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Internal Audit of the Close-In Weapon System (CIWS) Support Contracts

November 2008

7050-38 (CRS)



Canada 

Caveat

This audit is not intended to assess the performance of contractors; rather, it is an internal assessment of processes and practices within the Assistant Deputy Minister (Materiel) (ADM(Mat)) organization.

The values stated regarding the valuation of inventory are dependent on the accuracy of inventory pricing. Previous CRS audits have indicated the inventory prices are not accurate within the CFSS. The inventory values in this report are reported values from the Canadian Forces Supply System and vendor inventory systems and may not represent the actual value of the inventory.

This audit represents a high level of assurance.



Table of Contents

Acronyms and Abbreviations	i
Synopsis	ii
Results in Brief	iii
Introduction	1
Background	1
Objective.....	1
Scope	1
Methodology	2
Criteria	2
Findings and Recommendations	3
Certification of Payment.....	3
Material Management.....	5
R&O Component Management	7
Vendor Reports	8
Basis of Payment.....	9
Risk Management.....	12
Annex A—Management Action Plan.....	A-1
Annex B—Audit Criteria	B-1
Annex C—Vendor-Held Inventory Stock Adjustments	C-1
Annex D—Vendor Reports	D-1



Acronyms and Abbreviations

AAS	Advance Accountable Spares	MRC	Maximum Repair Cost
ADM(Mat)	Assistant Deputy Minister (Materiel)	MRP	Mobile Repair Party
ASC	Audit Services Canada	NATO	North Atlantic Treaty Organisation
CA	Contract Authority	NDQAR	National Defence Quality Assurance Representative
CF	Canadian Forces	ORDALT	Ordnance Alteration
CFSS	Canadian Forces Supply System	OCI	Office of Collateral Interest
CRPA	Contractor Repair Parts Account	OPI	Office of Primary Interest
CIS	Contract Issue Spares	PD	Project Directive
CIWS	Close-In Weapon Systems	PM	Project Manager
CRS	Chief Review Services	PTI	Phalanx Thermal Imager
DGMEPM	Director General Maritime Equipment Project Management	PWGSC	Public Works and Government Services Canada
DGMSSC	Director General Materiel Systems and Supply Chain	RA	Requisition Authority
DIHRS	Defence Integrated Human Resource System	RMA	Repairable Materiel Account
D Mar P	Director Maritime Procurement	R&O	Repair and Overhaul
DMPP	Director Materiel Policy and Procedures	RMP	Risk Management Plan
DMSS	Director Maritime Ship Support	RPC	Repair Priority Code
DND	Department of National Defence	RSA	Repair Supply Account
DQA	Director Quality Assurance	SM	Supply Manager
DSCO	Director Supply Chain Operations	SNAPS	Selection Notice and Priority Summary
FAA	<i>Financial Administration Act</i>	SOW	Statement of Work
FMAS	Financial Managerial Accounting System	SUP	Standard Unit Price
FMF	Fleet Maintenance Facility	TA	Technical Authority
FSR	Field Service Representative	TVM	Time Value of Money
FY	Fiscal Year	TIES	Technical Investigation Engineer Studies
GFOS	Government Furnished Overhaul Spares	US	United States
HMCS	Her Majesty's Canadian Ship	WO	Work Order
HST	Harmonized Sales Tax		
INCO	Inspection and Checkout		
JIT	Just in Time		
Knet	Knowledge Network		
LCMM	Life Cycle Materiel Manager		



Synopsis

As part of an ongoing effort to improve departmental contract management practices, Chief Review Services (CRS) completed an analysis¹ of 15,000 active contracts to identify contracts that may warrant audit attention. The Close-In Weapon Systems (CIWS) support contracts were two of only four contracts identified. Since the combined value of these two contracts represents less than 1 percent of all service contracts, the CIWS support contract management practices are not representative of departmental contracting practices.

The purpose of the two contracts was to purchase upgrade material worth \$65 million for the CIWS and perform the five-year cyclic repair and overhaul (R&O) with a contract value of \$85 million. The audit was initiated sufficiently early to ensure that any issues raised will benefit the remaining two years of the R&O contract as well as the planning and negotiations for the follow-on contract to be awarded in 2010.

Several areas were noted where improvements could be made in the future management of these contracts. For instance, contract managers will now ensure that better supporting documentation is provided to support profit levels and that more oversight is provided over subcontractor transfer prices. Regarding vendor-held inventory, a recent departmental initiative will significantly strengthen material management practices and will further require all Senior Executives to sign an annual attestation as to their materiel accountabilities.

The Department will monitor progress made in implementing the management action plans and will undertake an audit follow-up if warranted.

