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# REPORT: RISK ANALYSIS OF CONTRACTS MANAGED BY THE CANADIAN FORCES HEALTH SERVICES GROUP

January 2005

7055-42-5 (CRS)

Canada

## NOTICE OF CAVEAT TO THE READER

This risk assessment was conducted as a special project and was not included in the annual Chief Review Services Work Plan. The conclusions do not have the weight of an audit. While sufficient to enable the development of recommendations for consideration by management, the assessment provided and conclusions rendered, are not based on the rigorous inquiry or evidence required of an internal audit. Accordingly, they are not represented as such.

It should also be noted that the analysis is not intended to assess the performance of contractors; rather it is an internal review of processes and practices within the DND/CF. Contractors have not been interviewed or otherwise asked to provide comment or feedback.

# SYNOPSIS

*This report presents the results of a risk analysis of contracts managed by the Canadian Forces Health Services Group. The analysis was performed at the direction of the Deputy Minister (DM). This direction followed a targeted review of a single contract for professional healthcare services. The intent of this current follow-on analysis was to flag any additional contracts exhibiting higher-risk attributes. The methodology utilized has been adapted from that developed to support a broader risk analysis of DND's contracting.*

*This analysis identified 215 active contracts being managed by the CF Health Services Group. Of these, Public Works and Government Services Canada (PWGSC) is the contracting authority for 210, having a total value of approximately $168M. The DND, Director Contracting Policy (DC Pol), is the contracting authority for an additional five CF Health Services Group contracts, with a total value of approximately $1M.*

*An initial analysis of the 215 active contracts identified 22 that exhibited higher-risk attributes – the total value of these 22 contracts was $160M. Further pointed analysis of these 22 contracts isolated one contract and two standing offer agreements which warrant detailed audit – these three have a total value of $15M. Additionally, 11 contracts were flagged as requiring close monitoring by the CF Health Services Group. In this latter respect, we conclude that the management of medical contracts could be improved through greater use of commitment accounting, increased use of standing offer arrangements, and more proactive risk mitigation measures.*

*Finally, it was noted that the CF Health Services Group experienced difficulty in providing contracting information to the CRS team – this is certainly not a problem which is exclusive to the CF Health Services Group. Information on service contracting has not been routinely captured in departmental information systems. The devolved nature of contract management in the Department presents difficulties for all higher-level formations in maintaining a monitoring and oversight capacity to ensure that all contracts within their sphere of responsibility are properly managed.*

*As noted above, the analysis of the CF Health Services Group contracts is being conducted by CRS as a sub-set of a larger risk analysis of DND/CF contracting. It is in this context that we have developed our recommendations.*

***RECOMMENDATIONS***

Severed under Section 20(1)c) of the AIA – Third Party Information.

*CRS will propose the inclusion of one …… contract and two …… standing offers in the Annual Review Services Plan. Other recommendations are intended to improve the oversight and risk management of contracting, to streamline the procurement process, and to mitigate contract risk with strategies such as incentive-based contract terms.*

***MANAGEMENT ACTION PLAN***

*The CF Health Services Group has taken several initiatives to improve the management of medical contracts. These include the following:*

- *Further risk assessments on high value contracts;*
- *The inclusion of a summary of contract information in quarterly financial reports;*
- *Establishment of a contracting cell to explore improved procurement instruments; and*
- *Post-payment reviews for major medical contracts.*

*In the larger context, it is also worth pointing out that a Departmental Contract Oversight Committee, co-chaired at the Assistant Deputy Minister level, has now been established. It is actively pursuing solutions to improve the monitoring and analysis of contracting.*

***A summary of key recommendations and corresponding management actions/plans is presented in matrix format on report page 4.***

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# RESULTS IN BRIEF

## INTRODUCTION AND BACKGROUND

In June 2003, the DM directed CRS to conduct a risk analysis of all contracts managed by the CF Health Services Group. This followed a targeted review of a contract for professional healthcare services. In the same timeframe, CRS was conducting a risk analysis of service contracts across the DND/CF and developing an overarching methodology for the identification of those contracts exhibiting characteristics consistent with higher risk. The 'filter' methodology was completed and presented to the DM in October 2003. It was then adapted for use in this more-focused analysis of CF Health Services Group contracting as portrayed in Figure 1 below.

