



National
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Chief Review Services / Chef - Service d'examen

CRS  CS Ex



IT MAINTENANCE CONTRACTING Updated Audit Analysis

October 2004

7053-30-8 (CRS)



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Evolution and Analysis of Controls: *It is important to consider the context and evolution of management controls within government.*

... increasing focus on results, as opposed to traditional stewardship over inputs consumed.

In the face of decreased resources at the supervisory and middle management levels, managers have tended to concentrate available resources on operations, vice more traditional controls. This has reflected an intention to achieve an increasing focus on results, as opposed to traditional stewardship over inputs consumed. Relatively labour-intensive controls have become progressively less viable. Direct supervision and double-checking have been reduced – controls were often viewed as red tape.

In this context, “modern comptrollership”, including risk management, ethics, and better use of information systems, is intended to provide an alternative to labour-intensive checks and balances. It contemplates a move from emphasis on direct hands-on controls, to an accountability-based framework encompassing values, ethics and risk management as well as making use of available integrated financial and non-financial information for decision making.

A conclusion of internal audit is that there is a need to accelerate the transition from labour-intensive controls, to more technology-intensive controls. As expressed in a 2002 CRS report on the Review of the Management Operating Budgets “...it is clear that there can be no going back, at least not all the way. The question now must be how to work smarter...”.

Modern Comptrollership: *The situation respecting IM/IT maintenance contracts illustrates certain of the challenges remaining for “modern comptrollership”. Management needs to strengthen departmental guidance, training, technological enablers and monitoring. Better interfaces are required between people and technology (i.e., virtual segregation of duties), including intelligent front-end edits in our enterprise systems. Also imperative is that there be better monitoring and management reporting based on the availability of better-integrated financial and non-financial information. In the current environment, effective computer-assisted internal auditing, as well as ongoing detective and preventive controls, have been hindered. Additional comments appear in other reports on the CRS Internet Site (<http://www.dnd.ca/crs/>) – note, in particular, internal audit reports on the Management of Local Funds, Baseline Survey of Risk Management, Preliminary Risk Analysis of Contracts and Contracting for Professional and Technical Service. (Annex G.)*

A recurring theme reported by internal audit has cited the limitations in information available to allow a full view of contracting within the Department. Management oversight has an inherent deterrent effect that has not been prevalent. Functional authorities, including Finance and Procurement, need to provide straightforward guidance, tools/enablers, performance standards and monitoring of adherence to such standards. As a by-product of contracting and corresponding payments, technology must capture information on the volume, value and nature of business being conducted. This theme is developed in the report on the Audit of the Management of Local Funds......

Some Context: *Excuses cannot be offered for the control breakdown which has occurred. In the early 1990's, DND maintained a very traditional, bureaucratic and costly control regime. This was substantially abandoned during extensive downsizing and re-engineering. Efforts shifted to devolved resource management, greater operational flexibility and to focusing controls more on the achievement of results, within defined budgets. There was a concerted effort to eliminate red tape – restrictive procedures were set aside in favour of more streamlined guidance.*

New enterprise management systems have been introduced for financial, human resource and materiel management, respectively. There was also greater attention to ensuring that strategic investment decisions allocated funding to highest and best use. At the same time, internal audit reported that the pendulum had swung too far and that resource managers in the field were not respecting reasonable constraints on how business should be accomplished. It was recommended that a new regime of guidance, enablers (e.g., training, information) and monitoring (GEM) be established. Audit also repeatedly stressed the lack of management information to monitor service contracting throughout the Department. There was a concerted program to revitalize Modern Comptrollership, with emphasis on ensuring sound management of devolved resources. New guidance and authorities were also developed with respect to contracting – unfortunately, the issue of contracting management information remained unattended.

Care must also be taken regarding the overall implications of this serious control breakdown. In this respect, recent intensive internal audit work applied to the management of local operating funds, amounting to approximately \$1.2B annually, found the vast majority of transactions to be fully in order – the rate of non-compliance was about 7 per cent. Steps were recommended to consolidate gains in Comptrollership. (Ironically, the central comptrollership function experienced lapses in areas that were being actively corrected in the field.) At the same time, a major audit of \$3B in annual payments for Military Pay observed reasonable controls to be in place. Similarly, a comprehensive audit of contracting for Professional & Technical Services examined a large sample of transactions and found an error rate of approximately 6 per cent. However, this latter audit also stressed that the lack of management information precluded audit assurance on the soundness of service contracting activity. In this respect, audit has consistently promoted the



requirement to accelerate the transition from labour-intensive controls, to more technology-based controls that exploit the capabilities of new information systems and electronic transaction controls.