¹ CRS *Risk Analysis of Operations and Maintenance Contracts*, April 2007.



Results in Brief

To identify contracts that exhibited high-risk attributes, CRS conducted a risk analysis² on 15,000 active contracts with a cumulative value of \$22 billion. The results indicated that the Navy CIWS support contracts were two of the four higher-risk contracts warranting audit attention.

As the value of the two contracts was less than 1 percent of all service contracts, the findings and results from this audit are not representative of all Department of National Defence (DND)/Canadian Forces (CF) contracting practices.

The two seven-year CIWS support contracts consisted of a \$44-million³ R&O contract and a \$53-million material contract. The purpose of these contracts was to procure upgrade material, spare parts and perform the five-year overhaul cycle on 24 CIWS mounts. These two contracts were awarded in June 2003 and April 2004, respectively, and subsequently amended to a combined value of \$148 million to exercise overhaul options and the procurement of spare parts.

Overall Assessment

- Assurance cannot be provided that adequate risk management and control frameworks were in place to effectively manage the CIWS support contracts.
- The contract did not require the provision of sufficient supporting data in order to
- Because payment holdbacks were not used, there was no incentive for the vendor to deliver on time,
Improvements in R&O component and material management are necessary to realize economies and safeguard assets.

Findings and Recommendations

Certification of Payments

Contract provisions for additional supporting documentation to allow better oversight by DND contract managers could have reduced costs by \$5.4 million of which
Because the material contract did not specify the progress claim supporting documentation, there was insufficient detail in subcontract invoices for DND to ensure that inter-company transfer fees between affiliated firms

It is recommended that consideration be given to deferring payments

² CRS Risk Analysis of Operations and Maintenance Contracts, April 2007.

³ All numbers in this report exclude taxes.



Material Management

DND contract managers did not ensure vendor compliance with the policy for holding adjustments/stocktakings of vendor-held DND inventory with a reported value of \$3.0 million. From fiscal year (FY) 2002/03 to FY 2005/06, It was also observed that DND procured \$3.3 million of the depot spares that have had no issues over the last year. It was noted that two-thirds of spare parts were new inventory and could not be verified due to lack of usage history.

It is recommended that controls be strengthened for compliance with vendor-held DND inventory stocktaking/adjustment policy and that other procurements of spare parts include a credit clause for excess and inactive spares.

A recent ADM(Mat) initiative will require all Senior Executives to sign an annual attestation for material accountability. The purpose of this initiative, to be fully implemented by December 2009, is to ensure stocktaking is completed as required, and that due diligence is enforced regarding the management of inventory.

R&O Component Management

Improved DND management of R&O component repair priorities, appropriate maximum repair costs (MRC) and use of in-house resources could defer \$1.3 million of repairs and reduce annual component R&O costs by \$405,000.

It is recommended that the CIWS component R&O efficiency be improved by the appropriate assignment of repair priority codes (RPC), MRCs and optimization of DND maintenance resources.

Vendor Reports

Measures need to be taken to ensure all Key contract management information necessary to provide effective oversight of the work was not defined in the R&O contract.

For the follow-on contract, it is recommended that essential contract management information requirements be identified in specific report formats and that the delivery and quality of key reports be linked to payments.

Basis of Payment

Time Value of Money (TVM) and optimal learning curve efficiency gains were not included into the contract due to the sole-source nature of the contract and the relatively small user of equipment that the Canadian Navy represents. Moreover, holdbacks and value engineering provisions were not included in the contract to assure value for money. There are opportunities in the follow-on contract



It is recommended that the follow-on contract take into consideration
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Risk Management

A formal DND risk management plan (RMP) for the CIWS support contract did not exist, nor did DND require the vendor to use risk management best practices. Some of the issues identified in this report might have been mitigated with appropriate risk management.

For the follow-on contract, it is recommended that a DND RMP be developed and the vendor be requested to develop a comprehensive RMP.

Note: For a more detailed list of CRS recommendations and management response please refer to [Annex A](#)—Management Action Plan.



Introduction

Background

In 2007, CRS conducted a risk analysis to identify higher-risk contracts. Only four contracts exhibited higher-risk attributes warranting a comprehensive audit, two of which were CIWS support contracts. These two contracts—one for material and the other for R&O—provide life cycle support to CIWS mounts (see Figure 1) on three Canadian Navy fleets and the fleet schools.