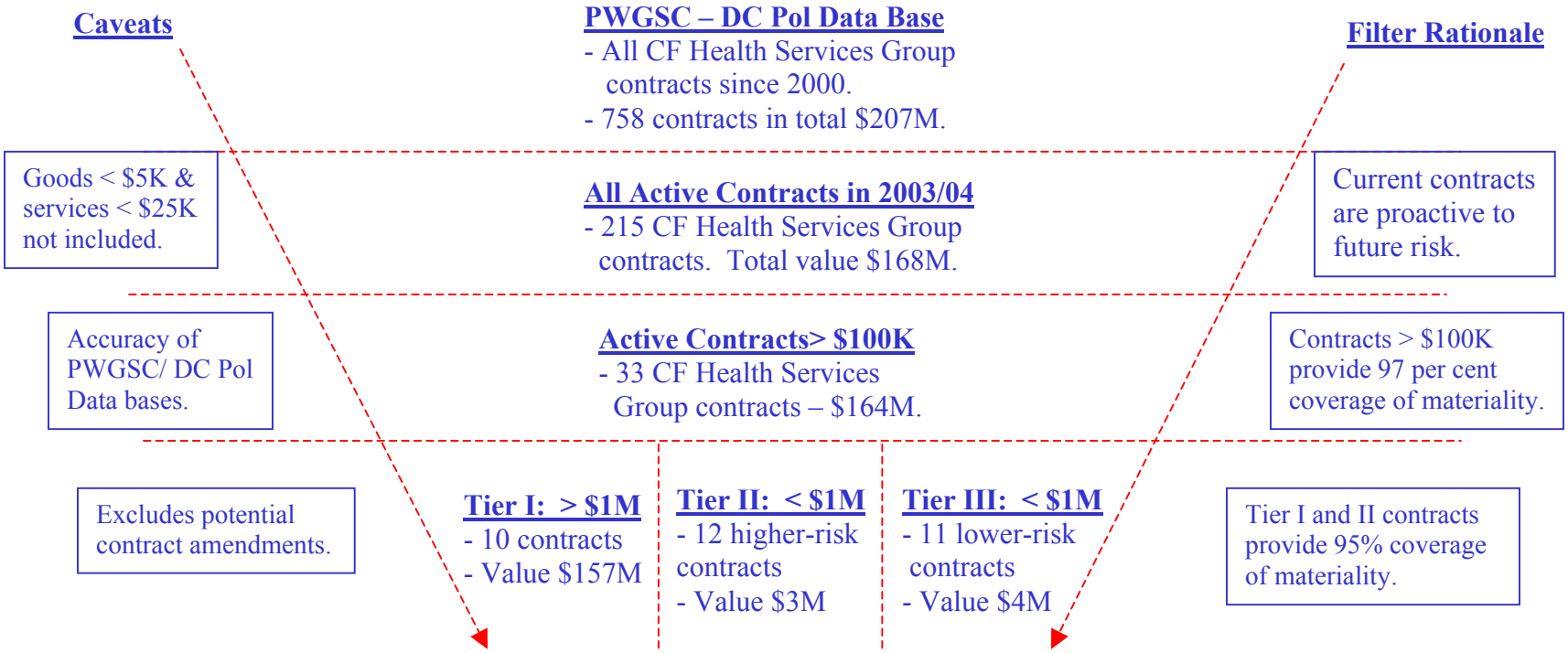


**Figure 1 – Global Filter Methodology Application to CF Health Services Group Contracts**

After determining initial baseline information, CRS applied its global filtering methodology and a related scoring system, to identify the higher-risk contracts managed by the CF Health Services Group. The CRS preliminary risk analysis methodology, including caveats, is described in detail in Annex A.

In brief, the preliminary risk analysis involved the application of materiality filters and automated risk criteria to the medical contracts in the PWGSC and DND/DC Pol databases. The active contracts worth more than $100K were categorized into three tiers:

- Tier I – 10 contracts greater than $1M in value;
- Tier II – 12 contracts between $100K and $1M scoring high on risk criteria; and
- Tier III – 11 contracts between $100K and $1M that are considered lower risk.

The CRS team then focused on *Tier I* and *Tier II* contracts – 22 active medical contracts totalling $160M in value and achieving 95 per cent materiality coverage. The contracts in Tier III amount to $4M in value and should be monitored by the CF Health Services Group.

## OVERALL ASSESSMENT

We have observed some improvements in the management of medical contracts since the September 2003 CRS report on *Contracting for Professional Healthcare Services*. However, improvements have been limited by the same systemic obstacles affecting contracting across the Department; that being, the lack of availability of critical contracting information. Considerable time and effort were required by the CF Health Services Group to provide a listing of its contracts to the CRS team. Much of the detailed contracting information is maintained on spreadsheets. The Department's Enterprise Resource Planning (ERP) systems have not been a helpful source of information for users. Without suitable contracting information, senior managers in the CF Health Services Group are challenged to provide oversight of the contracting process. To supplement and confirm the CF Health Services Group contracting information, the CRS team obtained data from the PWGSC and DC Pol databases.

**Follow-on Audit.** Our detailed risk analysis of the 22 medical contracts resulted in the identification of two standing offers and one contract which require more detailed audit – their combined value is $14.7M. We observed that expenditure ceilings on standing offer agreements were being exceeded by as much as 30 per cent and there was insufficient tracking of expenditures by vendor. With respect to the single contract, which pertains to ……., there are significant schedule delays and scope creep that require further audit.

Severed under Section 20(1)c) of the AIA – Third Party Information.

**Commitment Accounting.** Some CF Health Services Group contract managers are not complying with the Department's commitment accounting policy articulated by the Chief Financial Officer, in March 2002. An objective of commitment accounting is to provide visibility for senior management to accurately forecast financial pressures so that funding can be reallocated accordingly. For our sample of 22 medical contracts, there were 10 for which commitments were not entered into the Financial Management and Accounting System (FMAS) – a multi-year commitment value of $31M. It is our view that the accuracy and ease of producing CF Health Services Group quarterly forecasts is adversely affected without the practice of commitment accounting by all contract managers.

**Standing Offer Arrangement.** The repetition of the contract award process to the same vendors creates an unnecessary workload for CF Health Services Group procurement staff. Since the year 2000, we found that 192 of the 687 contracts were concentrated with 15 vendors. An opportunity exists to reduce the contract requisitioning workload by employing other procurement instruments such as standing offers.

**Health-Care Services Contract.** We reviewed the $109M, three-year, healthcare service provider contract and found that the cash flow proposed in the option period, commencing in April 2004, is 25 per cent higher than the existing cash flow. A December 2003 amendment to the contract anticipated the monthly cash flow in the 10-month option period commencing April 2004 to be $5.1M – 25 per cent higher than the existing expenditures of $4.1M per month. Although there has been improvement in the verification of payments, we are concerned that quarterly forecasts based on the contract's cash flow will be inflated.

**Key Risks and Mitigating Strategies.** Risk mitigation strategies by the CF Health Services Group did not address schedule slippage. Spreadsheets, vendor reports, and FMAS were found to be the most common risk mitigation tools utilized to track expenditures. It is our view that these tools identify risk but do not mitigate it. Schedule risk can be addressed by offering performance incentives that are linked to delivery schedule. We observed one innovative measure to address the vendor's financial constraints; an informal agreement for a 0.5 per cent discount to the Department, if an invoice was paid within five days, which led to savings of $627K – net savings of $157K taking into account future value of money considerations.

## RECOMMENDATIONS/MANAGEMENT ACTION PLAN

CRS will include the audit of a ……. standing offer and …….. contract in the CRS Review Plan. In the interim, it would be appropriate for the CF Health Services Group to give these contracts particular attention.

