National Defence Défense nationale

Chief Review Services Chef - Service d'examen

CRS CS Ex

AUDIT OF CONTRACTING FOR TRANSPORTATION

August 2006

7053-65 (CRS)



Canada

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LIST OF ACRONYMS

ADM(Fin CS)	Assistant Deputy Minister (Finance and Corporate Services)
ADM(Mat)	Assistant Deputy Minister (Materiel)
CANOSCOM	Canadian Operational Support Command
CICA	Canadian Institute of Chartered Accountants
CMSG	Canadian Materiel Support Group
CRS	Chief Review Services
DC Pol	Director Contracting Policy
DG Proc Svcs	Director General Procurement Services
DLBM	Director Logistics Business Management
DND	Department of National Defence
FAA	*Financial Administration Act*
FAM	Financial Administration Manual
FMAS	Financial Managerial Accounting System
FY	Fiscal year
GL	General ledger
J4 Mat/DG Log	J4 Materiel/Director General Logistics
MCP	Materiel Priority Code
NMDS	National Materiel Distribution System
NMSO	National Master Standing Offer
PWGSC	Public Works and Government Services Canada
SOP	Standard operating procedure
TA	Transportation agent

RESULTS IN BRIEF

This audit was initiated as a special tasking in response to other Chief Review Services (CRS) work which recognized weaknesses in the control framework for software and personnel services contracts managed by the J4 Materiel (J4 Mat)/ Director General Logistics (DG Log) group within the Assistant Deputy Minister (Materiel) (ADM(Mat)) organization. CRS determined that an examination of contracting for the transportation of personnel and goods—the group's primary contracting activity—was warranted.

Overall Assessment

- The vast majority of sampled contracts for air, rail and sea transport and for road freight were awarded in the absence of proper contracting authority and with inadequately documented competition and bid evaluation.
- Local transportation agents (TA) do not have enough information to ensure the selected carrier provides best value or, in some cases, is even certified to carry the goods.
- Contractual terms were not well defined, creating a situation where it is difficult to confirm that payment is in accordance with the contract, as required for *Financial Administration Act* (FAA) Section 34.

Observations

Awarding of Contracts. The observed contracting process did not meet all Treasury Board and Department of National Defence (DND) requirements:

- The DND delegated contracting authority was exceeded and/or the contract was not signed by an individual with proper authority in 92 of 109 sampled air, rail and sea transportation contracts;
- While 89 of these contracts were technically awarded via competition, the method used—i.e., e-mailing or faxing requirements to at least two selected companies—may have omitted many potential suppliers and may not have resulted in best price;
- Received bids were not adequately secured, creating a risk of information being inappropriately shared, in particular in light of the high number of contractors working in this area;
- For air transport contracts, there was no clear method of determining how the winning bid was selected, and 18 of the 87 sampled air contracts were sole-sourced with no documented rationale;
- Tariff rates received in bid packages from 34 road freight carriers were included in the National Materiel Distribution System (NMDS) tariff tables; however, only three of these carriers complied with all bidding requirements. Company profiles, copies of licences to carry dangerous goods, and/or signed tariff rates were missing in 88 percent of the received packages, and nearly one-third were received after the closing date; and
- Neither the individual responsible to evaluate the bid packages, nor the Base/Wing TAs who issued waybills based on the NMDS tariff tables, had documented authority to contract on behalf of the Department.

Contract Management Including FAA Section 34 Certification. FAA Section 34 certification was non-existent on paid invoices related to 13 of the 109 sampled air, rail and sea contracts, and the quality of the FAA Section 34 certification was questionable on a high percentage of the remaining invoices. More than half the sampled air, rail and sea contracts either did not include a contract ceiling, or the ceiling had been exceeded without benefit of a contract amendment. Invoices related to 39 percent of the sampled contracts included charges for items not mentioned in the contract and 24 percent did not include supporting documentation for third-party charges. The process for FAA Section 34 certification for road freight invoices was also weak. In fiscal year (FY) 05 and FY 06, respectively, 1,008 and 3,593 waybills were paid with no indication in NMDS that the shipment was received. As well, surcharges added at the time of invoicing make it difficult to confirm that price is in agreement with the contract.

Road Freight Carrier Selection. Much of the carrier selection has occurred outside of the NMDS tariff tables and in some cases without full confirmation of proper licensing. Best price was not always achieved because of various surcharges and questionable priority shipments:

- For each shipment, TAs are directed to choose one of the three lowest price carriers from an NMDS-generated listing—for 29 of the 101 sampled waybills, this did not occur. Of all waybills awarded in FY 06, 84 percent were awarded to carriers who had submitted NMDS rates, while the remaining 16 percent were awarded to carriers who had not submitted NMDS rates—these accounted for 53 percent of the total dollars expended on freight;
- When selecting carriers for shipments of ammunitions and explosives, TAs are instructed to consult a Director Logistics Business Management (DLBM)-maintained website to identify properly licensed carriers. However, the website is not up-to-date, and 9 carriers who shipped ammunition and explosives for DND in FY 06 were not listed on this website;
- TAs selected road carriers based on NMDS tariffs that were net of surcharges. Because the surcharges varied by carrier and were as much as 30 percent of the total bill, the lowest overall price was not always selected; and
- Carriers are often selected based on their ability to meet delivery requirements. However, 61 percent of priority 1 shipments were not received by the requested delivery date, suggesting the premium paid for this service is often not warranted.

Management Information. Annual departmental transportation expenditures cannot be accurately determined because of inconsistencies in the financial reporting practices. This undermines management's ability to track trends or to recognize unusual transactions. There is no clear understanding regarding the proper general ledger (GL) accounts to use. As well, inconsistent direction has been provided regarding when freight costs should be included in the cost of purchased goods as opposed to being recorded as a separate item in the financial records. Inconsistent methods of reallocating costs among cost centres further reduce the accuracy of financial records.

Recommendations

Authority to contract for transportation services needs clarification and reinforcing. The various contracting approaches used, including contracting through brokers, contracting via waybills, etc., need to be examined to ensure they are in accord with delegated authorities. As well, the authority of all individuals involved must be properly documented. Improved monitoring processes should be implemented, in particular a more robust FAA Section 34 process, to ensure all charges are in agreement with the contract and are fully supported. TAs should be provided with improved tools to ensure that all goods are carried by authorized carriers and that best price is achieved. Finally, improved direction should be provided with regards to recording financial information. This will increase management's ability to track trends and monitor costs.

Note: For a complete list of CRS recommendations, please refer to Annex A—Management Action Plan.