- **Material Contract.** A seven-year material contract worth \$53 million was awarded in April 2002 to provide ordnance alteration (ORDALT) kits to upgrade the CIWS mounts. The contract amount was subsequently amended to \$65 million to buy spare parts.
- **R&O Contract.** A seven-year R&O contract worth \$44 million was awarded in June 2003 to perform the five-year overhaul cycle for each CIWS mount and install the ORDALT kits. In September 2004, the R&O contract was increased to \$83 million to exercise two options for upgrade of an additional 16 CIWS mounts. The contracted services also included configuration management and CIWS component R&O.



Figure 1. The Close-In Weapon System (CIWS). The CIWS is an anti-missile system mounted on a surface combat ship.

The CIWS support contracts were flagged for audit due to the following risk indicators:

- The relatively high value of the contracts;
- Cost escalation of 30 percent for the material contract;
- A sole-sourced contract award process;
- and
- A time and materiel basis of payment for the R&O contract.

Objective

The objective of this audit was to assess whether adequate governance, risk and management controls were in place to administer the CIWS support contracts.

Scope

- The contract award and management of the current CIWS support contracts;
- The project directive (PD) for the follow-on contract to be awarded in fall 2009; and
- Expenditures totaling \$110 million from April 2002 to February 2008.

The audit of prime/subcontractors was out of scope, as this is an ASC role.



Methodology

- Data Analysis—Financial Managerial Accounting System (FMAS)/Canadian Forces Supply System (CFSS)/Defence Integrated Human Resource System (DIHRS);
- Site Visits—End-user Her Majesty’s Canadian Ship (HMCS) Regina, HMCS Protector, HMCS Calgary, Fleet Maintenance Facility (FMF) Cape Breton, and National Defence Quality Assurance Region Calgary;
- Review of contract documentation and vendor reports;
- A sample of progress claims (48 progress claims and invoices representing \$83 million—75 percent of expenditures to date); and
- Interviews with key staff in Director Maritime Ship Support (DMSS).

Criteria

The audit criteria scorecard is at [Annex B](#).



Findings and Recommendations

Certification of Payment

Additional supporting documentation would allow improved oversight by DND contract managers on

..... The current payment certification process does not ensure that are being adhered to; however, payments were made in accordance with the contract firm lot price. A large sample of payments for material, the majority of which was

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-

Subcontractor Invoices. Because the material contract did not require the vendor to provide supporting documentation, progress claims for some upgrade material lacked sufficient supporting documentation to justify the payments. Twenty percent of the payments sampled worth \$14 million were not supported with subcontractor invoices.⁴ Moreover, when subcontractor invoices were provided, they did not include cost details to determine the amount of Accordingly, we were unable to assess whether Procurement policy requires that inter-company transfers result in a fair and reasonable price to

Subcontractor invoices did not include cost details to determine the amount of

Time Verification. The R&O contract included a clause that allowed DND to conduct a time verification of the vendor’s labour charges. Although the majority of costs incurred in the R&O contract are related to contractor labour, the time verification clause was not exercised. Nearly 62 percent (\$29.0 million) of the R&O contract expenditures were for labour. A review of sample invoices for FY 2006/07 determined that

⁴ Charges associated with missing subcontract invoices were represented by exchange rate adjustment documents.
⁵ PWGSC Supply Manual, Chapter 10, Cost and Profit. <http://www.tpsgc-pwgsc.gc.ca/app-acq/ga-sm/chapitre10-chapter10-eng.html>.



Tax A review of all tax charges for the R&O contract determined that
..... The *Canadian Tax Act* imposes HST for
goods and services that are brought into participating provinces only, which include
New Brunswick, Nova Scotia, Newfoundland and Labrador.⁶
.....

Foreign Exchange Adjustment. According to the material contract, the foreign exchange
adjustments should be calculated using the rate on a set date each month.
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Recommendations

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- Request an audit of the CIWS material subcontracts through Public Works and
Government Services Canada (PWGSC). (OPI: ADM(Mat))

⁶ Canada Revenue Agency <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/gnrl/hst-tvh/bright/menu-eng.html>.



Material Management

Improved DND oversight of vendor-held inventory and recommended buys of spare parts is required to ensure that assets are safeguarded and that value for money is realized.

Safeguarding Assets

Vendor Stocktakings. The R&O contract required the vendor to complete a 100-percent stocktaking every two years for all vendor-held DND material.⁷ However,

- The FY 2006/07 stocktaking report—four years after contract award—was the only report available for three vendor-managed contract issue spares (CIS) accounts with a recorded value of \$2.4 million.
- No stocktaking had been completed on two other Advance Accountable Spares (AAS) accounts with a reported value of \$411,000.
- No oversight was provided for nearly \$207,000 of government-furnished equipment spares identified in the material contract to maintain the CIWS test equipment.

