



# IT Hardware Maintenance: Interim Report on Internal Audit Work

December 2003

7053-30-8 (CRS)



Severances under sections 16 (1) c), 20 (1) c) & 23 of the AIA

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This page updated 7 Jul 04

# Overview

Synopsis Updated/Amended 11 Jan 04 & minor edit 01 Feb 04

## Synopsis:

*This report presents certain interim results of audit work performed by the DND Chief of Review Services (CRS) with the objective of reconstructing, analyzing and situating circumstances pertaining to contracting for the provision of Information Management (IM) and Information Technology (IT) maintenance support services. This reconstructive audit work is progressing in the context of analysis and review to ascertain the scope, causes and implications of a serious breakdown in control, as well as to assess the sufficiency of corrective action.*

*In our view, the report very much illustrates that the Departmental control framework must make a transition to new control philosophies based on Smart Controls, that is, to controls which exploit risk management and technology. This will require significant front-end investment, much of it intellectual, including attention to recent and longstanding internal audit recommendations. Necessary changes will not happen overnight, but we have demonstrated that interim solutions can be pursued. We also believe that the conditions are not necessarily specific to the DND/CF. Traditional, labour-intensive controls are no longer practical; new approaches should ultimately prove more effective. Functional authorities must manage complexity, as well as provide practical guidance/direction and training, well-designed/risk-oriented delegated authorities, appropriate standards, monitoring and reporting. The current difficulties with IM/IT maintenance contracting provide an imperative to focus immediate and longer-term efforts in this respect.*

*It will be necessary for internal audit to contribute expertise in the use of technology, to continue to provide independent assurance audits and to prepare an annual report which includes an assessment of the Departmental control framework. However, notwithstanding three Enterprise Management Systems, shortcomings in the capture of information continue to hamper our audit capacity to provide early warning. This has pointedly been the case with respect to contracting, and has repeatedly been reported as such.*

# Overview

## Synopsis: (continued)

*Internal audit work in the past few years speaks to weaknesses in fundamental internal controls. However, large, randomly-selected transaction samples also help to set limits on the extent to which current IM/IT contracting issues can be extrapolated across the different management streams through which goods and services are acquired by the Department. For example, a major audit of the Management of Local Funds could not offer positive assurance, but did suggest that there are DND/CF organizations exercising relatively tight control over their resources. For example, it was found that the Chief of the Maritime Staff had a reasonable financial control regime within NDHQ -- lessons can be learned from their approach. Similarly, a prior audit of over 300 service contracting transactions, found an error rate of about 6 per cent in terms of compliance with contracting policy and the Financial Administration Act (FAA). Additionally, our internal audit of contracting for advertising services observed a breakdown in financial controls, but was able to obtain confirmation that goods and services had been received for recent contracting transactions. The principal control was that the responsible management team was business oriented and had demanded delivery of product.*

*Notwithstanding the apparent cooperation between external and internal players, and the similarly apparent efforts by individuals to disguise the substance of IM/IT contracting transactions, basic financial controls and monitoring would have brought critical attention to red flags around this situation.*

*Our work to date has also identified additional lines of inquiry which we will continue to pursue. These are outlined in this report, under the heading the Way Ahead. They include such issues as the visibility of the IM/IT asset base, including software, and the reasonability of maintenance, replacement and renewal expenditures.*

*It is also important to point out that we have encouraged that management formulate an integrated, corporate improvement/action plan. This is underway and we anticipate receiving this action plan in the near term.*



# Overview

Severances under sections 16 (1) c), 20 (1) c) & 23 of the AIA

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# Overview

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# Overview

Severances under sections 16 (1) c), 20 (1) c) & 23 of the AIA

## Introduction & Background: (continued)

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### Other Pertinent CRS Work:

Analysis of Risk Facing the Public Service. In August 2001, the current CRS led and co-authored, a study sponsored by the TBS Centre of Excellence for Internal Audit. That study, *Internal Audit Planning Perspectives: Risks Facing the Delivery of Results for Canadians*, was scoped to be public-service wide, and cited risk regarding the sufficiency of resources "...to protect program integrity and lack of appropriate controls and support systems necessary to ensure responsible spending". The study also stressed the criticality of modern comptrollership to responsible spending: "If program managers do not embrace the principles and practices of modern comptrollership, this would be a serious setback for responsible spending." The study report further stated the following:

# Overview

## Introduction & Background: (continued)

### Other Pertinent CRS Work: (continued)

*“Risks arise in seeking to devolve decision-making while promoting a focus on results. This is especially so if devolution has been accompanied by downsizing on the front lines of service delivery. These risks can be further exacerbated if devolution has outpaced the introduction of risk management strategies and tools as well as new smart controls, particularly those that capitalize on new technological enablers and are less resource-intensive. It becomes a question of appropriately balancing service and control objectives.”*

*“...there must be corporate visibility of, and guidance to, the conduct of public business at all levels within the public service. Guidance, enablers and monitoring must be in place. In addition, delivery systems will typically have fewer resources. Accordingly, the timely and effective implementation of new control philosophies, as reflected in modern comptrollership will be critical. Smart controls must be designed to exploit the capabilities of enterprise management systems. For example, new interfaces between people and IT can achieve more effective controls than those that were more resource intensive and existed previously (e.g., segregation of duties). IT systems and smart edit functions which learn with each transaction processed, can flag high risk/abnormal transactions and contribute to effective quality control. The danger is that during the period of transition, longstanding controls may be set aside before new controls are in place. Enterprise management systems have much capability, but this sophistication is accompanied by complexity and associated risks.”*

Finally, this study report, which was designed to be updated annually by the TBS, provided a road map for audit activity and arrived at a listing of the top management risks/opportunities facing public service management in the delivery of Results for Canadians. Among the topics listed are the following: Contracting Strategies and Management; Financial Management; Devolution and Smart Controls; and, Integrated Risk Management. This report was influenced by, and has since guided, DND Internal Audit planning and recommendations. In many aspects, it provides an important frame of reference for analyzing serious problems related to much of DND’s IT procurement as well as to financial and procurement controls in the larger context.



# Overview

## Introduction & Background: (continued)

### Other More Specific CRS Work:

CRS Audit of the Management of Local Funds. A major (18-month) assurance audit of the *Management of DND/CF Local Funds* (~ \$1.2B annually) has been reported in draft. Variation across sites visited precluded a conclusive statement by the auditors regarding department-wide financial management practices and controls. The variation was attributed to factors including: inconsistent policies; unclear authorities; and, varying experience and training with respect to financial management. Key recommendations focus on standards and monitoring for financial administration, improved systems interfaces, policy clarification (including account/invoice verification requirements) as well as improved risk management. Note that this work was performed largely as follow-on to a CRS *Review of the Management of Operating Budgets*, reported in 2001, which identified major control weaknesses.

CRS Audit of Contracting for Advertising & Related Services (Sponsorship). This completed audit included comment on financial authorities and controls. It observed on weaknesses in expenditure authorization and invoice validation. However, it was also reported that the Central Departmental Accounting Office, within the Finance and Corporate Services Group, had ceased performing the post-payment verification required by DND and TBS policy, and that high-risk transactions were not consistently reviewed in advance of payment. There was also insufficient training of those involved in this contracting process. Among other things, the audit recommended improved monitoring, training, segregation of financial duties, and clarification of the requirements of those responsible for requisitioning payments to suppliers (i.e., FAA Section 33 Certification).

CRS Audits of Contracting for Services. A report, finalized in 2002, communicated the results of a major audit of *Contracting for Professional and Technical Services*. Certain of the key findings pertaining to systemic issues involving authorities, guidance, information and oversight were similar to those reported in 1995. The 1995 report called for the Department to "...rethink the management of the service contracting process at a macro-levels." The more recent audit concluded that the most important of the issues was "...the longstanding, and increasingly pressing, need for improved information so that the inherent risks in service contracting can be monitored and managed at the corporate level. This lack of information impeded our capacity to assess the extent of any non-compliance with applicable contracting policies and regulations."