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Management Action: Management has launched, or accelerated, concerted actions in response to recent contracting problems. In addition to continuing audit and risk analysis, a Departmental Contracting Oversight Committee has been established and delegated authorities have been revised/tightened. A new Comptrollership Action plan includes a program of “back to basics” in financial administration. Over 12,000 employees have undertaken training and testing to enhance and validate their knowledge of the requirements of the Financial Administration Act. Systems adjustments have also been brought to bear to ensure that expenditures can more easily be related to the applicable contracts. The Comptrollership Action Plan can be viewed at (http://admfincs.mil.ca/comptsec/docs/Strengthening_Accountability_e.pdf).

Audit Action: Additional audit work continues, including the conduct of risk analyses relative to DND’s contracting and financial controls.



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..... *Additionally, audits of Software Acquisition, and Service Contracting, within the IM Group, are currently underway. Finally, CRS will continue its assessment of IM Governance and control issues.*

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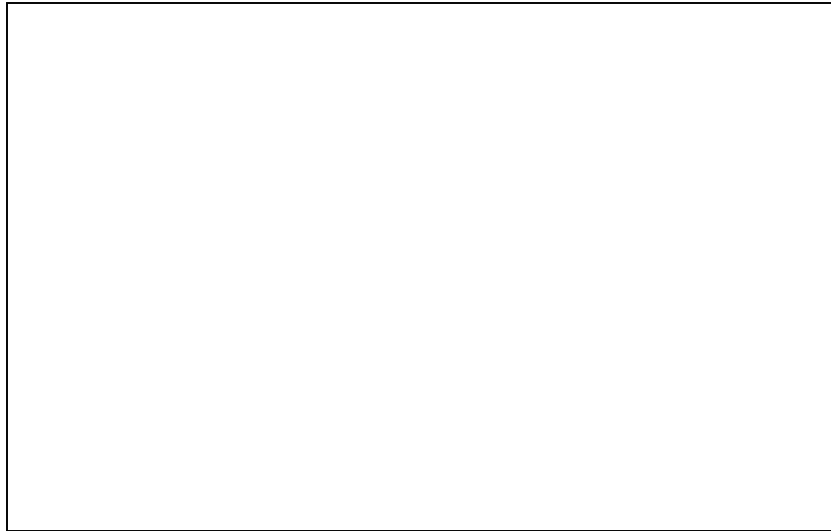
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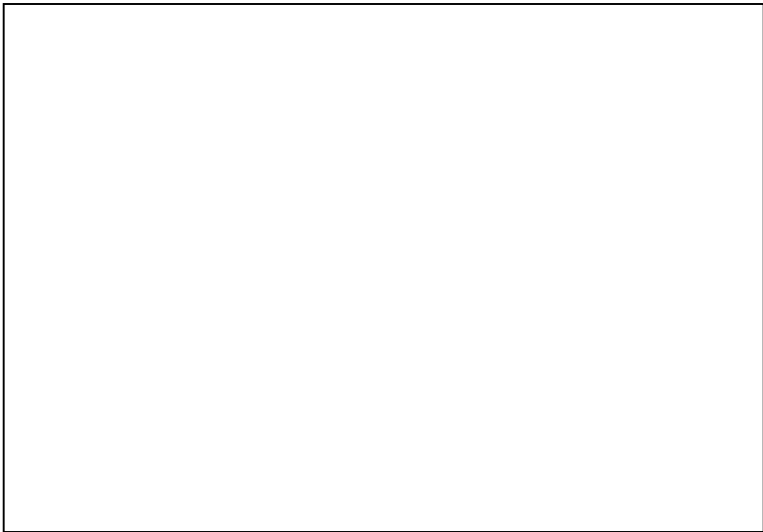
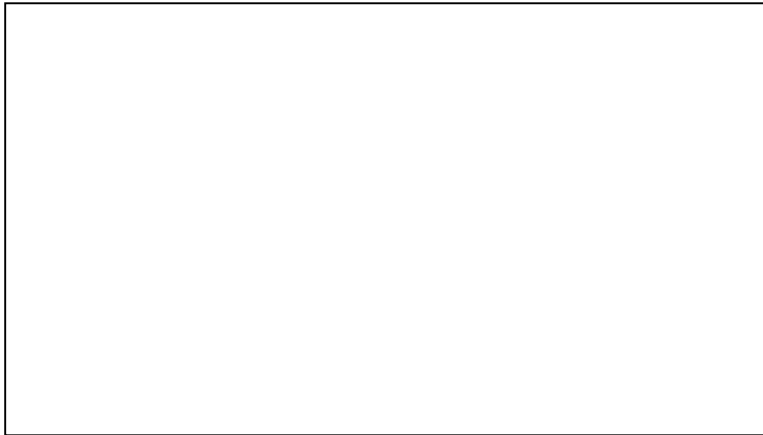