Vendor Adjustments. A review of stock adjustments of DND material from FY 2002/03 to FY 2007/08 determined that more than 54 percent of vendor adjustment transactions were not approved by the National Defence Quality Assurance Representative (NDQAR)—contrary to DND policy. For example,

- As shown in [Annex C](#), since FY 2002/03 stock adjustments
..... were made on the Repairable Materiel Account (RMA) and the Contractor Repair Parts Account (CRPA), respectively.
.....
.....
- Controls over vendor adjustments did improve in FY 2006/07 as the NDQAR supply technician rather than the vendor started entering the adjustments in the CFSS. However, inappropriate use of reason codes and insufficient supporting documentation were found for adjustments totalling \$205,000.⁸

Vendor-Held Inventory Accounts. DND did not have visibility of inventory with a reported value of \$356,000 even though these AAS items had a North Atlantic Treaty Organisation (NATO) Stock Number assigned to them, and hence should have been recorded in a CRPA.⁹ For instance, items in the Lay Away Spares AAS account (\$138,000) and the Gun and Ammo Spares AAS account (\$217,000) should be moved to the CRPA.

⁷ *DND Special Instructions for Repair and Overhaul Contractors*, A-LM-184-001/JS-001, Chapter 6, October 2004.

⁸ There are 31 different CFSS reason codes for holding adjustments of which only 10 require a CF152 Report of Write-off.

⁹ *DND Special Instructions for Repair and Overhaul Contractors*, A-LM-184-001/JS-001, Chapter 5, para 7.



From CRPA usage history, items were identified that had over three years of stock in other DND warehouses with a recorded value of \$2.0 million. Instead of the vendor purchasing this material, DND can avoid markups by making these excess spares available to the vendor.

Value for Money

Depot Spares. In 2002, the vendor recommended that certain spare parts be held at the DND depots for the CIWS upgrade, which DND scrubbed down from \$27.3 million to \$14.9 million. As two-thirds of the suggested spare parts were new inventory, DND contract managers could not verify the vendor-recommended buy quantities because there was no usage history for these parts. Therefore, some of the 174 depot line items that cost \$9.4 million had inventory levels that were found to be surplus to requirements for some items and deficient for others.

- The usage history showed that 103 line items with a recorded value of \$3.3 million were not issued in FY 2007/08. If no usage of these items continues, the annual carrying cost of \$163,000 for these surplus items will persist.
- Forty issued line items acquired for a total price of \$761,398 also had surplus holdings.
- Twenty-four issued line items had insufficient stock.
..... reprovisioning will be required—an estimated replacement value of \$644,000. Consideration should be given to offset the cost of reprovisioning by exchanging surplus items against those items that are in high demand by the vendor or allies.

Recommendation. ensure compliance with vendor-held stocktaking/adjustment policy, and rationalize AAS/CRPA holdings. (OPI: ADM(Mat))



R&O Component Management

Assigning proper DND repairable component RPCs could defer \$1.3 million in repairs. Appropriate MRC settings and using in-house maintenance resources could reduce annual R&O costs by \$405,000.

Repair Priority Codes Settings. DND contract managers have assigned high priority RPCs for components that do not need to be repaired right away. For instance, 50 of 370 CIWS components that are automatically sent to the vendor for repair had more than 24 months of stock. In this case, the RPC should be changed to “pending” so that unserviceable components will be sent to the DND supply depot as repairable reserve rather than being repaired by the vendor. The correct setting of the RPC could defer nearly \$1.3 million of component R&O costs over two years.

Maximum Repair Cost. The MRC for certain components is greater than the cost to replace the item; this can lead to poor repair decisions. The vendor was tasked to revise MRCs to reflect the updated unit prices for all 370 components repaired by the vendor. The revised MRCs proposed by the vendor were accepted by the DND Life Cycle Materiel Manager (LCMM) and Supply Manager (SM). The usual LCMM practice is to set the MRC to be approximately 70 percent of the most current standard unit price (SUP).
.....
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.....

Stocked-out Items. Weapon technicians on and at had serious concerns about the shortage of CIWS spare parts. For 41 items that are repairable by the vendor the DND warehouses are out of stock. Only two of these items were on the vendor’s component repair line. The audit of the CFSS reorder point settings, necessary for automatic replenishment, found that there were no such settings for the 41 stocked-out items. Upon further examination of all 5,444 unique CIWS line items in the CFSS, only 7 percent had reorder points. If not rectified, this will likely result in more stock-outs

DND in-House Repairs. For some R&O components, there are DND in-house resources that could be used rather than contractor support. Four CIWS components repaired by the vendor were identified that are within the capacity of the FMF to repair. This could reduce R&O component costs by \$60,000 per year.