Severed under Section 20(1)c) of the AIA – Third Party Information.

| Ser | CRS Recommendation | OPI | Action/OPI Comments |
|---|---|---|---|
| 1 | ADM(HR-Mil)/CF Health Services Group implement a process to monitor the 11 contracts, identified in this report as *Tier III* contracts. | DCOS HS Del<br><br>DCOS Med Ops (G4)<br><br>Compt ADM(HR-Mil)<br><br>DMSDP | Detailed risk assessment templates have been completed on the *Tier III* contracts. The quarterly financial reporting process has been modified to include summary data on *Tier I, II*, and *III* contracts. Post-payment reviews are being done by DCOS HS Del and DCOS Med Ops (G4) on major medical contracts. ADM(HR-Mil) is examining all contracts greater than $1M in value. DMSPD has established a contract management cell that includes CF Health Services Group personnel to monitor major contracts. |
| 2 | In conjunction with ADM(Mat), ADM(HR-Mil) conduct a check of CF Health Services Group's contract management capacity, giving particular attention to the availability of monitoring information and systems. | CFHSG | ADM(Mat) has been approached to review the procurement capacity of CF Health Services Group. A formal review will be complete by December 2004. |
| 3 | ADM(HR-Mil)/CF Health Services Group adopt commitment accounting practices in accordance with the C Fin O criteria. | Compt CFHSG | FMAS is being upgraded to include a mandatory entry of contract numbers and commitments by November 2004. CF Health Services Group personnel with signing authority under the Financial Administration Act have undergone the ADM(Fin CS) Expenditure Course which reinforces the need for commitment accounting. Compt CF Health Services Group will review the need to provide additional user guidance on commitment accounting to budget managers and if required, issue such guidance by April 2005. |
| 4 | ADM(HR-Mil)/CF Health Services Group explore other procurement instruments to reduce the workload associated with the contract award process for medical contracts. | CFHSG | A new contracting cell is being established in CF Health Services Group to pursue further opportunities for standing offers or other multi-year supply arrangements. Progressive procurement strategies have recently been adopted including a third party service provider contract, a MOU with Veteran Affairs for off duty medical support, and two standing offers. |
| 5 | ADM(HR-Mil)/CF Health Services Group revisit the anticipated cash flow in the option years of the service provider contract. | Compt CFHSG | DMSDP has provided resources for improved controls on the service provider contract. Although a high initial estimate was used to determine the contract ceiling, the actual cash flows will be taken into account in quarterly financial reports to ADM(HR-Mil). |
| 6 | Consider more proactive contract risk mitigation strategies such as performance incentives and discounts. | CFHSG | These types of contracting arrangements will be identified and brought to the attention of the contracting authority – PWGSC for all major contracts. |

# OBJECTIVES, SCOPE & METHODOLOGY

## OBJECTIVE

The risk analysis and assessment of medical contracts was directed by the DM. The purpose of the risk analysis was to identify medical contracts that warrant comprehensive audit.

## SCOPE

Subsequent to a targeted review of a contract for professional healthcare services in June 2003, the DM directed CRS to conduct a risk analysis of all contracts managed by CF Health Services Group. This entailed all contracts for medical/dental services and goods to CF Health Services Group units across Canada.

CF Health Services Group experienced difficulty in producing comprehensive, readily available information pertaining to their contracts. Therefore, as a complement to the CF Health Services Group information and as a basis for this analysis, CRS utilized a list of CF Health Services Group contracts from the PWGSC Automated Buyer Environment (ABE) database and from the DC Pol database as described in Annex A. CRS is aware of potential weaknesses in the accuracy and completeness of these databases; however, it was determined to be the most comprehensive information that was readily available.

Based on information from 2000 to the present, the scope of the analysis included:

- Medical and dental goods contracts greater than $5K tendered by PWGSC;
- Medical and dental service contracts greater than $25K tendered by PWGSC;
- All standing offers for medical/dental goods or services tendered by PWGSC; and
- Medical and dental service contracts tendered by DC Pol greater than $5K and less than $1M in value.

## METHODOLOGY

An overarching methodology was developed for the identification of those DND contracts exhibiting characteristics consistent with higher risk. The risk identification process employed a number of automated filters that could be applied to a contract database to limit the number of contracts and assign a risk assessment score. Those contracts with the highest score were chosen for further analysis. The 'filter' methodology was completed and presented to the DM in October 2003. It was then adapted for use in this more-focused analysis of CF Health Services Group contracting. It should be noted that the caveats in relation to the overarching methodology for the larger contracting review apply equally to this report. The CRS methodology is described in detail in Annex A to this report.

From the PWGSC and DND/DC Pol databases, CRS noted the following baseline medical/dental contract information:

- Over the last three years, the CF Health Services Group managed 758 contracts (A complete list is available from CRS);
- The total value of those contracts is approximately $205M;
- PWGSC was the contracting authority for 682 of the contracts – 90 per cent of the contracts; and
- DND/DC Pol was the contracting authority for 76 of the contracts.

CRS applied its global filtering methodology and a related scoring system to identify the higher-risk contracts managed by CF Health Services Group. The application of active contracts and materiality global filters resulted in the stratification of contracts below:

- Of the PWGSC - awarded, 215 were active, with an approximate total value of $168M;
- Of the 215 active PWGSC – awarded contracts, ten have a value of $1M or more; and
- Of the DC Pol group, five contracts are active with an approximate total value of $1M.

To ensure adequate materiality coverage by the risk assessment, the current medical contracts were stratified by value as portrayed in Table 1. By examining ten contracts greater than $1M (5 per cent of the total number of contracts) we were able to examine 92 per cent of the total value of current medical contracts. For those 23 contracts between $100K and $1M, an automated risk analysis was performed to select 12 contracts that warranted further risk assessment. The seven automated risk criteria are described in detail in Annex A.