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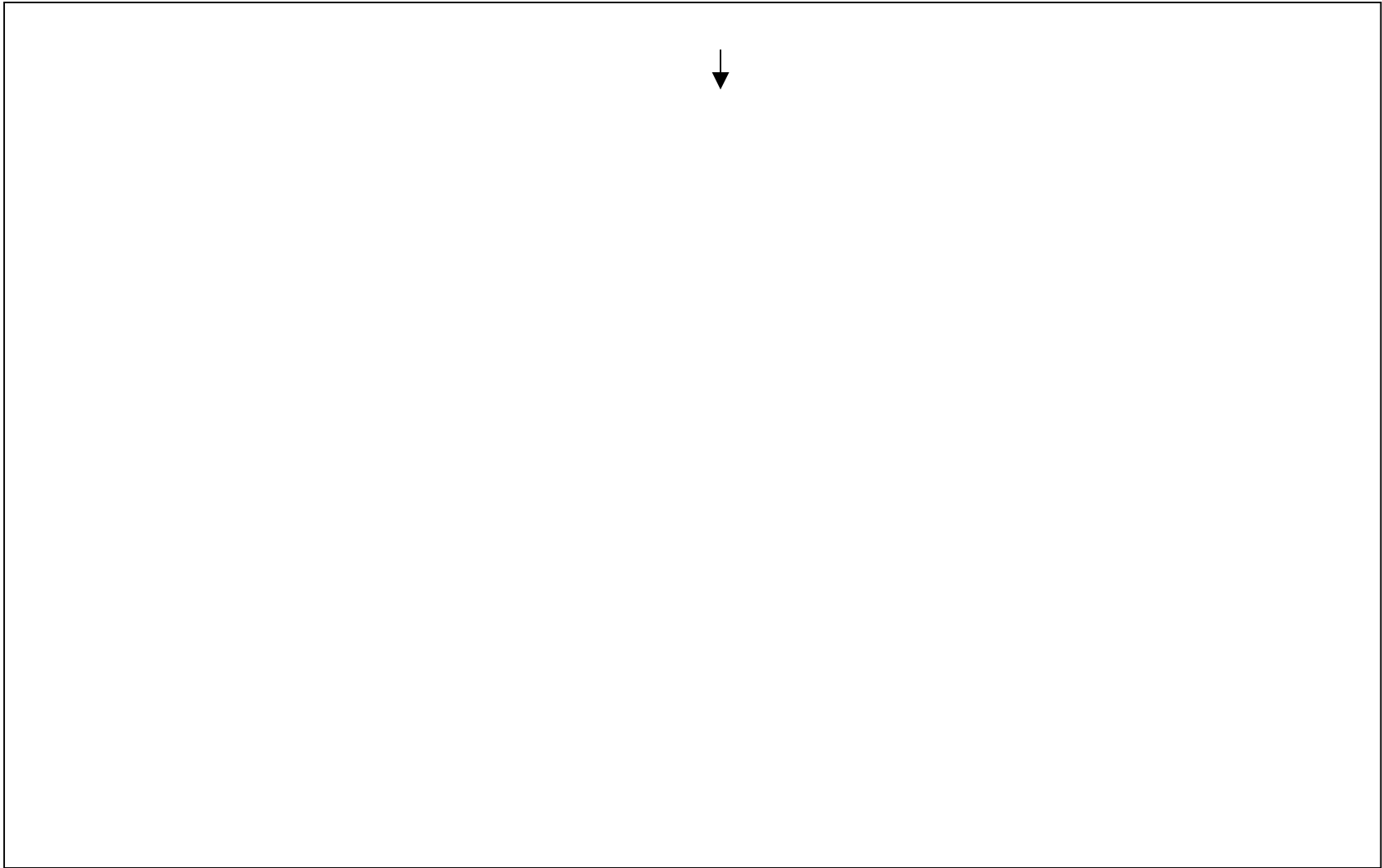
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ANNEX B

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ANNEX D

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ANNEX D

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ANNEX D

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ANNEX D

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Annex E – Review of Financial Administration Act Sections 34 and 33 Certifications

CRS work on contracting for advertising and related services, as well as work performed in collaboration with PricewaterhouseCoopers (PwC), noted that the Central Departmental Accounting Office (CDAO) was not exercising due care relative to certifications to requisition contract payments. CRS had noted the discontinuation of procedures whereby quality assurance monitoring was to take place on samples of payments made. It was subsequently reinforced to PwC that certifications pursuant to Section 33 of the FAA were being given in the absence of due care. This prompted a targeted CRS examination of individual payments processed by this office and exceeding \$1M.

A statistical sample of 60 payments was drawn, and these were then categorized according to risk. Risk was assessed on criteria such as: the type of payment (e.g., milestone, progress...); the nature of the transactions (i.e., goods or services); the number of delivery locations; and, the location of the supporting documentation. Through this selection process, 32 sample items were categorized as being of relatively higher risk and warranting immediate follow-up examination.

CRS was not satisfied with the validation of contractor invoices for 50 per cent of the sample. 4 transactions were certified pursuant to FAA Section 34 with high reliance being placed on input from quality assurance representatives or technical authorities. An additional 12 transactions were certified with minimal verification having been performed.

- **Examples of Detailed Observations:**

- The Director of Quality Assurance (QA) advised that QA Reps are responsible for ensuring that goods are produced in accordance with contract technical specifications. Contrary to the understanding of many Section 34 signatories, the role of the QA does not include ensuring receipt of goods or validating hours worked.
- Invoices for clothing, consolidating monthly deliveries to 200 possible points within Canada, were processed with less than 1/10 of 1 per cent verification of receipt of goods. An attempt by CRS to perform reasonableness tests was unsuccessful, as not all receipt of goods are recoded in the Supply system.
- Only 7 of the 60 sample items over \$1M were subjected to a payment verification review and these were performed post payment rather than before payment as required by policy. Effective May 2004, new measures were put in place to include pre-payment review of all payments exceeding \$250K and the establishment of three new payment cells to review payment documents processed by the Materiel, Infrastructure & Environment and Information Management Groups respectively.



ANNEX E

Overall Assessment: Clearly, the observed circumstances support the Finance & Corporate Services Group’s “Back to Basics” initiative with respect to financial administration. Legislated financial controls have not been functioning effectively within NDHQ, at least for O&M expenditures. CRS has witnessed many improvements outside of the National Capital Region. The impacts of strengthened Comptrollership are evident. It is ironic that critical lapses have occurred within the organization responsible for sponsoring the improvement program in the field. It is unacceptable that the requirements of FAA Section 33 were not being satisfied at the centre and that no assurance was being sought that other NDHQ Groups were fulfilling the requirements of FAA Section 34. The majority of the fixes will be as recommended in the CRS Report on the Management of Local Funds (<http://www.dnd.ca/crs/>).



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Annex G – Pertinent Audit & Review Reports

PricewaterhouseCoopers Preliminary Assessment Report – 25 September 2003

- *Fast-tracked preliminary forensic assessment of contracts for DND hardware and software maintenance.*

PricewaterhouseCoopers Management Review of Information Management Procurement – 16 December 2003

- *High-level independent review of the management of IM procurement.*

IT Hardware Maintenance: Interim Report on Internal Audit Work – December 2003

- *Interim results of CRS audit work to reconstruct, analyze and situate circumstances pertaining to contracting for the provision of Information Management and Information Technology maintenance support services. This reconstructive audit work was 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.*

Preliminary Risk Analysis of Contracts – January 2004

- *First in a series of reports being generated to capture the results of a risk analysis of DND contracting. It is intended to cast a broad net to identify any contracting situations that may warrant additional management and/or internal audit attention.*

Internal Assurance Audit of the Management of Local Funds – January 2004

- *Report examines resource management controls for local operating funds ~ \$1.2B annually. Recommendations focus on increasing the use of technology as a means to enhance accountability and control, to provide improved processing efficiency and to ensure more accurate, complete information is available for risk analysis and management decision-making. Recommendations also address verification to ensure compliance with applicable legislation as well as the application of risk management to the design of effective delegated authorities and the automated monitoring of financial management/control performance.*



ANNEX G

Baseline Study: Integrated Risk Management in the DND/CF – January 2004

- *This report presents the results of a study to assess progress by the DND/CF toward implementation of Integrated Risk Management.*

Internal Audit of the Contracting for Advertising & Related Services – 2002

- *Report included comment on financial authorities and controls. It observed weakness in expenditure authorization, invoice validation and payment authorization.*

Internal Audit of Contracting for Professional and Technical Services – 2002

- *A key issue raised in this report centred on weaknesses in the availability of information on contracting – information to monitor activity and risks.*