Recommendation. Improve CIWS R&O management by adjusting MRCs, RPCs, CFSS reorder points, and employ in-house resources to reduce R&O component contractor support costs. (OPI: ADM(Mat))



Vendor Reports

DND did not ensure that the vendor provided complete and relevant reports to support decision making.

Reporting Obligations. DMSS contract managers did not ensure that all vendor reporting was compliant with the contract obligations, making it more difficult for DND to manage the contract. The result of a review of the 17 vendor reports listed at [Annex D](#) is as follows:

-
- Six reports were not retained by DMSS
- and
- The contract did not specify the required content for four reports. Formats for the quarterly logistics management and free-flow R&O reports could have included some key management information necessary for improved decision making.

Key Information. Analysis of the vendor reports required in the R&O contract found that key information listed below was not requested to effectively manage the contract. For example:

- Although the contract specified a warranty period and warranty rates, there was no requirement for the vendor to maintain a list of warranty claims. This information could reduce the cost of replacing defective material and ensure the use of lower warranty labour rates. To date, there has been no use of the R&O contract’s warranty labour rates.
- Schedule comparisons (planned vs. actual) would help assess the vendor performance, predict operational risks and develop work around plans.
- Earned value reporting, a standard project management practice for major tasks, would allow for cost and schedule oversight for the overhaul of each CIWS mount. Each mount overhaul costs \$1.2 million in labour.
- Procurement lead time for spares that are procured from the prime contractor were not known, thus increasing the risk of inventory stock-outs
- Estimated component repair costs by the vendor would improve DND budget controls and predict future cash flow.

Recommendation. In the follow-on contract, develop a specific format for each vendor report, link key reports to payments and improve key contract management information requirements. (OPI: ADM(Mat))



Basis of Payment

The bases of payments for the CIWS support contracts did not assure value for money.

Time Value of Money Loss. Due to the sole-source limitations in contract negotiation, there was no consideration for TVM loss associated with ORDALT kits and spares procured under the material contract to support the R&O contract. A review of the material contract cash flow and scheduled delivery of ORDALT kits determined that some payments were made too early. Due to the relatively small Canadian Navy order and the need for standard ORDALT kit configuration, the material was ordered well before the scheduled R&O work. As shown in Figure 2, some material was delivered over three years early and had an expired warranty by the time the R&O work was performed. The contract payment schedule resulted in a potential TVM¹⁰ loss of \$3.7 million as well as increased DND financial risk.

