



Office of the Auditor General

**Audit of Public Works and Environmental
Services Department – Contract Management**

Tabled at Audit Committee

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The team responsible for this audit, comprised of Orbis Risk Consulting and Louise Proulx from the Office of the Auditor General (OAG), under the supervision of Sonia Brennan, Deputy Auditor General and the direction of Ken Hughes, Auditor General, would like to thank those individuals who contributed to this project, and particularly, those who provided insights and comments as part of this audit.

Original signed by:

Auditor General

Executive summary

Purpose

The Audit of Public Works and Environmental Services Department (PWESD) – Contract Management examined the efficiency and effectiveness of PWESD’s contract management activities.

The Audit of Environmental Services (Part II) – Operational Review, subsequently renamed Audit of PWESD, was included in the 2017 Audit Plan of the Office of the Auditor General, approved by City Council on December 14, 2016. This audit of PWESD’s contract management activities, along with an audit of Frozen Services and Hydrant Management and Maintenance, were completed in accordance with the 2017 Audit Plan.

Rationale

From January 2016 to April 2018, PWESD managed over eleven hundred contracts (or purchase orders) with suppliers for a value of over \$262 million. These purchase orders were for goods and services such as snow removal services, engineering services, construction materials, the supply of heavy equipment, among many others. Procedures for contracting at the City of Ottawa are set out within the City’s Purchasing By-law and other guidance materials. Departmental managers are responsible for identifying the need for specific goods/services that are required from a supplier. Supply Services is responsible for advising and supporting managers in the supplier selection process and is ultimately responsible for issuing the contract with the supplier.

Once a contract, or purchase order (PO) is in place, the departmental director or delegated manager is then responsible for managing the contract. The purpose of contract management is to ensure that the supplier delivers the goods and services ordered in accordance with the terms and conditions of the contract. Key contract management activities include accepting the delivery of goods and services in accordance with the terms and conditions of the contract, resolving disputes, managing contract changes, communicating effectively with suppliers, keeping Supply Services apprised of major contract issues, and approving payment of invoices after determining that deliverables are acceptable.

Sound contract management practices are important to ensure that adherence to relevant laws, by-laws and policies, as well as helping to ensure that contracted goods and services provide the City with value for money.

Findings

The audit focused on assessing the following contract management activities:

- Communicating specifications/expectations and monitoring supplier performance;
- Ensuring supplier's adherence to relevant laws, by-laws and policies;
- Inspecting and accepting goods or services prior to payment;
- Managing contract changes (amendments, change orders or scope changes); and
- Resolving disputes.

Key findings associated with each activity are as follows:

1. Communicating specifications/expectations and monitoring supplier performance

The City ensures “best value” for taxpayers’ dollars, when vendors deliver goods and services on time, and at the agreed price per quantity, quality, and in accordance with the contract requirements. To achieve best value requires a number of important practices, protocols and considerations, including the following:

- Contracting documents (e.g. solicitations, contracts/purchase orders, etc.) should clearly communicate the relevant specifications and expectations for contract deliverables; and
- There is an effective monitoring program whereby contract deliverables and milestones are assessed against agreed specifications and expectations.

A) Communication of specifications/expectations

The audit team examined contracting documents (e.g. solicitations, contracts/purchase orders, etc.) to identify if they included clear requirements regarding the City's specifications and expectations for the contracted goods or services.

Of the 35 files examined, 22 were the result of a formal request; Request for Proposal “RFP”, Request for Standing Offer “RFSO” or Request for Tender “RFT”. Of these 22, all were found to include clearly established specifications, including technical requirements where applicable, and expectations for contract deliverables within the solicitation documents as well as the resulting PO.

For the 13 sole-source contract files examined, the findings were less positive. POs associated with 2 of these contract files (representing approximately 27 per cent of the total value of these 13 contracts) included only a reference to the specifications and requirements set out directly on the supplier's quote/estimate. Auditors noted that the language set out in these quotes/estimates presented a potential risk insofar as they lacked clear descriptions of the requirements, for example, they were vaguely worded.