## Table 1 – Stratification by Contract Value of Current Tendered Medical Contracts

| Contract Value | Number of Contracts | Per Cent of Contracts | Value of Contracts | Per Cent of Value |
|---|---|---|---|---|
| < $100K | 181 | 80% | $4,346,781 | 3% |
| >$100K <$200K | 13 | 9% | $1,077,351 | 2% |
| >$200K <$300K | 3 | 2% | $1,141,180 | 1% |
| >$300K <$400K | 1 | 0% | $315,089 | 0% |
| >$400K <$500K | 1 | 0% | $490,186 | 0% |
| >$500K <$600K | 2 | 1% | $1,597,293 | 1% |
| >$600K <$700K | 1 | 0% | $622,276 | 0% |
| >$700K <$800K | 2 | 1% | $1,513,335 | 0% |
| >$800K <$900K | 0 | 0% | $0 | 0% |
| >$900K <$1M | 0 | 0% | $0 | 1% |
| > $1M | 10 | 5% | $156,971,173 | 92% |
| **Total** | **215** | | **$168,074,664** | |

Three tiers of higher-risk contracts were identified. They were categorized as follows:

- Tier I – PWGSC was the contracting authority and the materiality or dollar value was greater than $1M. While the aggregate/overall risk assessment score may be low, the materiality is the over-riding risk factor for these contracts;

- Tier II – PWGSC was the contracting authority, the dollar value is between $100K and $1M, and the risk assessment score was 2.5 or above on a scale from one to six (where one indicates lower risk and six indicates higher risk). The scale was provided in Annex A, Table 8; and

- Tier III – PWGSC or DC Pol was the contracting authority and the dollar value was between $100K and $1M and the risk assessment score is either below 2.5 or could not be assessed.

Table 2 provides a list of the ten Tier I, high-value medical contracts, ranked from the highest risk to the lowest risk. These high value contracts were considered to require further risk assessment by ADM(HR-Mil)/CF Health Services Group and CRS. CRS designed two templates, provided in Annexes B and C, to assist with the further risk assessment.

**Table 2 – Tier I High Value Contracts Tendered by PWGSC Managed by the CF Health Services Group**

| In Order of Risk | Contract Number | Vendor Name | Contract Value | Risk Assessment Score |
|---|---|---|---|---|
| 1 | …….. | …….. | …….. | …. |
| 2 | …….. | …… | …….. | …. |
| 3 | …….. | …… | …….. | …. |
| 4 | …….. | …….. | …….. | …. |
| 5 | …….. | …… | …….. | …. |
| 6 | …….. | …… | …….. | …. |
| 7 | …… | …… | …….. | …. |
| 8 | …….. | …….. | …….. | …. |
| 9 | …….. | …… | …….. | …. |
| 10 | …….. | …… | …….. | …. |
| | | **Total $ Value** | **$156,971,173** | |

Severed under Section 20(1)c) of the AIA – Third Party Information.

Table 3 is a list of Tier II, higher-risk contracts. These are contracts with a value of between $100K and $1M that have a risk assessment score of 2.5 and above. They were viewed as also requiring further risk assessment by ADM(HR-Mil)/CF Health Services Group and by CRS.

**Table 3 – Tier II Higher-Risk Contracts Tendered by PWGSC Managed by the CF Health Services Group**

| In Order of Risk | Contract Number | Vendor Name | Initial Contract Value | Risk Assessment Score |
|---|---|---|---|---|
| 1 | …….. | …….. | ……. | …. |
| 2 | …….. | …….. | ……. | …. |
| 3 | …….. | …….. | ……. | …. |
| 4 | …….. | …….. | ……. | …. |
| 5 | …….. | …….. | ……. | …. |
| 6 | …….. | …….. | ……. | …. |
| 7 | …….. | …….. | ……. | …. |
| 8 | …….. | …….. | ……. | …. |
| 9 | …….. | …….. | ……. | …. |
| 10 | …….. | …….. | ……. | …. |
| 11 | …….. | …….. | ……. | …. |
| 12 | …….. | …….. | ……. | …. |
| | | **Total $ Value** | **$2,777,337** | Max score is 7.0 |

The contracts in Tier III, shown in Tables 4a and 4b indicate contracts that require close management attention. Further risk assessment work is not required at this time. They have not been targeted for further assessment as the risk assessment score was less than 2.5.

Severed under Section 20(1)c) of the AIA – Third Party Information.

### Table 4a – Tier III Higher-Risk PWGSC Tendered Contracts Managed by the CF Health Services Group

Severed under Section 20(1)c) of the AIA – Third Party Information.

| In Order of Risk | Contract Number | Vendor Name | Initial Contract Value | Risk Assessment Score |
|---|---|---|---|---|
| 1 | …….. | …… | …… | …. |
| 2 | …….. | …… | …… | …. |
| 3 | …….. | …… | …… | …. |
| 4 | …….. | …… | …… | …. |
| 5 | …….. | …… | …… | …. |
| 6 | …….. | …… | …… | …. |
| 7 | …….. | …… | …… | …. |
| 8 | …….. | …… | …… | …. |
| 9 | …….. | …… | …… | …. |
| | | **Total $ Value** | **$2,852,852** | Max Score 7.0 |

### Table 4b – Tier III Higher-Risk DC Pol Tendered Contracts Managed by the CF Health Services Group

Severed under Section 20(1)c) of the AIA – Third Party Information.

| …… …… | Contract Number | Vendor Name | Initial Contract Value | …… …… |
|---|---|---|---|---|
| … | 01/0080 | Activation Laboratories Ltd. | $770,400 | …. |
| … | 02/0220 | JSS Medical Research Inc. | $200,000 | …. |
| | | **Total $ Value** | **$970,400** | |

Although Tier III contracts amount to $3.8M in value, given their relatively low automated risk score, CRS did not perform a more detailed risk analysis on these contracts. An ADM(HR-Mil)/CF Health Services Group monitoring process to provide ongoing management of these lower risk contracts will be necessary.

**Recommendation.** ADM(HR-Mil) ensure a process is implemented by CF Health Services Group to monitor the 11 contracts, identified in this report as Tier III contracts, by November 2004.

# OBSERVATIONS AND FINDINGS

This section of the report examines in detail:

- Contract management capacity;
- High-risk CF Health Services Group contracts/standing offers requiring comprehensive audit;
- Observations on compliance with financial policy on commitment accounting;
- Potential for increased use of standing offers;
- The contract for professional health care services; and
- Key contract management risks and mitigation strategies.