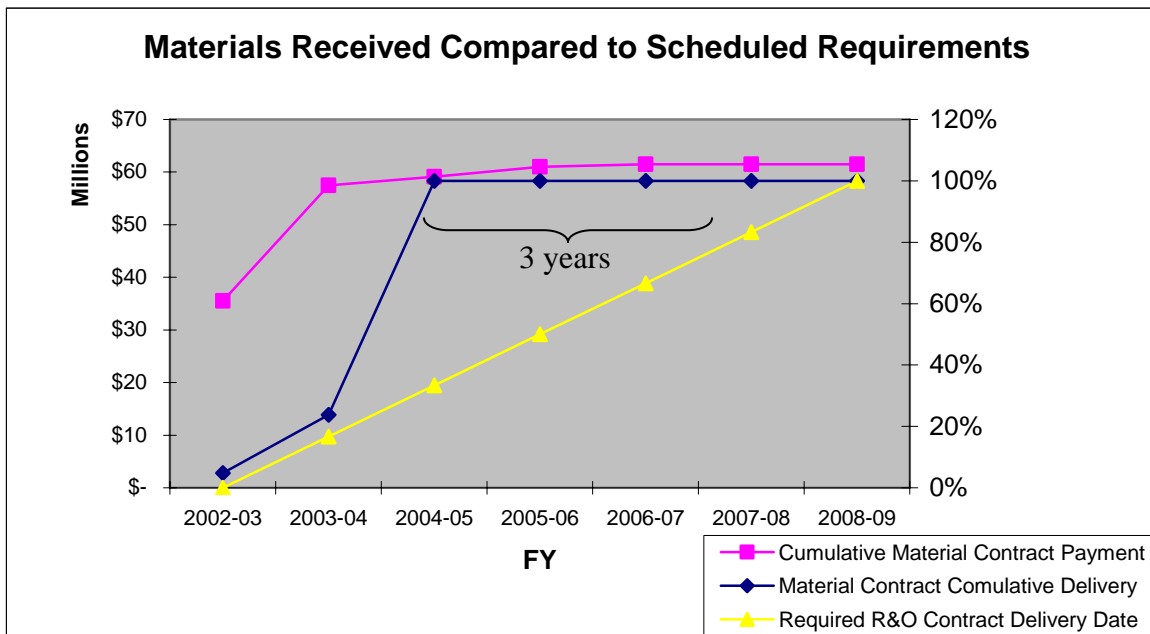


Figure 2. Material Delivery Schedule Compared to Scheduled Requirements. This chart demonstrates that 90 percent of payments of \$44.5 million were made with only 5 percent deliverables received. Accordingly, 71 percent material was delivered early. Cumulative actual expenditures start at \$35.5 million in FY 2002/03 and increases to \$61 million in 2005/06. The line increases slightly to \$61.5 million in the following fiscal year and then stabilizes at that level for the remaining fiscal years until 2008/09. Material received starts at 5 percent in 2002/03; it subsequently increases to 24 percent in the following fiscal year. A sharp increase to 100 percent occurs in FY 2004/05, where it remains. Material required increases slowly and uniformly in each fiscal year from 0 percent in 2002/03 to 100 percent in 2008/09. The data table below shows the cost breakdown by fiscal year:

¹⁰ Bank of Canada Rate 2.87 percent, lowest rate in contract duration.



FY	Cumulative Material Contract Payment	Material Contract Cumulative Delivery	Required R&O Contract Delivery Date
2002-03	\$35,546,432.42	5%	0%
2003-04	\$57,447,970.43	24%	17%
2004-05	\$59,111,218.05	100%	33%
2005-06	\$61,010,895.64	100%	50%
2006-07	\$61,460,204.25	100%	67%
2007-08	\$61,460,204.25	100%	83%
2008-09	\$61,460,204.25	100%	100%

- Normally, only 50 to 65 percent of start-up payments are made prior to steady state production whereas for the CIWS material contract it was 90 percent.
- At contract award, a milestone payment of \$12.4 million for subcontractor manufacturing resources planning, 25 percent of ORDALT kits value, was made 21 months before steady state production. If payments for the subcontractor planning staff had been done throughout the production planning phase a TVM loss of \$559,000 would have been avoided.
- For the \$14.9 million spare parts procurement, a similar early 25 percent milestone payment was made before the 21 month manufacturing planning phase—a TVM loss of \$151,000.
- Nearly 70 percent of ORDALT kits were to be delivered well before the R&O scheduled requirements—a further loss of \$3.0 million in TVM.
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R&O Contract Learning Curve. Learning curve efficiency gains for new work in the R&O contract was not fully recognized. Learning curve models project at least a 20 percent efficiency gain every time production doubles but the contract allowed for only a 1.0 percent efficiency gain.

- Although an efficiency gain of 1 percent was expected, the second batch of CIWS overhauls saw an increase in labour costs of 5.5 percent (excluding rate increases).
- For the new recurring work worth \$7.7 million, learning curve efficiency gains for the three batches of overhauls could have reduced costs by \$2.8 million.
- 11
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Holdbacks

To avoid overpayment and to act as an incentive for the contractor to complete the job, holdbacks are mandatory for contracts with progress payments.¹²

- At the time of audit three mounts were behind schedule, one over 11 months late.
- A 10-percent holdback should have been applied to each mount overhaul to mitigate the risk of late delivery. As well, the decision not to include a holdback contract clause resulted in a TVM loss of nearly \$406,000.¹³ A similar TVM loss could be avoided in the follow-on contract with the use of holdbacks.

Value Engineering Clause. This clause encourages the vendor to suggest cost saving measures for recurring work with a known cost baseline. Although it is typical for Army and Air Force R&O contracts to include a value engineering contract clause to act as an incentive for the vendor to reduce costs, this provision did not exist in the Navy CIWS R&O contract.

Spares Procurement. Since the Canadian Navy was the first to acquire the CIWS Block 1 B upgrade spares it was difficult to determine the quantity and the price for some of the spare parts. However, it was observed that:

- there were no individual item prices in the contract, although pricing information for 46 percent of the line items existed at the time of negotiation in 2002;
-
-¹⁴

Recommendation. (OPI: ADM(Mat))

¹² PWGSC Supply Manual, Chapter 6 -6E.599 <http://www.tpsgc-pwgsc.gc.ca/app-acq/ga-sm/chapitre06-chapter06-eng.html>.

¹³ TVM loss of \$16,900 per mount for 24 mounts because holdbacks were not used.

¹⁴



Risk Management

Risk management was not fully exercised by DND or requested from the vendor.