# Overview

Severances under sections 16 (1) c), 20 (1) c) & 23 of the AIA

## Introduction & Background: (continued)

### Other More Specific CRS Work: (continued)

The 1995 report on Service Contracting also made the following observation: "...The role of common service organizations (e.g., PWGSC) has evolved such that they no longer appear to provide the same level of safeguards limiting the opportunity for unacceptable contracting practices to occur...."

CRS Baseline Survey of Risk Management. As follow-up to a CRS *Survey of Risk Management Principles and Practices*, a draft CRS report has been released on the state of risk management within the DND/CF. While observing that there are pockets of sophisticated risk management, particularly for military operations, flight safety etc., integrated risk management is at early stages of development within the DND/CF (as well as in most other departments). Covering correspondence to this report emphasizes the importance of a risk-managed approach to the design of delegated authorities, monitoring and oversight.

CRS Risk Analysis of DND Contracting. In response to DM direction, CRS has produced an interim report which has applied systematic criteria to identify 25 higher-risk DND contracts from an active population of 12,000. This methodology has relied on the PWGSC database of contracts and is now being progressed in conjunction with management. The interim report makes systemic recommendations to advance DND's capability to monitor its contracting.

Management Review of DND IM/IT Contracting. This review is now in the reporting phase and has been performed by PricewaterhouseCoopers, in collaboration with CRS. It has the objective of providing a high-level assessment of controls and to assess the sufficiency of corrective action plans by DND/CF management. It is being further assisted by an advisory panel of a serving ADM from another department, as well as a former ADM who served in another department.

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# Overview

Severances under sections 16 (1) c), 20 (1) c) &  
23 of the AIA

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# Overview

Severances under sections 16 (1) c), 20 (1) c) & 23 of the AIA

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# Overview

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# Overview

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# Overview

Severances under sections 16 (1) c), 20 (1) c) & 23 of the AIA

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# Overview

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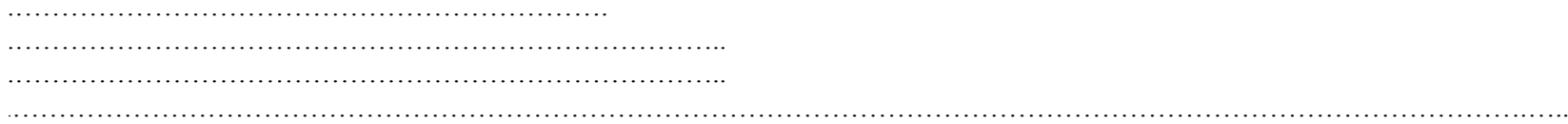
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Severances under sections 16 (1) c), 20 (1) c) &  
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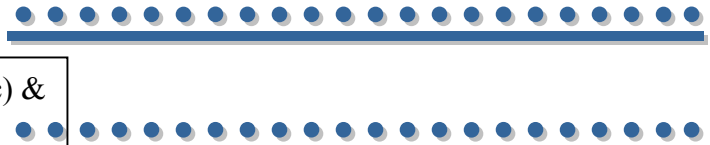


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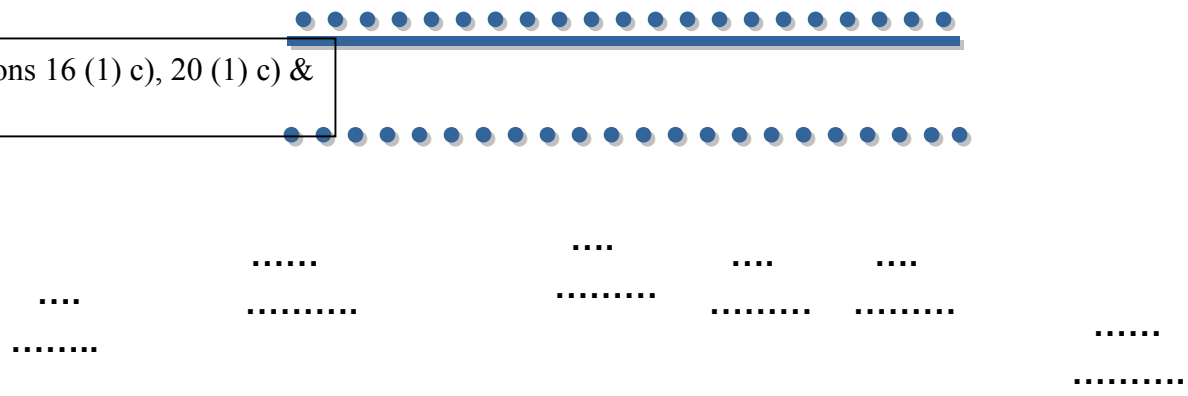
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Severances under sections 16 (1) c), 20 (1) c) &  
23 of the AIA