## CONTRACT MANAGEMENT CAPACITY

In addition to determining which contracts are higher-risk, CRS noted the difficulty the CF Health Services Group experienced in producing comprehensive, readily available information about its contracts. Although some CF Health Services Group units responded more readily than others, this has led to preliminary concerns regarding the adequacy of available contracting information and the Group's capacity to manage several hundred active contracts. We also observed that contract management information was maintained in spreadsheets off-line from DND enterprise information systems, and, as such, were not visible to senior managers in the CF Health Services Group. The diffusion of contract information limits the ability of senior management in the CF Health Services Group to provide oversight of medical contracting activity.

**Recommendation.** ADM(HR-Mil), in conjunction with ADM(Mat), conduct a check of CF Health Services Group's contract management capacity, giving particular attention to the availability of monitoring information and systems by April 2004.

## FOLLOW-ON AUDIT WORK

The CRS analysis of the 22 risk assessment templates (Annexes B and C), completed by CF Health Services Group, identified the need for detailed audits of two related standing offers and one contract. The risk assessment results that identified these standing offers/contracts are provided in Annexes D and E. In these annexes, CRS judgemental risk scores and contract escalation values are summarized for the 10 high-value contracts (greater than $1M, at Annex D) and the 12 higher risk contracts (less than $1M, at Annex E). Table 5 provides the specific rationale for the recommendation to conduct three comprehensive audits.

### Table 5 – Medical Contract/Standing Offers Requiring Additional Audit

| Ser | Contract/Standing Offer Number | Vendor | Value | Issues |
|---|---|---|---|---|
| 1 | …… | …… …… | …… | …… …… …… |
| 2 | …… | …… …… | …….. | …… …… …… |
| 3 | …… | …… …… | ……. | …… …… …… …… |
| | | **Total** | **$14.7M** | |

**Recommendation.** CRS will include the audit of a ……. standing offer and ……... contract in the CRS annual review work plan.

Severed under Section 20(1)c) of the AIA – Third Party Information.

## COMMITMENT ACCOUNTING

We found that a significant number of CF Health Services Group contract managers are not utilizing the commitment function in the Department's Financial Management and Accounting System (FMAS). In our sample of 22 medical contracts, we found ten contracts for which there were no commitments entered into FMAS – a multi-year commitment value of $31M. In fiscal year 2002/03, we observed that CF Health Services Group made 217 high value payments amounting to $23.6M without commitments –

approximately 11 per cent of the CF Health Services Group budget. This practice does not comply with the Department's commitment accounting policy articulated by the Director General Finance (DG Fin) in March 2002. The DG Fin commitment accounting criteria are provided in Annex F. The intention of commitment accounting is to provide visibility to senior management to enable accurate forecast of financial pressures throughout the fiscal year so that funding can be reallocated accordingly. It is our view that the accuracy and ease of producing CF Health Services Group quarterly forecasts is adversely affected without the practise of commitment accounting.

**Recommendation:** ADM(HR-Mil) ensure that commitment accounting practises are adopted in accordance with the C Fin O instructions.

## STANDING OFFER ARRANGEMENTS

A number of the medical contracts were found to be with the same vendors. Since the year 2000, we found that 192 of the 687 contracts were with the 15 vendors listed in the table below. Assuming that there are a limited number of qualified vendors, the repetition of the contract award process to the same vendors creates an unnecessary workload for CF Health Services Group procurement staff. An opportunity exists to reduce the requisition and tendering workload by employing other procurement instruments such as standing offers.

## Table 6 – Medical Contract Awards to Vendors Since Year 2000

| Ser | Vendor Name | Value of Contracts | Number of Contracts | Average Contract Value |
|---|---|---|---|---|
| 1 | Akorn Inc. Taylor Pharmaceuticals | $156,799 | 7 | $22,400 |
| 2 | Aventis Pasteur Ltd. | $1,345,318 | 61 | $22,054 |
| 3 | Alaris Medical Canada Ltd. | $532,595 | 10 | $53,260 |
| 4 | Carsen Group Inc. | $271,402 | 7 | $38,772 |
| 5 | Henry Schein Arcona | $135,667 | 7 | $19,381 |
| 6 | Impact Instrumentation Inc. | $771,318 | 14 | $55,094 |
| 7 | Innova Medical Ophthalmics | $127,228 | 12 | $10,602 |
| 8 | Paterson Dental Inc. | $382,152 | 11 | $34,741 |
| 9 | Precision Ophthalmic Inc. | $132,386 | 8 | $16,548 |
| 10 | Roxon Medi-Tech Ltd. | $2,116,296 | 23 | $92,013 |
| 11 | Steris Canada Inc. | $108,935 | 7 | $15,562 |
| 12 | Summit Technologies Inc. | $146,526 | 7 | $20,932 |
| 13 | Welch Allyn Canada Ltd. | $426,284 | 6 | $71,047 |
| 14 | Zimmer Canada Ltd. | $78,621 | 7 | $11,232 |
| 15 | Smiths Medical Canada | $890,829 | 5 | $178,166 |
| | **Total** | **$7,622,356** | **192** | **$39,700** |

**Recommendation:** ADM(HR-Mil) explore other procurement instruments to reduce the workload associated with the contract award process for medical contracts.

## HEALTHCARE SERVICE-PROVIDER CONTRACT

Our review of the $109M, three-year, healthcare service provider contract found that the cash flow proposed in the option period commencing in April 2004 is 25 per cent higher than the existing cash flow. This could result in the inflation of fiscal year 2004/05 commitments and distort CF Health Services Group financial forecasts. The management shortfalls associated with this contract was reported in the September 2003 CRS report *Contracting for Professional Health-Care Services.* Since this report, we have observed that:

- Improvements made in the verification of invoices and tracking of expenditures have avoided costs of $1.5M;
- The number of service providers under the contract has been reduced by at least 100 (11 per cent);
- Monthly expenditures on the contract have been reduced from $4.7M to $4.1M (15 per cent); and
- A December 2003 amendment to the contract anticipated the cash flow in the 10-month option period commencing April 2004 to be $5.1M – 25 per cent higher than the current expenditures. The DND economic model anticipates an escalation of contracted medical services of only 2.2 per cent.