Risk Management Planning. Continuous risk management is prescribed as a best practice for all business activities¹⁵ in DND. However, at the time of the CIWS contract award, a formal RMP was not required. Although the PD for the follow-on CIWS contract includes a brief risk assessment, it is not supported by a formal RMP. For example, a DND RMP should include:

- Five risk thresholds with specific criteria for each threshold;
- A risk ranking method based on the impact and probability of each risk;
- Quantification of risk impact on cost and schedule determined by mitigation cost option analysis; and
- Mitigation strategies that include contingency plans and triggers.

Other Internal and External Risk. Although the current and follow-on contract PD included a risk assessment, there were other internal or external risks to the Crown that were not identified. For example, some risks experienced under the current contract were as follows:

-
- and
- Inaccurate forecast of CIWS upgrade inventory requirements.

Vendor Risk Management. The vendor risk management reports were not requested by the DMSS contract management team. These vendor reports would have assisted in managing the CIWS contract risk.

- Risk impact threshold and criteria,
- Risk ranking methodology,
- Risk quantification techniques, and
- Reporting frequency.

Recommendation. Develop a DND RMP and require the vendor to improve the management and the reporting of risk in the follow-on contract. **(OPI: ADM(Mat))**

¹⁵ Continuous Risk Management, ADM(Mat) Knet website.



Annex A—Management Action Plan

CRS Recommendation

1. Certification of Payment

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Management Action

Vendor to provide supporting documentation to verify actual profit amount and take action as necessary to This will commence during the Progress Review Meeting in November 2008.

OPI: ADM(Mat)/DGMEPM/D Mar P **Target Completion Date:** February 2009

CRS Recommendation

- Request an audit of the CIWS materiel subcontracts through PWGSC.

Management Action

A formal request will be sent to PWGSC for an audit on CWIS materiel subcontracts.

OPI: DGMEPM/D Mar P **Target Completion Date:** December 2008

CRS Recommendation

2. **Materiel Management.** ensure compliance with vendor-held stocktaking/adjustment policy, and rationalize AAS/CRPA holdings.

Management Action

During the National Inventory Control Point procurement of spares, the requirement to add credit clauses for surplus spares will be included.

OPI: ADM(Mat); OPI: DGMEPM/DMSS **Target Completion Date:** February 2010

Management Action

D Mar P 3-4-3 will notify company of stocktaking requirements and DQA will supervise the stocktaking and make the appropriate stocktaking adjustments.

OPI: ADM(Mat); OCI: DGMSSC/DQA **Target Completion Date:** On an ongoing basis.

Management Action

DQA will perform a review of the continuing effectiveness of the contractor controls through a sample of stocktaking prior to end FY 2008/09.

OPI: ADM(Mat) **Target Completion Date:** March 2009

Management Action

DGMSSC, through DSCO and DQA, is conducting a review of AAS and GFOS with a view to identifying all holdings by end FY 2008/09 and implementing appropriate actions and oversight in FY 2009/10.

OPI: ADM(Mat) **Target Completion Date:** March 2010



CRS Recommendation

- 3. **R&O Component Management.** Improve CIWS R&O management by adjusting MRCs, RPCs, CFSS re-order points, and employ in-house resources to reduce R&O component contractor support costs.

Management Action

The Supply Manager (SM), in collaboration with the Technical Authority (TA), will review the SNAPS yearly and make the appropriate adjustments to the MRCs and review RPCs, as well as CFSS reorder points. The SM/TA will review the CFSS assets to see if there are any excess items that can be used in the R&O facility and employment of in-house resources will be examined for the four R&O components repaired by the vendor.

OPI: ADM(Mat)/DGMEPM/DMSS **Target Completion Date:** Yearly review completed by February of each year.

CRS Recommendation

- 4. **Vendor Reports.** In the follow-on contract, develop a specific format for each vendor report, link key reports to payments and improve key contract management information requirements.

Management Action

IAW the appropriate DND standards, a separate Contract Data Requirements List and Data Item Description Statement of Work (SOW) are being developed and will be implemented in the new contract.

OPI: ADM(Mat); OPI: DGMEPM/DMSS **Target Completion Date:** March 2009

Management Action

DMPP 4-4-2 in coordination with D Mar P will review the list of reports, validate its requirements, develop templates and will amend the R&O Log SOW if required.

OPI: ADM(Mat); OCI: DGMSSC/DMPP **Target Completion Date:** March 2009

CRS Recommendation

- 5. **Basis of Payment.**

Management Action

During the negotiations, D Mar P will address the following items:

OPI: ADM(Mat)/DGMEPM/D Mar P **Target Completion Date:** February 2009



ANNEX A

CRS Recommendation

6. **Risk Management.** Develop a DND RMP and require the vendor to improve the management and the reporting of risk in the follow-on contract.

Management Action

A RMP is under development to support the project and link this to the vendor RMP in order to improve this issue.