INTRODUCTION

Objectives

- To assess whether the awarding of contracts for transportation services by J4 Mat/DG Log complies with Treasury Board and departmental policies.
- To assess whether controls over carrier selection and the payment process are sufficient to mitigate risks, improve efficiencies and achieve greater economy.
- To assess whether sufficient, accurate information is available to management for comprehensive process monitoring.

See Annex B for a listing of criteria used to evaluate these objectives.

Scope

- Transportation arrangements made by J4 Mat/DG Log for air, sea, rail and road movement of personnel and goods.
- Expenditures for FY 03 through FY 06 were examined to determine trends. Detailed examination included some transactions from FY 03 and FY 04, but was primarily focused on expenditures in FY 05 and FY 06 YTD[1]—$64M and $33M, respectively.

Methodology

- Reviewed relevant policies and procedures, including Treasury Board and departmental contracting policy, FAA, Treasury Board and Departmental Delegation of Authorities, and departmental direction on the use of the NMDS.
- Interviewed 40 people including transportation contracting officers, Base/Wing TAs, warehouse personnel, NMDS operations and support personnel, and invoice processing personnel.
- Completed site visits to 25 Canadian Forces Supply Depot Montreal, Central Materiel Traffic Terminal, Canadian Forces Support Unit (Ottawa) Uplands, and the Inbound Logistics Headquarters (QA Toronto).
- Analyzed expenditures for air, rail, sea and road transportation recorded in the Financial Managerial Accounting System (FMAS) and analyzed movement of road freight using NMDS data.
- Reviewed in detail 433 invoices relating to 109 contracts for air, sea, and rail transportation, as well as 101 road freight waybills and their supporting documentation. These documents were selected for review based on random and directed sampling methodologies.

[1] FY 06 YTD included April through November 2005. Expenditures for the complete FY 06 were $118M.

Note: Several differences exist between road freight and the three other methods of transport:

Method of Transport	Number of Payments	Average Payment Value (in $ '000)
Rail	28	175
Sea	47	97
Air	551	156
Road	3180	6

Table 1—Payment Volume and Value. *Number of J4 Mat/DG Log payments and average payment size for each method of transport during FY 06.*

- **Volume and Value.** Contracts and payments for road freight are high in volume, but low in value, while contracts and payments for the other three methods of transport are much lower in volume but higher in value. An internal ADM(Mat) study[2] indicated that in 2004, there were 73 contracts awarded for air, sea and rail transport combined, compared to over 61,000[3] for road freight. Table 1 gives the number and average value of J4 Mat/DG Log payments for each of these methods of transport during FY 06.
- **Process.** Air, sea, and rail transport requirements are normally met using individual contracts arranged by J4 Mat/DG Log staff. Separate sections within the DLBM organization are responsible for each of air, rail and sea transport. Most contracts have a small number of payments associated with them. DLBM staff make payments centrally. By comparison, an arrangement similar to a standing offer has been established for road transport. Tariff rates are listed in a nationally available database—NMDS. TAs at each Base/Wing access this system, choose a carrier, and generate a waybill. The waybill serves as the contractual document between the Department and the carrier. The carrier invoices the Department based on the waybills, and the invoices are paid centrally by DLBM staff.

These differences in volume, value and process impact the observations and recommendations. While some of the audit observations apply to all four modes of transport, others are more specific to either air, rail and sea or to road freight. As well, while the recommendations are similar in the two areas, process differences will impact their implementation. As a result, one section of the report addresses transport by air, sea and rail, while a second section deals with road freight.

[2] Review of the Contracting Process Transportation – DLBM, 16 February 2005.
[3] In this case, each individual waybill has been considered a call-up (or contract) against a standing offer. Several waybills may subsequently be billed on a single invoice.

A third section of the report speaks to limitations in the available management information. The issues discussed in this section have been raised in many previous CRS reports, and are not unique to the management of transportation contracts. They are included in this report for further emphasis, and to allow discussion of their implications on this specific area of financial reporting and resource management.

At the time of the audit, J4 Mat/DG Log was responsible for all aspects of transportation contracting. Currently, the Canadian Operational Support Command (CANOSCOM)/Canadian Materiel Support Group (CMSG) has assumed responsibility for defining special heavy lift requirements, while ADM(Mat)/Director General Procurement Services (DG Proc Svcs) is responsible for the procurement process, including contract approvals. The responsibility for road and courier services has been transferred from DLBM to CMSG. Throughout the report, we have identified the responsible organization at the time of the audit; however, recommendations have been directed to the newly responsible groups.

OBSERVATIONS AND RECOMMENDATIONS

AIR, RAIL AND SEA TRANSPORT

Awarding of Contracts

While contracts awarded by DLBM for the movement of personnel or goods by air, sea and rail have met operational requirements, Treasury Board and departmental contracting requirements have generally not been met. Contracts have been awarded without proper authority and with inadequate or undocumented competition.

Contracting Authority

- DLBM has been delegated unlimited authority to competitively acquire "transportation services from ***common carriers***, if the rates charged ***do not exceed the normal rates*** for such services."[4] When these conditions are not met, the Director's authority to competitively acquire transportation and freight is limited to $400,000. In either case, authority is limited to $25,000 if the service is acquired non-competitively. This authority cannot be re-delegated; i.e., the Director cannot assign a staff member to carry out this function.

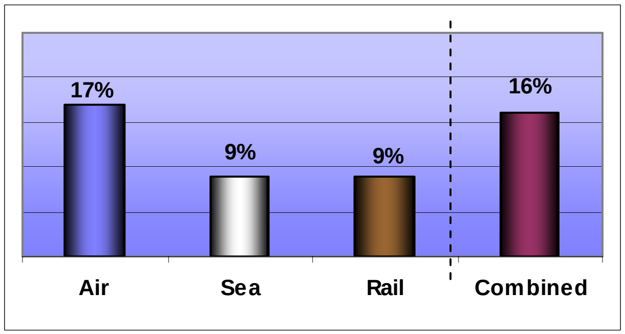

Figure 1—Proper Contracting Authority.
Percentage of sampled air, sea and rail contracts with proper contracting authority.

- However, 83 of 109 sampled contracts were authorized by individuals subordinate to the Director. In six of these cases, a contractor rather than a government employee had authorized the contract. In addition, nine of the sampled contracts contained no signature. Overall, appropriate contracting authority was exercised in only 16 percent[5] of the reviewed contracts, as shown in Figure 1.
- Forty-two of the sampled contracts were with transportation brokers, rather than with common carriers, yet exceeded the $400,000 limit. Indeed, for air transport, contracting through brokers was the norm.
- In addition, there was no process in place to confirm that the rates charged did not exceed normal rates.
- The Department has recently made a submission to Treasury Board seeking increased authority to contract for transportation through brokers, as this has become the industry norm.

[4] Delegation of Authorities for Financial Administration for DND and the CF, A-FN-100-002/AG-006, 20 December 2004.
[5] The sample included 87 air, 11 sea and 11 rail contracts. The combined column is based on the total 109 contracts.

- As an interim measure, since summer 2005, the Director Logistics Services has authorized all air, sea, and rail transport contracts.

Competitive Process

- Due to the operational nature of the requirements and the generally short lead times involved, it was often not feasible to post requirements on MERX[6]. Rather, DLBM faxed an invitation to tender to a selected list of suppliers.
- For 82 percent of the 109 sampled air, sea and rail contracts, requirements were faxed to more than one company, as shown in Figure 2, and therefore met a strict definition of being competitively let.
- However, the process for inclusion on the source list was not documented or widely advertised and as a result may have omitted many potential suppliers.
- In particular, 21 percent of the 87 sampled air services contracts—varying in value from $22,000 to $5.7M—were sole-sourced, with no documented rationale for directing these requirements. One air broker was awarded 56 percent of these contracts.

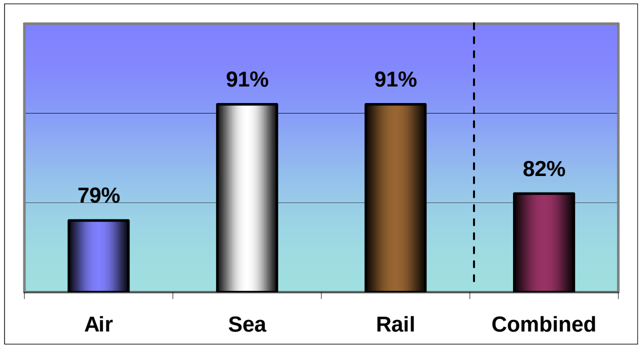

Figure 2—Competitive Contracts. *Percentage of sampled air, sea and rail contracts competitively awarded.*

Bid Evaluation and Security

- Suppliers' bids were sent to DLBM by unsecured fax and were received in an open office accessible by various staff, including many contractors. While we did not observe any instances of bids being compromised, there is a risk of sensitive information being shared inappropriately.
- DLBM staff evaluated the suppliers' responses and determined the winning bid. For sea and rail charters, a bid recap sheet documented the evaluation process and indicated how the successful bid was chosen. The staff involved in the process signed the recap sheet.
- A bid recap document was not prepared for air charters. In the sample of air contracts, the lowest price bid from those on file was normally chosen. However, in the absence of documentation to confirm who received and responded to the invitation to tender, we cannot confirm that best value was obtained.
- One broker dominated the contracts for air services, winning 68 percent of the sampled contracts (including those which were sole-sourced), representing over 90 percent of the dollars expended.

[6] MERX is an Internet-based electronic tendering system that advertises government contracting opportunities to potential bidders across Canada.

Departmental Ship's Agent

- In 2000 the Department recognized the requirement for a ship's agent to arrange various port services, including loading and offloading cargo. By August 2001, DLBM staff had arranged with a commercial firm to provide ship's agent services at a monthly rate of $4,900. This increased to $6,950 in October 2002 and to $8,950 in May 2004. Between August 2001 and November 2005, the Department paid over $368,000 to this firm.
- A number of issues relating to this situation cause concern:
  - The requirements were not originally documented;
  - A competitive process was not used to select the chosen firm, and no rationale for the choice is on file;
  - All details of the agreement were verbal until July 2004 when a formal contract was prepared; and
  - Invoices from August 2001 until November 2005 did not provide details regarding the services provided.
- This arrangement is still in place; however, DLBM staff informed us that they are preparing to compete this requirement on the MERX.

Recommendations

Ensure proper contracting authority by:

- Updating the Departmental Delegation of Authorities document to reflect the current organizational structure and the use of transportation brokers; and
- Ensuring all individuals exercising contracting authority have properly delegated authority.

Improve competition and increase transparency by:

- Using MERX to compile air and sea supplier source lists;
- Documenting any rationale for sole sourcing to ensure it is adequately supported;
- Ensuring the bid process is documented and handled in a secure fashion; and
- Consistently completing bid recap summaries for air, rail and sea contracts.

Contract Management Including FAA Section 34

Key information, such as the contract ceiling amount and billable services, was missing in many of the sampled contracts. Contract amendments were rarely prepared to document changes to contract amount or to deliverables. As a result, payments were often not in agreement with the contract.

Contract Ceilings

- In more than half the sampled contracts, the contract ceiling was not stated or had been exceeded, as shown in Figure 3.
- Payments exceeded contracted value by 17 percent ($20M), 12 percent ($.8M), and 9 percent ($.5M) for air, sea and rail, respectively.
- Some observed air contracts listed prices for individual flights, but did not stipulate the maximum number of flights, and did not include a contract ceiling. In other air, rail and sea contracts, a ceiling amount was defined; however, total payments exceeded the ceiling and an amendment had not been authorized.

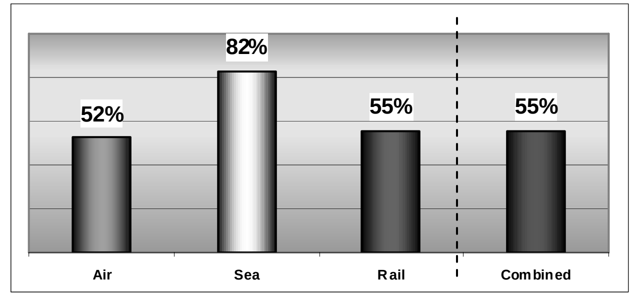

Figure 3—Contract Ceiling Exceeded.
Percentage of sampled air, sea and rail contracts that exceeded contract ceiling.

Billable Services

- Many invoices included charges for items not identified in the contract, including cancellation fees, insurance, storage, airport or port security fees, handling fees, and miscellaneous surcharges.
- Contract terms do not clearly state which of these are billable items and which, if any, are to be included in the negotiated rates.
- Figure 4 shows the percentage of contracts where invoices included charges not identified in the contract. All sampled rail contracts included billed items that were not identified in the contract. All these charges were processed for payment.