**Recommendation:** ADM(HR-Mil) revisit the anticipated cash flow in the option years of the service provider contract.

## KEY RISKS AND MITIGATING STRATEGIES

Although the primary risk reported by CF Health Services Group was schedule slippage, we found that the CF Health Services Group mitigation strategies did not address this risk. Table 7 outlines the risks and mitigation strategies reported by CF Health Services Group in the 22 completed risk assessment templates (Annexes B and C). The most common risk mitigation tools were spreadsheets, vendor reports, and FMAS to track expenditures. It is our view that these tools identify risk, but do not mitigate risk. Holdbacks are a more proactive measure to mitigate performance risk. Schedule risk can be addressed by offering performance incentives that are linked to delivery schedule.

### Table 7 – CF Health Services Group Contract Risks and Mitigation Strategies

| Key Contract Risks | | Mitigation Strategy | |
|---|---|---|---|
| **Type of Risk** | **No of Contracts** | **Mitigation** | **No of Contracts** |
| Schedule | 15 | Spreadsheets | 6 |
| Cost | 2 | Vendor Reports | 5 |
| Performance | 1 | FMAS | 4 |
| Subject Matter Experts | 1 | Holdbacks | 2 |
| | | Discount | 1 |
| | | Vendor Meetings | 1 |

We observed an innovative practice in the CF Health Services Group to address the vendor's financial constraints that could have led to performance risk. An informal agreement was made with the vendor for a 0.5 per cent discount to the Department if an invoice was paid within five days of receipt. This measure resulted in savings of $627K on contract payments of $109M. Had the payments been made 30 days from the date of invoice, the Department's future value of the delayed payments would have been $470K. Therefore, from a future value of money perspective, the net discount was $157K.

**Recommendation:** ADM(HR-Mil) consider more proactive contract risk mitigation strategies such as performance incentives and discounts.

## RECOMMENDATIONS

Severed under Section 20(1)c) of the AIA – Third Party Information.

CRS will include the audit of a …… standing offer and …….. contract in the CRS annual audit and evaluation work plan

It is recommended that ADM(HR-Mil):

- Implement a CF Health Services Group process to monitor the 11 contracts, identified in this report as Tier III contracts;
- In conjunction with ADM(Mat), conduct a check of CF Health Services Group's contract management capacity, giving particular attention to the availability of monitoring information and systems;
- Adopt commitment accounting practises in accordance with the C Fin O criteria;
- Explore other procurement instruments to reduce the workload associated with the contract award process for medical contracts;
- Revisit the anticipated cash flow in the option years of the service provider contract; and
- Consider more proactive contract risk mitigation strategies such as performance incentives and discounts.

# ANNEX A – METHODOLOGY FOR DETERMINING HIGHER-RISK CONTRACTS MANAGED BY CF HEALTH SERVICES GROUP

## INTRODUCTION

CRS examined all of the available information regarding contracts managed by CF Health Services Group where the contract authority was PWGSC or those where the contract authority was DND/DC Pol. Contracts that are used but not specifically managed by CF Health Services Group were not assessed in this review.

## METHODOLOGY

CRS obtained a list of contracts from CF Health Services Group but was concerned that the information was not sufficiently comprehensive for the purposes of this review. A search was conducted in both the PWGSC Automated Buyer Environment (ABE) database and DC Pol's database for information related to CF Health Services Group's contracts. This search resulted in the identification of 758 contracts considered by CRS as managed by CF Health Services Group. In order to reduce this number of contracts to a manageable quantity for analysis purposes, two global filters were applied to the list of CF Health Services Group contracts. The two principle filters were if the contract was still active, and the significance of the value of the contract. Of the 758 contracts, 215 were identified as active.

> Active contracts means contracts that contain at least one active document, which contains at least one key date (awarded, expired, first and last delivery) after 1 April 2003.

In the first tier of medical contracts, only those above $1M were included. In the second and third tiers, only those between $100K and $1M were considered. Of the 215 active contracts, 33 were considered to be of significant material value – amounting to $164M in total (98 per cent coverage of the materiality). Those with a value of less than $100K (the remaining 182 active contracts) were not assessed and represented only 3 per cent of the total dollar value of all current CF Health Services Group contracts.

> Materiality refers to the $ value of the contract. Recent problematic contracts that have come to the attention of senior management have ranged in value from $76M to over $400M. It was decided that a conservative filter would be a $1M threshold for the higher-risk CF Health Services Group, Tier I contracts and $100K for the Tier II contracts.

**Annex A**

The next step was to apply automated criteria in order to assign a risk assessment score to the 33 active contracts of significant material value and categorize the contracts into the appropriate tiers of high-risk contracts. The automated criteria are described below and the risk score assignment is summarized at Table 8.

**Automated Criteria.** The seven criteria described below were used to determine the risk assessment score of each contract.

- Materiality: The impact of risks associated with higher-value contracts were assessed to be greater than those with lower value. Ten current medical contracts greater than $1M in value were considered to have significant materiality. Based on the other automated criteria below, 12 current contracts between $100K and $1M were selected for more rigorous risk assessment.

- Contract Amendments: An amendment greater than 30 per cent of the contract value was considered significant, particularly if the amended value of the contract was greater than the value of the original requisition. The amended contract value was taken from the PWGSC ABE database. The average DND contract amendment for PWGSC tendered contracts is 17 per cent of the contract value. The average escalation for medical contracts is 13 per cent.

- Tender Process: Although contracts awarded through the competitive process still have the risk of being inappropriately managed, there is an increased element of risk if the Department has limited the contract award to a single contractor. For DND contracts as a whole, 23 per cent of the contracts tendered by PWGSC have invited only one bidder. For the current medical contracts, 72 per cent were limited to one bidder, which represented only 16 per cent of the dollar value of all the current contracts.

- Type of Commodity: Service contracts were scored higher in risk than goods contracts. In past CRS work, it has been observed that the scope of work for service contracts can be underestimated and it is more difficult to verify services rendered. Only 32 per cent of the current medical contracts were related to services, but this represented 80 per cent of the dollar value.

- Method of Payment: The most common methods of payment are milestone payments, payments upon delivery, and progress claims. Some contracts have a "multiple" method of payment and others also allow advance payments. Those with a "multiple" payment method and those with advance payment options were considered to have a higher risk as they are often more complex to manage and are more difficult to measure in terms of value for money.