# Annex A



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Severances under sections 16 (1) c, 20 (1) c & 23 of the AIA



# DND/CF Contracting & Financial Management

**CRS DISCUSSION DOCUMENT:** *Improving DND/CF Contracting and Attendant Financial Management (Provided to the DM, in draft, 28 July 2003.)*

*Of late, CRS has received an increasing number of unscheduled requests for audits to address circumstances involving weaknesses in contracting and associated financial management practices.*

Information on Service Contracting. A difficulty which consistently occurs in these circumstances is that weaknesses in information compromise our ability to analyze service contracting activity. Major internal audits reported in 1995 and 2001 have observed that the Department does not have reliable information on its service contracting – payments are not linked electronically to the corresponding contract. This precludes effective monitoring, quality assurance, commitment control and early warning mechanisms. The aftermath of the 1995 report was that the DM directed a major get-well program. The 2001 report resulted in DM direction regarding contracting information – this has yet to be implemented.

Comptrollership. A 2001 CRS report on the Management of Operating Budgets, expressed concern regarding the breakdown in controls at the local level. At the same time, the report did not contemplate a return to traditional, labour-intensive controls. Instead, it recommended the development of *Smart Controls* which take advantage of technology. The report helped to drive a major coordinated revitalization of Comptrollership at the base level. It stressed the importance of Guidance, Enablers and Monitoring (GEM).

Our most recent audit of the Management of Local Funds, has observed certain of the lasting benefits of this initiative. At the same time, we have noted a requirement to reinforce, and consolidate these benefits. Recent developments have further suggested that more needs to be done in the National Capital Region, particularly with respect to Agency and other specialized operations (e.g., OCIPEP, CFMG).

We are concerned that more needs to be done to emphasize the importance of authority and accountability relative to the initiation of expenditures, this is particularly so in instances whereby organizations access corporate accounts and contracts. Financial certifications, pursuant to FAA Sections 34 (contract performance) and 33 (payment authorization) are extremely important, but they deal with purchases already initiated.

## DND/CF Contracting & Financial Management (cont'd)

Our most recent audit work recommends the consolidation of invoice processing; current arrangements are relatively costly and inefficient. We also see advantage in ensuring that transactions generate information as they are accomplished – as occurs through the use of acquisition cards and electronic commerce. Even the Central Departmental Accounting Office has experienced major lapses in monitoring and control, this is normally attributed to resource constraints. Consolidation, resource balancing, information, guidance/training and monitoring will be key.

CRS Reports in 1995 and 2001 have stressed that contracting risks and issues need to be addressed from a corporate perspective. However, a longstanding and fundamental concern is that the Department does not have reliable information on the nature, volume and value of its service contracting.

“It is our view that information which permits post-contracting quality assurance checks, including the monitoring of trends and the integrity of our contracting process is key to facilitating the responsible devolution of contracting authority....An ongoing concern, with pervasive implications, is that the volume, value and location of departmental service contracting cannot be determined with a reasonable degree of accuracy.....” (CRS 1995)

Interestingly, this 1995 report also noted that “...The role of common service organizations (e.g., PWGSC) has evolved such that they no longer appear to provide the same level of safeguards limiting the opportunity for unacceptable contracting practices to occur....There is a need to clearly articulate, through contracting policy, that accountability ultimately rests with DND staff for ensuring that acceptable practices are followed....”