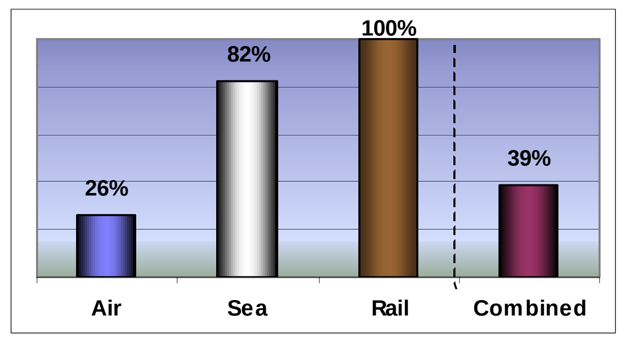

Figure 4—Deliverables not defined.
Percentage of sampled air, sea and rail contracts with billed items not identified in the contract.

Unsupported Charges

- Supplier invoices frequently included charges—for amounts as high as $30,000—from airport authorities, seaports, customs agencies, longshoremen's associations and other third parties. In many cases there was no supporting documentation, i.e., third-party invoice, to confirm that the supplier had paid this amount on DND's behalf.
- The number of contracts with invoices that included unsupported third-party charges, as Figure 5 shows, ranged from 18 percent for sea to 45 percent for rail. All such invoices were processed for payment.

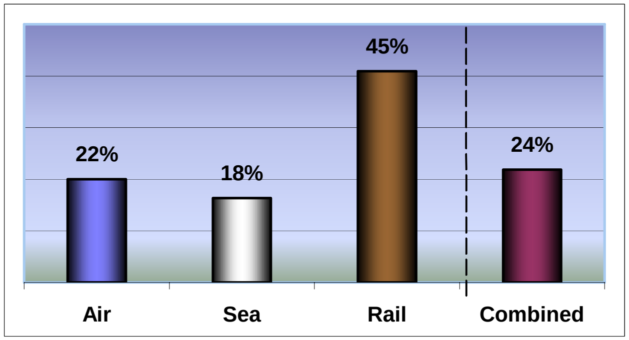

Figure 5—Insufficient documentation. *Percentage of sampled air, sea and rail contracts with incomplete supporting documentation for charges.*

Section 34 Certification

- The quality of the FAA Section 34 process is questionable given the high number of contract ceilings that were exceeded, the numerous invoices paid for services not listed in the corresponding contract and the frequent absence of sufficient supporting documentation.

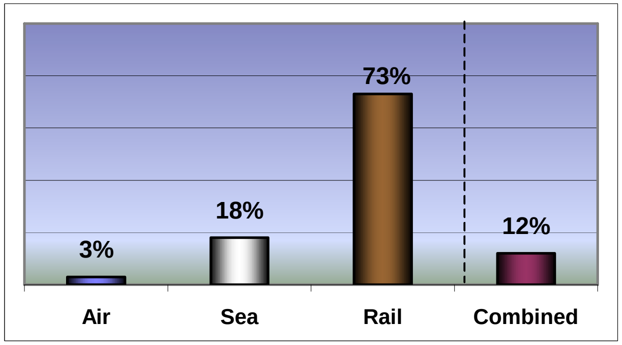

Figure 6—No FAA Section 34. *Percentage of sampled air, sea and rail contracts with paid invoices missing Section 34 certification.*

- FAA Section 34 certification was non-existent on many invoices related to the sampled contracts, as shown in Figure 6. Of the sampled rail transport contracts, invoices totalling $681,000 of $6.2M had been paid with no FAA Section 34 certifications.

Recommendations

To allow better contract management, ensure:

- Contract ceilings are stipulated and amendments processed when required; and
- Billable items are clearly stated in the contract and within scope.

Improve the FAA Section 34 process to ensure:

- All invoices have been properly certified before payment; and
- Adequate documentation exists for all charges, especially those relating to a third party.

ROAD FREIGHT

Awarding of Contracts

The process to establish road freight tariffs was not adequately documented. There was insufficient segregation of duties and received bids were not well secured. Ninety-one percent of the carriers whose bid submissions were accepted did not meet all the stated requirements. In addition the establishment of the standing offer and subsequent contracts (via waybills) was done without documented authority.

NMDS Bid Process

- As in previous years, in FY 06 a call letter was sent to a list of commercial carriers requesting tariffs for various shipping lanes. The MERX or a similar competitive process was not used to compile the list; rather, it was informally generated by DLBM staff with some input from local TAs.

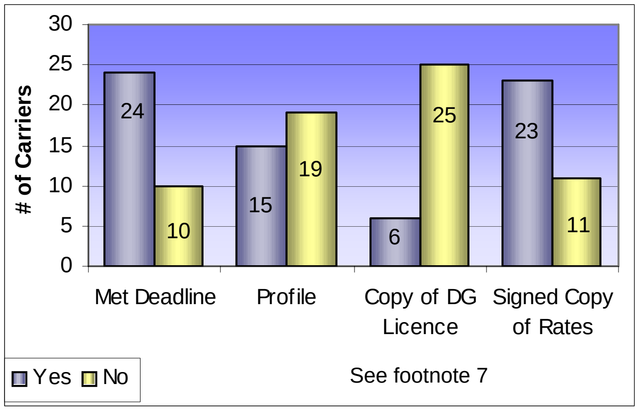

Figure 7—Bid Compliance. *Number of accepted carriers for FY 06 that did or did not meet requirements specified by DND.*

- Thirty-four carriers responded, of which only three were fully compliant with the criteria listed in the call letter. Ten of the bid packages were submitted after the closing date, 19 did not include the requested company profile, 25 did not submit proof of licensing to carry dangerous goods (yet submitted tariffs for this type of shipment),[7] and 11 did not include a signed copy of the offered rates, as shown in Figure 7.
- Despite being non-compliant, the tariffs from all 34 bid packages were entered into NMDS.
- In addition to the original request, a separate call letter was issued—again without using MERX or a similar competitive process—requesting tariffs for recurring shipments of ammunition. Combining the two requirements would have been more efficient.
- One person, a contractor, administered all aspects of the bidding process, including compiling the list of bid recipients, sending out bid requests, receiving bid packages, evaluating the bid packages, and forwarding the tariffs for entry into NMDS. There was no process to ensure that received bids were handled in a secure fashion.

[7] This total is less than the others in the chart as only 31 of the 34 carriers submitted tariffs for shipping dangerous goods.

- This lack of segregation of duties and inadequate security compromises the integrity of the process.
- For FY 07, the call for tariff rates was competed by Public Works and Government Services Canada (PWGSC) as part of a broader government requirement. MERX was used to solicit bidders and PWGSC was involved in the evaluation process.