OPI: ADM(Mat)/DGMEPM/DMSS

Target Completion Date: September 2009



Annex B—Audit Criteria

Objective

1. Risk Management

Criteria

Contracts include provisions designed to minimize risk to the Crown.

Comments

No gradual escalation for dispute resolution. Vendor liability insurance coverage not monitored by CA.

Rating:

Objective

2. Risk Management

Criteria

Risks are recognized, understood, and appropriately managed.

Comments

No RMP, with impact, tolerance thresholds, risk ranking methodology.

Rating:

Objective

3. Governance

Criteria

Roles and responsibilities of PM, RA, TA, NDQAR, and CA provide effective oversight. The size and training of staff is sufficient.

Comments

Vendor report not available to PM—only TA. TA needs to sign key progress claims. Time verification role unclear. Staff shortage in NDQAR, RA and TA. Formal risk/project management training shortfall.

Rating:



Objective

4. Governance

Criteria

Appropriate monitoring and reporting tools in place to provide timely, accurate, and relevant management information.

Comments

..... No format for vendor reports. Missing some key management information such as earned value, warranty, and repair history.

Rating:

Objective

5. Governance

Criteria

Controls and risks are balanced and support values and ethics.

Comments

Controls in DGMEPM business rules need improvement.

Rating:

Objective

6. Management Controls

Criteria

Financial management is in accordance with the FAA and Treasury Board Contracting Policy, and DND Regulations.

Comments

..... Post-verification of missing subcontract invoices.

Rating:



Objective

7. Management Controls

Criteria

Terms of prime contracts flow down to sub-contractor(s) and are certified by prime contractor.

Comments

CA does not hold copies of subcontracts. No visibility of inter-company transfers.

Rating:

Objective

8. Management Controls

Criteria

Procured assets and loaned material are safeguarded, accounted for, managed efficiently.

Comments

Correct RPC could defer repair costs.

Rating:

Objective

9. Management Controls

Criteria

The optimum basis of payment has been chosen for the contracts.

Comments

Early payment for material prior to receipt and need. No holdback provisions for late deliverables.

Rating:



Objective

10. Management Controls

Criteria

The Statements of Work for the contracts meet the stated requirements.

Comments

.....

Rating:

Objective

11. Management Controls

Criteria

Appropriate management oversight exists for the contracts and amendments to monitor value for money.

Comments

No learning curve consideration, value engineering clause, or spares buy-back provision.

Rating:



Annex C—Vendor-Held Inventory Stock Adjustments

RMA	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	Total	Average
Inventory Value								
Upward Adjustments								
Downward Adjustments								
Absolute Value								
Adj Value vs Inventory Value								
CRPA	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	Total	Average
Inventory Value								
Upward Adjustments								
Downward Adjustments								
Absolute Value								
Adj Value vs Inventory Value								

.....



Annex D—Vendor Reports

Vendor Report

1. Quarterly Logistics Management Report

Comment

No obsolete risk criteria,

Status:

Vendor Report

2. As Built Log

Comment

Nil

Status:

Vendor Report

3. System Condition Reports

Comment

Nil

Status:

Vendor Report

4. 50 Hour Test Reports

Comment

.....

Status:



Vendor Report

5. INCO Reports

Comment

Nil

Status:

Vendor Report

6. Quarterly Status Reports

Comment

Not retained by DND

Status:

Vendor Report

7. R&O Parts for Repair Report

Comment

Missing some data – DND quantities, MRC, SNAPS item.

Status:

Vendor Report

8. Logistics Free Flow (Components) Report

Comment

No cost estimates of repair,

Status:



Vendor Report

9. TIES Taskings Reports

Comment

Nil

Status:

Vendor Report

10. Exchange rate/milestone payment - form DSS-MAS-9411

Comment

.....

Status:

Vendor Report

11. Stocktaking Reports: RMA, RSA, CRPA, GFOS, AAS

Comment

Only 2007 stocktake summary, no stocktake reports for AAS.

Status:

Vendor Report

12. Semi-annual Progress Review Meetings - Minutes

Comment

Majority of action items do not have milestones.

Status:



Vendor Report

13. FSR/MRP Reports

Comment

Format should identify warranty work.

Status:

Vendor Report

14. Progress Review Meeting

Comment

No schedule comparison or earned value.

Status:

Vendor Report

15. Quarterly Progress Reports - Vendor Proposal

Comment

Contains overall R&O earned value, must be requested by DND.

Status:

Vendor Report

16. R&O Component History Record

Comment

Not requested by DND, avg repair cost for SNAPS items.

Status:



Vendor Report

17. Vendor Risk Management Report

Comment

.....

Status:

