.

1.129 There has been some discussion lately on whether the \$25,000 threshold for allowing directed contracts needs to be revised. In its October 2009 response to the Parliamentary Committee, the government committed to investigate the possibility of increasing the directed contracting threshold for service contracts through consultations with SMEs, industry associations and the Treasury Board Secretariat. This study, therefore, did not examine the appropriateness of the current threshold.

1.130 We focused on how the government balances the operational efficiencies arising from directed contracts under \$25,000 with the fundamental principles of fairness, openness and transparency in the procurement process.

1.131 We found that the government recognizes that the principles of fairness and openness could be negatively affected by directed contracts, and to compensate for this, government policies call for stronger transparency. This is to be achieved firstly by ensuring that procurement files contain documentation to justify and explain the decisions to direct a contract and the basis for selecting a particular supplier. A second requirement in support of transparency is the requirement to proactively disclose all contracts over \$10,000 on the government's websites.

1.132 Our study found shortcomings in the implementation of both of these risk mitigation strategies.

1.133 The requirement for having essential documentation is stated in various guidance documents and ensuring that the value of transparency is upheld is a condition of employment under the Values and Ethics Code for the Public Service. Not having proper documentation on files raises questions about the integrity of the procurement process and impedes the attainment of the government's stated objective of transparency in procurement.

1.134 Not all departments are following the Treasury Board guidelines on proactive disclosure. The information that is required to be disclosed is not detailed enough for conducting a meaningful analysis and the differences in the existing formats make the data difficult to consolidate across departments. This appears as an impediment to being able to assess procurement trends by department or across government, whether it is for purposes of deciding to pursue government business and how to access it, or properly preparing if people want to participate in discussions on procurement practices.

1.135 Although procurement and materiel management specialists are receiving basic training, this may not fully address the training requirements of others involved in the procurement process – responsibility centre managers and departmental oversight personnel. The government is facing a resource challenge as a large percentage of the workforce retires; the need to train those involved in procurement to ensure and



maintain a knowledgeable workforce is more critical than has been the case in previous years.

1.136 Mandatory use of standing offers and supply arrangements for repetitively purchased goods and services can mitigate the risks to fairness and openness for contracts under \$25,000. These tools can increase efficiency because contracts can be issued quickly. Despite the fact that using these tools is mandatory and only specialized requirements should be contracted outside them, the volume of directed contracts remains high and raises the question as to why. To date, the government has not completed an assessment of the impact of these mandatory tools.

1.137 In addition to directed contracts or standing offers and supply arrangements, there are other means of contracting that can be considered in certain circumstances. These include using simpler forms of competition such as requests for quotation, telephone buys and invitations to tender. These other means would promote fairness, openness and transparency and have a number of other benefits for departments and suppliers.

1.138 While soliciting bids is the norm, we recognize that there are times when the government needs to be able to direct contracts under \$25,000. Under the current threshold, there are already a number of risks to fairness, openness and transparency to be considered to find the balance between efficiency, reduced access to all suppliers and transparency in government procurement.