- Higher-Risk Organizations: Previous work by CRS has indicated that several organizations in NDHQ have less experience managing contracts than others. As well, organizations that initiate common-user contracts are at higher-risk of error due to

the centralized nature of the contracted services. For the purposes of this review, CF Health Services Group was considered a higher-risk organization.

- Consulting and Audit Canada (CAC): CRS reviewed the CAC database to determine whether CAC had conducted a cost audit of any of the contracts managed by CF Health Services Group. A history of significant CAC audit adjustments with a particular vendor demonstrated a high-risk contract situation.

The risk assessment scoring criteria and weights are indicated in Table 8. Please note, the higher the score; the higher the risk.

**Table 8 – Scoring Criteria/Weighting Methodology for Contracts Managed by the CF Health Services Group**

| Scoring/ Criteria | Dollar Value Score | Amendment Value Score | Tender Process Score | Commodity Score | Method of Payment Score | CAC Highlighted Vendor | Higher-Risk Organization |
|---|---|---|---|---|---|---|---|
| Scoring Weight | 1.0 > $10M<br>0.75 > $7.5M<br>0.25 > $2.5M<br>0.10 > $1.0M<br>0.0 < $1.0M | 1.0 > 30 per cent of the original contract value<br>0.0 < = 30% | 1.0 if sole sourced<br>0.0 if competed | 1.0 if medical, dental services, repair, etc.<br>0.5 if goods | 1.0 if advance payments<br>0.5 if multiple payments<br>0.0 if milestone payments or upon delivery | 1.0 > 10 per cent adjusted or other significant problems | 1.0 if managed within the CF Health Services Group organization (based on UIC codes) |

**Judgmental Criteria.** Once the seven automated assessment criteria were applied, 15 other judgmental criteria were evaluated through the examination of sources documents and information systems. The judgmental risk criteria were addressed by CF Health Services Group completion of the risk assessment templates for the identified 22 contracts (Annexes B and C). To complete the templates, CF Health Services Group undertook a manual review of their contract files, and extracted data from FMAS data or off-line expenditure tracking spreadsheets. Listed below are the 15 CRS judgmental criteria that were applied to each contract and incorporated in the risk assessment templates. The maximum judgmental risk score was 15. The results of the judgmental risk assessment are shown in Annexes D and E.

- Contract managers workload was reasonable. (The average number of contracts per manager in CF Health Services Group was eight);
- A competitive process was the basis of the contract award;

**Annex A**

- Less than four contract amendments were necessary;
- Contract escalation was less than 30 per cent – not including option years;
- The deliverables were within the contract scope of work;
- Most of the work was performed by the prime contractor;
- The contracted services were provided to one or two locations;
- The contracted services were not a new alternate service delivery initiative;
- Performance incentives related to the base amount of the contract;
- The contract expenditures were within the ceiling price of the contract;
- Commitment accounting practices were in place;
- Terms of payment did not include a cost plus arrangement;
- There was sufficient supporting documentation to verify the receipt of goods and services;
- The contract provided for linkage of payments to deliverables; and
- The contract statement of work clearly defined the deliverable.

The items listed above were included in the CRS methodology that was applied in the larger, concurrent CRS project to determine high risk contracts across the DND/CF.

# ANNEX B – CONTRACT SUMMARY TEMPLATE
## (For Tier One and Tier Two Contracts)

| Contract Summary Template | | |
|---|---|---|
| **Ser** | **Contract Information Requested** | **Management Response** |
| 1 | Vendor Name: | |
| 2 | Contract Number: | |
| 3 | Nature/Category of Service Provided: | |
| 4 | Award: Competitive/Non-Competitive: | |
| 5 | Duration of Vendor History Providing this Specific Service to DND: | |
| 6 | Principal Officer Acting as Technical Authority: | |
| 7 | Original Contract Value/Ceiling: | |
| 8 | Key Option Provisions: Contract Extensions Available/ Contract Off-ramps: | |
| 9 | Original Contract Term/Duration: | |
| 10 | Current Contract Value/Ceiling: | |
| 11 | Current Contract Term/Duration: | |
| 12 | Current Total Expenditures: | |
| 13 | Current Total Expenditures and Commitments: | |
| 14 | Current Forecast Total Expenditures: | |
| 15 | Advance Payments Made/Required: Details | |

**Annex B**

| Contract Summary Template | | |
|---|---|---|
| **Ser** | **Contract Information Requested** | **Management Response** |
| 16 | Per Cent Completion of Work and Per Cent of Contract Ceiling Utilized: | |
| 17 | Number of Substantive Contract Amendments: | |
| 18 | Key Risks Facing Contract: Schedule/Cost/Performance/ Other: | |
| 19 | Key Risk Mitigation Strategies: Schedule/Cost/ Performance/Other: | |
| 20 | Key Internal Management Reports Capturing Information on the Contract: | |
| 21 | Other Systems/Measures which will Provide Early-Warning of Problems: | |

# ANNEX C – DETAILED CONTRACT MANAGEMENT RISK ASSESSMENT
# (For Tier One and Tier Two Contracts)

| Detailed Contract Management Risk Assessment Template | |
|---|---|
| **Contract Number _____ Vendor Name _____ Technical Authority (Name, Appointment, Ph #)** | |
| **General** | **Management Response** |
| G1. Within your directorate, how many contract managers/ technical authorities are there, and how many contracts are active? | |
| G2. What are the five most common goods and services for which your organization contracts (e.g., IT/IM maintenance, repair and overhaul, medical services)? | |
| G3. What overall reporting and early-warning strategies are employed to monitor contracts? | |

**Annex C**

| Detailed Contract Management Risk Assessment Template | |
|---|---|
| **Contract Number _____ Vendor Name _____ Technical Authority (Name, Appointment, Ph #)** | |
| **Specific Contract Questions** | **Management Response** |
| S1. Does the Statement of Work (SOW) define the deliverables? Please provide a copy of the SOW, or an abbreviated version if the SOW is lengthy. | |
| S2. What evidence is provided to the technical authority to determine if goods or services have been received in accordance with the contract? What supporting documentation does the Section 34 signing authority have that the goods and services were received (e.g., packing slips, timesheets, etc.)? Did the technical authority sign all such supporting documents? Please provide an example of supporting documentation. | |
| S3. Who is signing for Section 34 of the FAA to certify that performance and price is in accordance with contract? Please provide name, organization and phone number. | |