“In all, we identified six main issues. Chief among these is the longstanding, and increasingly pressing, need for improved information so that the inherent risks in service contracting can be monitored and managed at the corporate level. This lack of information impeded our capacity to assess the extent of any non-compliance with the applicable contracting policies and regulations.....accurate, consolidated information on the extent and nature of service contracting does not exist.” (CRS 2001)

## DND/CF Contracting & Financial Management (cont'd)

In each instance, the respective Deputy Minister requested action to resolve this situation – it has not as yet occurred. We need the capacity to consistently link individual contract payments to the corresponding contract. Otherwise, monitoring, and commitment accounting, is thwarted.

The CRS 2001 report on the *Management of Operating Budgets* included the following key premise:

“Overall, our conclusions emphasize the premise that devolution should be made only to the level where appropriate resources, knowledge and tools can be concentrated to ensure a balance of risk and effectiveness.” (CRS Feb 2001)

This 2001 report sponsored a revitalization of Comptrollership, but principally at the Base level. It concluded that controls had deteriorated to the point that there was very little incentive to abide by basic regulatory requirements. However, it also emphasized that “...there can be no going back, as far as a [traditional, labour-intensive] control framework is concerned, at least not all the way. The question now must be how to work smarter and make what we have better.” The report emphasized *Guidance, Enablers and Monitoring (GEM)*. It stressed the importance of *Smart Controls*, which would take guidance, and training. The Defence Comptrollership Council and the Materiel Management Steering Committee spearheaded an effective improvement program. Our latest work on the Management of Local Funds, has noted many of the positive impacts of this corrective effort.

Work on other CRS audits, reviews and special examinations has noted the following:

- There are many centralized budgets under the control of NCR managers, which fund contracts against which local managers (both in the NCR and the field) can requisition goods and services, and charge the expenditures.
- Those accessing these accounts/contracts have limited accountability for value for money or conditions for appropriate use of the funds.
- There are insufficient reporting/monitoring measures on the part of NCR managers relative to the use of these accounts/contracts.

## DND/CF Contracting & Financial Management (cont'd)

- Greater emphasis is warranted regarding authority to initiate expenditures – once a decision has been made to acquire goods and services, financial signing authorities can only certify that goods and services were received and that the price is as per contract. Frequently, there is an insufficient documentation trail to indicate who actually authorized the original purchase.
- Payment verification and approval processes, even when the Department's principal accounting offices are involved, are not of consistent quality. The Central Departmental Accounting Office within the ADM(Fin CS) Group has experienced serious lapses in this respect.
- Consolidation of accounting office operations holds much promise for improvement. However, this must be accomplished in the context of *Smart Controls* which take advantage of technology.
- The quality of comptrollership within individual organizations is often dependant on the experience and personality of the individual comptroller.
- Greater integration of systems and coordination is required between functions, particularly the Materiel and Finance & Corporate Services Groups to improve Comptrollership and to ensure the quality of information for monitoring and decision-making.
- Special attention is required to ensure that Agency, special operations (e.g., OCIPEP, CFMG) and other organizations with significant management turnover or mandate change, appreciate and apply the principles of sound comptrollership.

## DND/CF Contracting & Financial Management (cont'd)

### **Actions Required:**

A concerted initiative is required to reinforce gains in comptrollership outside of the NCR and to target emerging concerns within the NCR. A starting point may be to revisit any unresolved issues relative to the Comptrollership Capacity Check performed by KPMG. Cooperative efforts between the Defence Comptrollership Council, the Financial Management Working Group, and the Defence Contract Advisory Committee can be beneficial in this respect. Previous joint initiatives, such as the work done through the Materiel Management Steering Committee, have demonstrated what can be achieved through this type of cooperation.

Purchasing and payment mechanisms, such as Acquisition Cards and E-Commerce, which automatically generate information warrant exploitation. DND will also have to work with PWGSC to ensure that contracts oblige that contractors provide meaningful reporting on business conducted.