Authority to Contract

- DLBM staff and local TAs generally consider the NMDS tariffs to be the equivalent of a standing offer, with each waybill constituting a call-up; however, there is no documentation to confirm this.
- Authority to enter into such a contractual arrangement was not present, a formal agreement was not prepared and no call-up limit was defined.
- TAs at each Base/Wing did not have any documented contracting authority, yet were entering into contractual arrangements via waybills. Fifteen of 16 TAs interviewed were not aware of any requirement for contracting authority or of any dollar limit on their authority to make shipping arrangements. While the majority of waybills were of low-dollar value, 2 percent exceeded $5,000.
- For some specialized shipments, such as vehicle movements, NMDS tariff tables were not consulted; rather carriers were contacted directly for rates. Again, the individuals involved had no documented contracting authority. In one instance the value of the resulting contract was over $400,000.

Recommendations

Ensure proper contracting authority by:

- Clarifying the contractual status of NMDS tariffs and the resulting waybills; and
- Ensuring all individuals exercising contracting authority, including those authorizing road freight waybills, have properly documented authority.

Improve competition and increase transparency by ensuring:

- The bid process is documented and handled in a secure fashion;
- MERX is used to compile supplier source lists; and
- Only compliant bids are accepted.

Road Freight Carrier Selection

Much of the carrier selection has occurred outside of the NMDS-provided tariff rates and in some cases without full confirmation of proper licensing. Best price was not always achieved because of various surcharges and questionable priority shipments.

Carrier Selection Often Not Based on NMDS Tariffs

- For each shipment, TAs are directed to choose one of the three lowest-price carriers from an NMDS-generated listing, or document the rationale for selecting otherwise.[8] Twenty-nine of 101 sampled waybills did not use one of the three lowest-priced carriers; however, only three included a documented rationale.
- TAs gave many verbal explanations for not choosing one of the lowest three, including: the carriers' unwillingness to provide service in some geographic areas (despite submitting tariffs for this area); the carriers' inability to meet the required delivery dates, or the TA's preference for a particular carrier. In some cases, TAs stated that the NMDS-selected carrier was inappropriate because all relevant criteria were not considered in generating the choice—for example, the requirement for a dedicated truck to ship ammunition.

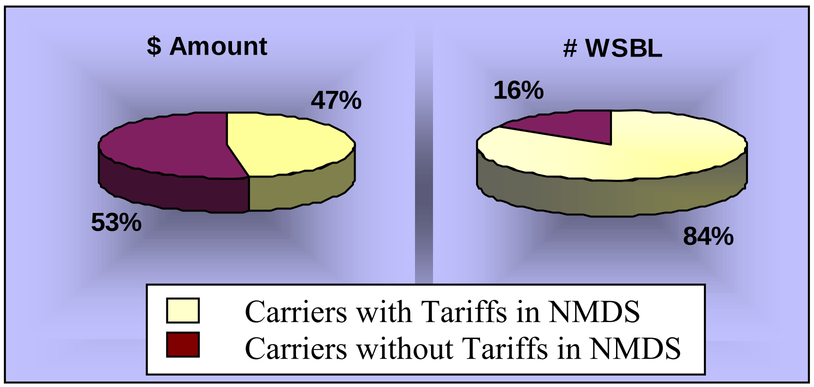

Figure 8—Shipments awarded using NMDS. *Comparison of waybills issued and amount paid to carriers with or without tariffs in NMDS April to November 2005.*

- In some cases, an alternate carrier is chosen using the NMDS tariff tables. In other cases, in particular for specialized requirements such as flatbeds, a one-time arrangement is made. As shown in Figure 8, 84 percent of waybills were awarded to carriers who had submitted NMDS tariffs, while 16 percent—accounting for over 50 percent of the dollars—were awarded to carriers without tariffs in NMDS.
- Only 31 of 79 carriers receiving payments in FY 06 had tariffs in NMDS. Of these, 35 percent received less than $10,000 each.
- Twenty-one of the 48 carriers who did not submit tariffs for inclusion in NMDS received payments totaling over $10,000, with the highest receiving $1.9M.
- This situation may lead some carriers to question the value of submitting bids, or of trying to compete for best rate. The transparency and fairness of the process may also be questioned.

[8] AIG 004/02 Material Traffic Carrier Selection, dated 5 March 2002.

Selecting Carriers for Dangerous Goods

- The NMDS system does not indicate which carriers can carry these goods; rather, a DLBM-generated website posts a list of carriers licensed to ship ammunition and explosives in Canada and outside of the country. TAs consult this website to find appropriate carriers.
- Between April and November 2005, 43 carriers shipped dangerous goods at a total cost of just over $1.9M—25 of these shipped ammunition and explosives.
- Sixteen of the 25 carriers who transported ammunition and explosives were listed on this website; however, only three had submitted proof of licensing for FY 06. The other carriers had remained on the list based on licensing from previous years. Nine of the carriers who shipped ammunition during this time period had not submitted proof of permits and were not listed on the NMDS website.
- Despite a disclaimer on the website which states the TA is responsible to confirm the carrier's licensing at the time of shipping, 7 of 11 TAs who had shipped dangerous goods stated that they relied almost exclusively on website contents. Without a clear process to confirm certification there is a risk that unlicensed carriers could transport dangerous goods.

Impact of Surcharges

- The NMDS price comparison is not based on an all-inclusive price. Fuel surcharges, for example, are not considered in determining the lowest price. Although the Freight Carriers Association of Canada publishes a weekly national fuel surcharge, carriers are free to establish their own rates. These are not submitted in advance to DLBM, but are simply added to the invoice at time of billing. The observed invoices had fuel surcharges varying from 0 percent to 30 percent. While most were near the national fuel surcharge amount for the applicable timeframe, some were up to 5 percent higher.
- At least two of the sampled waybills ultimately had a higher shipping cost than if another carrier had been used, due to the extra fuel surcharge.[9]
- When questioned, three TAs stated they were not aware of any additional surcharges; five others were aware of extra charges but did not know the cost and were not concerned with the final shipping price.
- While TAs are expected to choose the lowest price carrier they are not provided sufficient information to ensure this occurs.

[9] There may have been many more, but because the fuel surcharges are not included in the NMDS database this can only be determined on an individual waybill basis.

Impact of Delivery Date

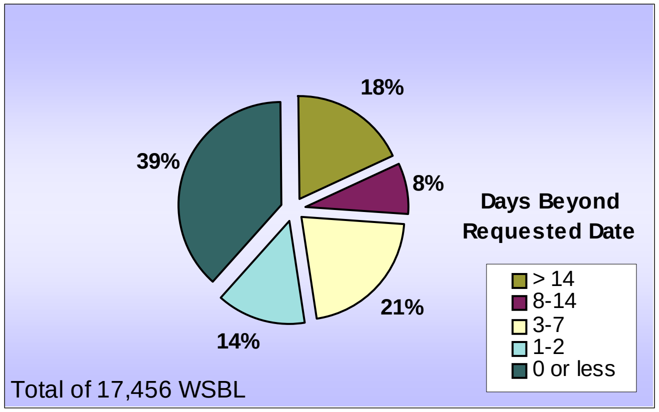

Figure 9—Delivery Performance. *Analysis of recorded delivery to requested date for priority 1 shipments.*

- From April to November 2005, 25 percent of shipments were sent by commercial carrier, priority 1 at a cost of $4.6M. As shown in Figure 9, only 39 percent of these were received by the requested date. NMDS data indicates 18 percent were received more than 14 days late.
- Often the problem is a lack of coordination between the Supply Group and Transport, with delays related to supply shortages rather than carrier deficiencies. However, shipping priorities are not adjusted based on availability of goods.
- A sample of 56 waybills was chosen to determine the premium that had been paid to send goods priority 1. For this sample, the total cost to send the goods priority 1 was twice the cost of using priority 2 or 3. Recorded deliveries varied from 6 to 301 days after due date.
- While only a rough order of magnitude, the Department could have saved approximately $1.4M by using priority 2 or 3 for the 61 percent of goods that arrived late.[10]

- The DND/CF green fleet exists as an alternative to sending items via commercial carrier.
- Green fleet is intended to be the carrier of choice, especially for non-urgent shipments.
- From FY 03 to FY 05 the overall use of green fleet increased, as shown in Figure 10. However, if fewer shipments were sent priority 1, greater use of green fleet could potentially be made.
- The green fleet is not included as a potential carrier in the NMDS selection process. It is used on an ad hoc basis with no efficient way of tracking capacity or availability.

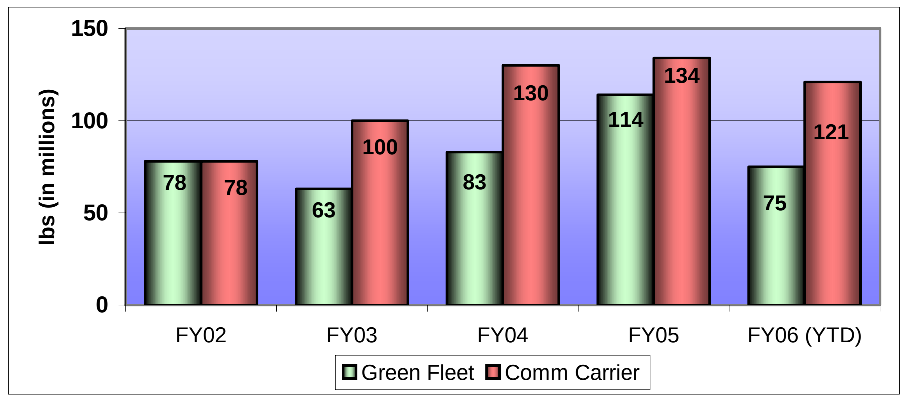

Figure 10—Green Fleet Use. *Use of green fleet versus commercial carrier.*

[10] Based on $4.6M multiplied by 61 percent multiplied by 0.5.

FAA Section 34 Certification

Many invoices were paid without verification that the goods were received and that the price was reasonable, as required by FAA Section 34.

- Carrier invoices are received centrally by the Audit Cell in J4 Mat /DG Log. This group confirms existence of the corresponding waybill in the NMDS, and marks the waybill as paid. They subsequently recommend the invoice for payment.
- No one is confirming that the shipment was actually received prior to making payment as required for FAA Section 34 certification.
- In FY 05, 1 percent of paid waybills were not marked as received in NMDS. At the time of the audit this had increased to 5 percent for FY 06; however, the increase may in part have been due to ongoing NMDS system modifications.
- For FY 05, 87 percent of invoices included surcharges. Advance notice of the amount of these surcharges is not required and varies among vendors and over time. For sample transactions, some vendors included a fuel surcharge that was as much as 5 percent above the nationally published rate. As a result, it is difficult to confirm that the price is in accordance with the contract or reasonable as required by FAA Section 34 certification.

Recommendations

Improve the FAA Section 34 process to ensure:

- All shipments are received before payment is made; and
- Standardized surcharges are used or a method exists to determine their reasonableness.

MANAGEMENT INFORMATION

Annual departmental transportation expenditures cannot be accurately determined because of inconsistencies in financial reporting practices.

- Data within the FMAS system was analyzed to determine the value of transportation expenditures processed annually by J4 Mat/DG Log[11] and to gain an understanding of the characteristics of these transactions.

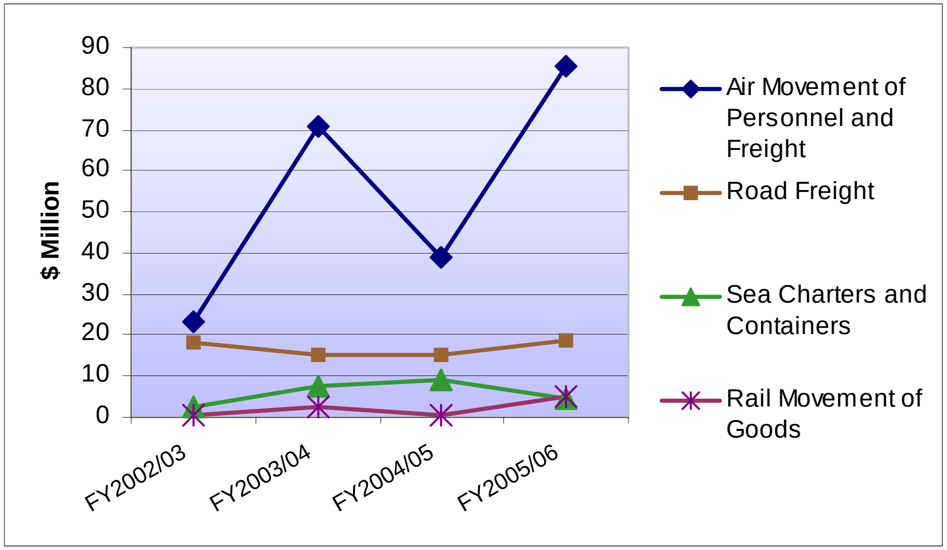

Figure 11—Transportation Expenditures. *Trend in Transportation Expenditures Processed by J4 Mat/DG Log, FY03 to FY06.*

- Figure 11 shows the trend in these expenditures from FY 03 to FY 06.
- The analysis provided a useful starting point, allowing us to isolate a sample population of transactions for further analysis.
- However, it also highlighted many inconsistencies in financial reporting which preclude accurate determination of total annual expenditures for transportation.

Inconsistent Use of GL Codes

- Expenditures for road, sea, and rail freight are generally charged to one of two GL codes established for Freight—Express and Cartage. Payments for individual packages transported by air are also recorded within these GL accounts.

- However, when arrangements are made to use an entire aircraft to move goods or personnel, the expenditures have been charged to either Charter Flight Travel or Rental of Aircraft. In FY 05, more than $43M was reported as Rental of Aircraft; of this approximately $35M was payments for moving personnel or freight. No direction has been provided on the appropriate use of these GLs, and each contains a host of other charges, including individual airfares associated with business travel, and costs of

[11] Total departmental expenditures for these services were first determined. The expenditures were then segregated by departmental accounting office to determine those processed by J4 Mat/DG Log.

renting aircraft for training purposes. One might expect Charter Flights to be used for the movement of personnel, and Rental of Aircraft to be used for the transport of goods (although a GL associated with Freight would be more appropriate); however, this rationale has not been applied.

- A similar GL account—Rental of Ships and Boats—has not been used when arrangements are made to use an entire ship to transport goods. Rather these expenditures have been recorded as Freight—Express and Cartage.
- As a result of this inconsistency in the use of GL accounts, it is not possible to accurately determine the total annual cost of moving goods and personnel. This complicates the subsequent management of these costs.

Freight Versus Cost of Goods Purchased

- The Canadian Institute of Chartered Accountants (CICA) and Treasury Board guidance clearly state that the cost of freight should be included in the laid-down cost of both capital assets and inventories. Departmental guidance is less clear, with the Financial Administration Manual (FAM) on inventories[12] stating that "shipping and handling *may* be included as part of the cost of inventories." Informal departmental guidance, including e-mails, has created additional confusion regarding proper accounting treatment of freight costs.
- In FY 05, over 3,600 vendors received payments coded as Freight—Express and Cartage. The vast majority of these vendors were non-transport companies, suggesting that the costs should more appropriately have been included as part of the cost of assets or inventories.
- The end result is that capital assets and inventories are undervalued by an indeterminable amount. This has implications for the accuracy of departmental financial statements under accrual accounting.

Cost Reallocation

- Many of the Department's requirements to move goods are met using internal resources—i.e., DND vehicles and drivers known as the green fleet. Indeed, goods associated with nearly half the waybills initiated in the examined years were transported using green fleet resources.
- J4 Mat/DG Log periodically reimburses those Bases/Wings providing green fleet resources at an established rate per kilometre.
- As with any cost reallocation, if the debit and credit are to the same GL account but a different cost centre, there is no net effect on the departmental financial statements.

[12] FAM Chapter 1020-5 Para 34 "Inventory," issued 24 August 2005.

- However, an analysis showed that while J4 Mat/DG Log have debited Freight—Express and Cartage, the associated credits have been to a variety of GL accounts including diesel fuel, rental of ships and boats, professional services, and engineering services.
- In FY 05, freight expenses were overstated by as much as $2M as a result.

Granularity of Information

- Despite these inaccuracies, J4 Mat/DG Log is attempting to collect very detailed cost information relating to transportation.
- More than 20 cost centres have been created in FMAS to separately track the cost, for example, of inbound movement of ammunition, inbound freight for army, and inbound freight for air.
- The majority of these cost centres include charges for only one GL: Freight—Express and Cartage.
- Nearly one-third of the total transactions within the Freight—Express and Cartage GL in FY 05 were adjusting entries to move amounts among these various cost centres.
- This complicates any attempt to track information, and to relate total expenditures to invoices and/or contracts. As well, it requires significant time and effort.
- This level of detail may be more appropriately collected in the NMDS system rather than FMAS. Alternatively, the use of internal orders rather than cost centres could be considered.

Recommendations

Provide additional guidance on the financial reporting of transportation expenditures, including:

- Appropriate use of GL accounts;
- Recording of freight expense versus including in the cost of capital assets or inventory;
- Acceptable cost reallocation approaches; and
- Appropriate degree of detail to record in departmental financial information system.

ANNEX A—MANAGEMENT ACTION PLAN

CRS Recommendation	OPI	Management Action & Milestones
Awarding of Contracts Ensure proper contracting authority by: • Updating the Departmental Delegation of Authorities document to reflect the current organizational structure and the use of transportation brokers;	ADM(Fin CS) in consult with CANOSCOM & ADM(Mat)	Treasury Board approved revised delegated transportation contracting authorities for strategic heavy lift on 16 Jun 06. On 2 Aug 06, the Minister of National Defence delegated these new contracting authorities to specific positions within ADM(Mat). The unlimited authority to competitively contract with common carriers has been transferred from DLBM to CANOSCOM/CMSG in light of their responsibility for road and courier services. ADM(Fin CS) is revising the Departmental Delegation of Authorities document to reflect the change for road and courier transportation contracting authority from DLBM to CMSG, and to include authority received from Treasury Board to enter into transportation contracts with other than common carriers. **Revised document to be finalized by 31 Dec 06.**
• Ensuring all individuals exercising contracting authority, including those authorizing road freight waybills, have properly documented authority; and • Clarifying the contractual status of NMDS tariffs and the resulting waybills.	ADM(Mat) & CANOSCOM	Effective 1 Apr 06, DND is a participant of the PWGSC National Master Standing Offer (NMSO) for freight and courier services. As such the NMSO tariffs are input into the DND NMDS system. The standard of government and industry use of the bill of lading (waybill) as a contractual instrument has been verified by PWGSC. The DND waybill is governed by CFP 158(4) which adheres to the PWGSC guidance on the use of waybills. The additional requirement for TAs to have documented delegated authority to issue call-ups against standing offers and/or to have delegated procurement authority to $5K (local purchase order) will be a topic of discussion between CMSG and Director Contracting Policy (DC Pol).
Improve competition and increase transparency by: • Using MERX to compile all supplier source lists; • Documenting any rationale for sole sourcing to ensure it is adequately supported; • Ensuring the bid process is documented and handled in a secure fashion and that only compliant bids are accepted; and • Consistently completing bid recap summaries for air, rail and sea contracts.	ADM(Mat) & CANOSCOM	As of Jan 06, MERX has been used to establish source lists of transportation contractors. The source lists will be re-validated in the Oct-Dec 06 timeframe and annually thereafter. Effective immediately all sole-source requirements will be documented on file in accordance with the requirements of the DC Pol Contract Advisory Bulletins and the Procurement Administration Manual. For special heavy lift requirements, the ADM(Mat)/DG Proc Svcs' standard operating procedure (SOP) for contract file management is now followed. Only compliant bids are accepted. As a result of DND's participation in the PWGSC NMSO, effective 1 Apr 06, only compliant bids for freight and courier services have been accepted and used to establish NMDS tariffs. The process for bid recap summaries has been improved as part of the standard file documentation reviewed by senior members of ADM(Mat) and CANOSCOM prior to contract award.

ANNEX A

CRS Recommendation	OPI	Management Action & Milestones
Contract Management Including FAA Section 34 Certification		
To allow better contract management, ensure: • Contract ceilings are stipulated and amendments processed when required; and • Billable items are clearly stated in the contract and within scope.	ADM(Mat) & CANOSCOM	Since Jul 06, all special heavy lift contracts now have ceiling amounts and appropriate clauses that stipulate the requirement for contract amendments to make changes, including the addition of funds. All special heavy lift contracts now clearly identify contract deliverables and associated costs.
Improve the FAA Section 34 process to ensure: • All invoices have been properly certified before payment; • Adequate documentation exists for all charges, especially those relating to a third party; • All shipments are received before payment is made; and • For road freight, standardized surcharges are used or a method exists to determine their reasonableness.	ADM(Fin CS) through the FAA Section 33 process	A review team from ADM(Fin CS)/Director Accounts Processing, Pay and Pensions will be conducting a comprehensive review of the FAA Section 34 process in the ADM(Mat) and CANOSCOM Transportation Contracting area. **This review will be completed by 31 Dec 06.** All transportation contract payments exceeding $250K will continue to be reviewed to ensure FAA Section 34 has been properly completed prior to FAA Section 33 certification being signed. This review will include a verification of the adequacy of supporting documentation. ADM(Mat)/DG Proc Svcs and CANOSCOM are committed to assisting ADM(Fin CS) on this issue.

ANNEX A

CRS Recommendation	OPI	Management Action & Milestones
Road Freight Carrier Selection Provide improved tools and additional information for carrier selection, including: • Current and complete licensing information;	ADM(Mat) & CANOSCOM	PWGSC NMSO carriers have provided requisite information IAW the request for proposal and selection process. Other selected carriers for specialized requirements have provided information. Additional information is being collected to improve the process. As well, CMSG is developing SOPs to ensure adherence to DND requirements. **Target implementation is NLT 31 Mar 07.**
• All inclusive pricing or use of standardized surcharges;		The NMSO has addressed this issue for road and courier freight. For non-NMDS selected carriers, including special heavy lift contractors, contracts use all-inclusive pricing.
• More complete information for establishing shipping priorities; and		Shipping priorities are established IAW Transportation Priority Codes required delivery dates, as established by the Materiel Priority Codes (MPC). Further, these are established IAW the CF Supply Manual. MPCs have recently been reviewed to validate the applicability of priorities.
• More integrated information on green fleet availability.		Liaison with Bases and the further development of service level agreements is on-going. Information on green fleet availability and cost is more readily available as a result. DND/CF SOPs to address this requirement will be developed as part of the CMSG review and update of CFP 158(4). **Targeted completion date is NLT 31 Mar 07.**
Monitor to ensure that rationale for selecting other than NMDS suggested carrier is sufficiently supported and documented.		As of 1 Apr 06, SOPs to address this requirement are in place. Non-NMDS selected carriers are utilized only when there is no NMDS carrier available. When this occurs, three bids are requested as per the Treasury Board requirement.

ANNEX A

CRS Recommendation	OPI	Management Action & Milestones
Management Information Provide additional guidance on the financial reporting of transportation expenditures, including: • Appropriate use of GL accounts; • Recording of freight expense versus including in the cost of capital assets or inventory; • Acceptable and consistent cost reallocation approaches; and • Appropriate degree of detail to record in departmental financial information system.	ADM(Fin CS)	ADM(Fin CS)/Director Financial Policy and Procedures began an initiative in 2005 to review and revise the existing GL structure. **A revised GL structure along with detailed definitions is expected to be finalized by Mar 07.** With regards to guidance on recording freight expenses versus including in the cost of capital assets or inventory, there is no implementable method available that would permit all affected parties to capture these costs as part of inventory in a uniform method. As both FAM Chapter 1020-4 (Capital Assets) and FAM Chapter 1020-5 (Inventory) were recently updated, no further action is planned at this time. CANOSCOM is committed to assisting ADM(Fin CS) on this issue. *Audit Note: Additional corrective action will be needed to increase the accuracy and consistency of financial records. This is a systemic issue, much broader than the area of Transportation Contracting, and as such effective resolution will require a comprehensive approach.*

ANNEX B—AUDIT CRITERIA

Objective	Area Assessed	Criteria
To assess the extent to which the awarding of contracts for transportation services by J4 Mat/DG Log complies with Treasury Board and departmental policies.	Identification of Potential Suppliers	Manner of advertising contract opportunities is extensive enough to reach all potential suppliers. All carriers receive same information (potential volume, lanes, equipment, delivery requirements).
	Evaluation of Supplier Response	All bids are evaluated fairly with objective criteria. Conflict of interest situations do not exist. All bids are evaluated at the same time (limits opportunity to provide proprietary info to vendors).
	Accuracy and Adequacy of Contracting Documents	Contracts have been properly authorized. Contracting documents reflect rates that suppliers bid. Contracts clearly define conditions, penalty clauses, delivery times, surcharges, etc.
To assess whether controls over carrier selection and the payment process are sufficient to mitigate risks, improve efficiencies and achieve greater economy.	Carrier Selection	Green fleet use is optimized. When other than green fleet is used, best price is chosen. Required delivery dates are met, premiums are not paid for unnecessary fast delivery. Carrier selection is fair, with no evidence of favouritism.
	Payment Process	Invoices contain sufficient FAA Section 34 certification. NMDS waybills support all payments. All waybills have been receipted.
To assess whether sufficient, accurate management information is available to monitor the process.	Management Information	Information regarding transportation is complete, accurate, and sufficient.