**Annex C**

| Detailed Contract Management Risk Assessment Template | |
|---|---|
| **Contract Number _____ Vendor Name _____ Technical Authority (Name, Appointment, Ph #)** | |
| **Specific Contract Questions** | **Management Response** |
| S4. What was the original contract period and contract value? How many option years were provided for in the contract. What is the current cumulative value of contract amendments and the length of time that the contract has been extended. Please summarize the contract value/date of the contract award and each amendment? | |
| S5. What are the terms of payment for the contract (e.g., firm price, a unit cost or a target price)? Are payments calculated by cost to contractor, plus a mark-up? Are advance payments made? Please attach the request for authority to make such payments. | |
| S6. Are terms of payments linked to deliverables? (Reasonableness of work performed compared to statement of work/deliverables in contract.) | |
| S7. Are there performance incentives/penalties/holdbacks in the contract? Please specify or attach copies of the relative terms of the contract. | |

**Annex C**

| Detailed Contract Management Risk Assessment Template | |
|---|---|
| **Contract Number _____ Vendor Name _____ Technical Authority (Name, Appointment, Ph #)** | |
| **Specific Contract Questions** | **Management Response** |
| S8. Were the services in this contract recently (within the last three years) performed by DND? | |
| S9. Was this contract sole-sourced? What is the substantiation for sole-source? Was an ACAN posted? If so, was the ACAN ever challenged by other potential suppliers? Please provide the documents pertaining to the challenge and our response. | |
| S10. Are there subcontractors associated with this contract? If so, how many and what portion of the work is being performed by them vis-à-vis the prime contractor. | |
| S11. Are the services of this contract provided to several DND locations across Canada? How many cost centres (approximate, if necessary) are charged for the use the goods or services of this contract? Please provide a list of the cost centres. | |

**Annex C**

| Detailed Contract Management Risk Assessment Template | |
|---|---|
| **Contract Number _____ Vendor Name _____ Technical Authority (Name, Appointment, Ph #)** | |
| **Specific Contract Questions** | **Management Response** |
| S12. How are the expenditures against the contract tracked? FMAS commitments, MASIS, separate spreadsheet, etc. Please provide a list of the FMAS commitment numbers, and a copy of any other expenditure-tracking tools. | |

# ANNEX D – CRS JUDGMENTAL MEDICAL CONTRACTS RISK ASSESSMENT RESULTS – TIER I (>$1M)

| Ser | Contract Number | Vendor Name | Value $M | % Esc | Judgment Score | Reason Selected/Not Selected |
|---|---|---|---|---|---|---|
| 1 | ……. | …… | …… | …… | … | CRS reviewed/improved controls |
| 2 | ……. | …… | …….. | .... | … | Expenditure tracked by vendor |
| 3 | ……. | …….. | …… | .... | … | No escalation |
| 4 | ……. | …….. | …… | …… | … | Change in scope, schedule delay |
| 5 | ……. | …… | …….. | .... | … | No escalation |
| 6 | ……. | …… | …… | …… | … | Ceiling Exceeded by $0.9M |
| 7 | ……. | …….. | …… | .... | … | No escalation, low score |
| 8 | ……. | …… | …….. | .... | … | No escalation, low score |
| 9 | ……. | …… | …… | .... | … | 51 per cent spent, 65 per cent work done |
| 10 | ……. | …… | …… | .... | … | No escalation, low score |
| | | | **$184.3** | | | |

Shaded Serials 2, 4, and 6 have been selected for further audit. Maximum judgment score was 15.

Severed under Section 20(1)c) of the AIA – Third Party Information.

# ANNEX E – CRS JUDGMENTAL MEDICAL CONTRACT RISK ASSESSMENT RESULTS – TIER II (>$100K < $1M)

| Ser | Contract Number | Vendor Name | Value $K | % Esc | Judgment Score | Reason Not Selected |
|---|---|---|---|---|---|---|
| 1 | …… | …….. | ……. | ……. | … | Consumable option exercised |
| 2 | …… | …… | ……. | …. | … | No escalation |
| 3 | …… | …… | ……. | …. | … | No escalation |
| 4 | …… | …….. | ……. | ……. | … | Clerical error on option buy |
| 5 | …… | ……... | ……. | …. | … | No escalation |
| 6 | …… | ……... | ……. | ……. | … | Descalation, low risk score |
| 7 | …… | ……... | …. | ……. | … | Descalation, low risk score |
| 8 | …… | ……... | ……. | …. | … | No escalation |
| 9 | …… | ……..…… | ……. | …. | … | No escalation |
| 10 | …… | …… | ……. | …. | … | No escalation, low risk score |
| 11 | …… | …… | ……. | …. | … | No escalation, low risk score |
| 12 | …… | …… | ……. | …. | … | No escalation, low risk score |
| | | | **$2,674** | | | |

Maximum judgment score was 15.

Severed under Section 20(1)c) of the AIA – Third Party Information.

# ANNEX F – DIRECTOR GENERAL FINANCE COMMITMENT ACCOUNTING CRITERIA

- A commitment must be recorded once an obligation is created. It is recommended that recording begin as soon as an intent involving the expenditure of public funds is initiated;
- Commitment accounting should be focused on those transactions that have the greatest impact on budgets;
- Those transactions that exceed $5K should be committed;
- FMAS commitments may not be necessary when the expenditure is paid within the same month that the formal commitment is established;
- For those Level Ones who commit 'en masse' Salary Wage Envelope (SWE), it will be necessary to manually reduce the commitment after each pay period because SWE expenditures do not reference commitments; and
- Care must be taken to ensure that commitments originating in systems that interface with FMAS are not erroneously duplicated (i.e., Canadian Forces Supply System Upgrade, American Express).

Note: Source of commitment criteria is 7000-1 (DG Fin) Memorandum 30 March 2002.