In addition to technical specifications and requirements, the audit also examined the extent to which monitoring provisions were included in PWESD contracts with suppliers. This testing indicated that the existence of such provisions varied depending on the selected contracting mechanism. Contracts resulting from formal requests (RFP, RFISO or RFT) were more likely to include adequate monitoring provisions compared to sole-source contracts. Even when sole-source contracts were found to include monitoring provisions, they were found to be relatively less robust, for example, monitoring was established by the supplier's proposal or via reference to the City's General Terms and Conditions for Contracts.

B) Monitoring supplier performance

There are a number of effective practices and techniques (e.g. periodic meetings, interim reporting, quality testing etc.) to monitor supplier performance such that any issues or concerns are identified and addressed in a timely manner. Many of these techniques are described in the City's June 2017 *Contract Administration and Reporting on Supplier Performance* guide. In addition, the City has developed a Vendor Performance Management (VPM) program including VPM Guidelines that set out specific expectations for monitoring their suppliers. The audit team's examination of VPM documentation indicated that these guidelines reflected a number of effective and appropriate contract management practices. VPM is currently being rolled out within PWESD.

Audit testing revealed that 34 of 35 contract files examined included at least some evidence of effective monitoring against agreed specifications and expectations. However, the extent and nature of documented monitoring activities varied considerably as they ranged from basic, for example, included only minutes of a meeting and/or email chain, or did not address all contract deliverables, to highly effective. For the latter, we found that consistent with VPM Guidelines there were formal meeting agendas, documentation of report review results, use of tracking sheets, on-site quality testing and inspections, formal notifications of contract violations/ unacceptable

performance, requests for corrective actions, etc. Further examination of these results revealed that the extent and nature of documented monitoring was impacted by the nature of the good/service and the underlying contract. For example, files for larger, multi-year service contracts were more likely to include evidence of sound monitoring than contracts for the one-time delivery of a good.

Though the documentation was generally less rigorous in nature than the 21 files referenced above, testing of 13 sole source contracts revealed that 11 files contained at least some evidence of documented contract monitoring.

As PWESD has not established minimum requirements and expectations for monitoring contracts, there is a range of inconsistent practices that have been implemented across the Department. This situation increases the likelihood that some contracts will not be sufficiently monitored; resulting in avoidable cost over-runs, quality gaps or delays.

2. Ensuring supplier's adherence to relevant laws, by-laws and policies

Section 7 of the City's General Terms and Conditions (Ts & Cs) for contracts requires that all contractors and their employees who provide goods, services or facilities to the City comply with applicable legislation, City by-laws, and policies. These range from the Occupational Health and Safety Act, Accessibility for Ontarians with Disabilities Act to the City's Policies on Ethical Purchasing and Bilingualism. By submitting a bid for a City solicitation, bidders confirm that they have read these Ts & Cs and agree to be bound by them in any resulting contract. For sole-source contracts, suppliers are required to sign a contractual acknowledgement that refers to these Ts & Cs. Testing indicated that such contractual acknowledgements were signed by vendors during contract negotiations.

Interviews conducted by the audit team revealed that compliance monitoring responsibilities for PWESD contracts are shared between PWESD and Supply Services. For example, the Strategic Procurement group within Supply Services is responsible to ensure that a supplier has appropriate insurance and complies with WSIB requirements.

Audit testing of 35 contract files revealed that none of the files contained evidence of identified compliance issues or follow up that would support the existence of effective compliance assessment. Further, interviews with PWESD management indicated that the Department had not developed a process to monitor suppliers' compliance with applicable legislation, by-laws and policies. This finding is consistent with other recent

audits completed by the Office of the Auditor General and indicates an increased risk that incidents of non-compliance will not be identified and addressed in a timely manner.

3. Inspecting and accepting goods or services prior to payment

Section 3 of the City's General Ts & Cs for contracts provides that the City reserves the right to determine, at its sole discretion, whether goods or services were performed to the City's satisfaction before advancing any payment to a supplier. Similarly, the City's *Contract Administration and Reporting on Supplier Performance* guidelines state that "... departmental staff should review or inspect the goods and services for compliance with the specifications or work plan described in the contract documents...Before the supplier's invoice is approved for payment."¹

Audit testing of a sample of contract files was conducted to identify if payments are made to the contractor only after the completion of a satisfactory inspection of contract deliverables.

Of the 35 files tested during the audit, 32 had at least one contract deliverable where the contractor had reached a milestone or had provided a good or service. Of these, nearly 16 per cent (five contracts representing a total value of over \$4.2 million) lacked evidence of inspection and approval of the contract deliverable prior to payment of the supplier's invoice. While it is conceivable that the inspection and approval occurred but was not documented, there is an increased risk of making payment for deliverables that are later discovered as unacceptable.

4. Managing contract changes (amendments, change orders or scope changes)

Changes to a contract can result from a revised delivery date, change in scope of work, amended price quotation or amended proposal for additional work. Contract changes may be called amendments, change orders, or scope changes. In addition to requirements set out in the City's General Ts & Cs for contracts and Purchasing By-law, the City's Purchasing Manual requires that project managers provide Supply Services with a detailed rationale for the change before the change would be approved.

For 19 of the 35 contract files selected for audit testing, there were changes since their original approval. Examination of these files revealed that documentation of the rationale for each change was provided, but this rationale varied widely in terms of

¹ Page 3 of the City's Contract Administration and Reporting on Supplier Performance, June 2017

extent and nature, for example, letters, emails, additional proposals/quotes/estimates, or some combination thereof. Furthermore, 9 of the 19 files were missing one or more required documents or other details supporting the change. Failure to comply with requirements or otherwise applying proper diligence when documenting rationale for a contract change can increase the risk that contract changes may not be in the City's best interest or otherwise properly justified.

5. Resolving disputes

Disagreements with suppliers over contractual requirements can lead to significant and/or costly delays as well as additional administrative, legal or other costs incurred by the City. In some cases, contract disagreements can escalate to include costly litigation.

The audit identified that processes for dispute resolution and escalating contract issues are set out in the City's *Contract Administration and Reporting on Supplier Performance* guidelines. Interviews with both PWESD and Supply Services personnel indicated that disputes over contract requirements in PWESD were infrequent and, when they did occur, they very rarely required escalation to Supply Services or the City's Legal Services branch. These assertions were supported by audit's testing of contract files. Of the 35 contract files examined during the audit, 2 contained evidence of a disagreement regarding contractual requirements. For one of these files, the matter had subsequently been resolved, and evidence was provided to support adherence to the City's Contract Administration Guidelines. For the other file, the dispute was still under discussion between PWESD and the supplier.

Conclusion

Overall, the audit identified evidence that PWESD had implemented a number of contract management activities that reflect requirements and good practices while also helping to ensure that the City receives value for money. These activities included monitoring of supplier performance during the term of a contract, and inspecting goods or services prior to payment and formal processes for contract changes. For some of the contracts examined, the audit identified evidence of highly effective and well-documented contract management, which was consistent with the City's recently developed Vendor Performance Management (VPM) guidelines.

However, the audit procedures also revealed that PWESD had not developed clearly established expectations for how contract management should be applied, implemented

and documented across the Department. As such, the audit found that contract files exhibit a wide range of contract management activities, including examples of contract files that were missing, or significantly lacking in, evidence of effective monitoring. The audit also identified other gaps and opportunities for improvement regarding the establishment of clearly defined deliverables, and monitoring vendor compliance with applicable legislation, by-laws and policies.

Potential savings

This audit identified a number of opportunities for potential savings. These include efficiencies that could be realized by adopting a risk-based approach to help ensure that PWESD's contract management activities focus on those contracts posing the highest risk of preventable cost overruns, quality or timeliness issues. The audit also identified opportunities to better ensure that suppliers that are party to sole sourced contracts are clearly and consistently meeting the City's requirements and expectations. While such process improvements would be expected to generate cost savings over time, the audit did not quantify these amounts due to lack of information.

Recommendations and responses

Recommendation #1

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent monitoring of supplier performance (if not already subject to VPM).

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent monitoring of supplier performance. The Departments will work together to examine the existing contracts, with the goal of identifying and establishing criteria that will trigger appropriate monitoring of supplier performance for higher risk contracts.

In the interim, PWESD and Supply Services have developed contract management training in response to the recommendations contained in the 2017 Audit of Roads Services – Contract Management, which addresses best practices – including the effective monitoring of supplier performance. This training is

currently being delivered to Roads Services contract managers. Moving forward, PWESD and Supply Services will deliver similar training to the other Service Areas within PWESD.

This recommendation will be implemented by Q2 2020.

Recommendation #2

That PWESD, in conjunction with Supply Services, take steps to accelerate and expand further roll out of VPM:

- Include applicable contracts within all PWESD branches;
- Include a wider range of contracts, such as all professional services; and
- Develop communications and training to support adoption of good practices set out in the VPM Guidelines.

Management response:

Management agrees with this recommendation.

The VPM program will be expanded to include all applicable contracts within all PWESD Service Areas by the end of 2019. The expansion of VPM to other commodities will be undertaken in accordance with Supply Services' VPM Expansion Strategy and associated risk assessments.

Communications and training related to the Contract Administration Policy (which reflect VPM Best Practices) has already been developed for Roads Services and is currently being delivered to its contract managers. This training was developed in response to the recommendations contained in the 2017 Audit of Roads Services – Contract Management. Moving forward, PWESD and Supply Services will deliver similar training to the other Service Areas within PWESD.

This recommendation will be implemented by Q4 2019.

Recommendation #3

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent monitoring of supplier compliance with applicable legislation, by-laws and policies.

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent monitoring of supplier compliance with applicable legislation, by-laws and policies. The Departments will work together to examine the existing contracts, with the goal of identifying and establishing criteria that will warrant a periodic review of compliance with applicable legislation, by-laws and policies, as outlined in the contractual documents.

This recommendation will be implemented by Q2 2020.

Recommendation #4

That for sole-sourced contracts, PWESD should introduce a process whereby these contracts are reviewed to determine if specific compliance requirements (i.e. beyond the City's Ts & Cs) should be applied.

Management response:

Management agrees with this recommendation.

PWESD and Supply Services will review the Department's current sole source contracts. Based on this review, the Department will identify criteria to be used to determine whether supplemental terms and conditions may be required during the future procurement of specific goods and/or services.

This recommendation will be implemented by Q4 2019.

Recommendation #5

That PWESD, for sole-sourced contracts, introduce a process whereby such contracts are reviewed to ensure that the City's specifications and expectations are sufficiently clear to support effective performance inspections and payment approval activities.

Management response:

Management agrees with this recommendation.

PWESD and Supply Services will review the Department's current sole source contracts. Based on this review, the Department will determine whether there are specific types of goods and/or services that require more detailed information to be

requested by the contract manager during the initial quotation/proposal stage of future procurements with respect to specifications, inspections, and/or payments (e.g. milestone payments).

This recommendation will be implemented by Q2 2020.

Recommendation #6

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent inspection prior to payment of invoices.

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent inspection prior to payment of invoices. While inspection prior to payment is already a standard practice, management recognizes that certain risk-based criteria may necessitate additional measures for inspection and documentation prior to invoice payment.

In the interim, PWESD and Supply Services have developed contract management training in response to the recommendations contained in the 2017 Audit of Roads Services – Contract Management, which addresses best practices – including the inspection of goods and/or services prior to payment. This training is currently being delivered to Roads Services contract managers. Moving forward, PWESD and Supply Services will deliver similar training to the other Service Areas within PWESD.

This recommendation will be implemented by Q2 2020.

Recommendation #7

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent requirements for the documentation of the rationale for contract amendments.

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent requirements for the documentation of the rationale for contract amendments. The Departments will work together to examine the existing contracts in place, with the goal of identifying and establishing criteria that will trigger more detailed information and documentation requirements for future contract amendments.

This recommendation will be implemented by Q2 2020.

Detailed audit report

Audit of Public Works and Environmental Services Department – Contract Management

Introduction

The Audit of Environmental Services (Part II) – Operational Review, subsequently renamed Audit of Public Works and Environmental Services Department (PWESD), was included in the 2017 Audit Plan of the Office of the Auditor General, approved by City Council on December 14, 2016. This audit of PWESD’s contract management activities, along with an audit of Frozen Services and Hydrant Management and Maintenance, were completed in accordance with the 2017 Audit Plan.

Background and context

From January 2016 to April 2018, PWESD managed over eleven hundred contracts (or purchase orders) with suppliers for a value of over \$262 million. These purchase orders were for goods and services including snow removal services, engineering services, construction materials, the supply of heavy equipment, among many others. Procedures for contracting at the City of Ottawa are set out within the City’s Procurement By-law and other guidance materials. Departmental managers are responsible for identifying the need for specific goods/services that are required from a supplier. Supply Services is responsible for advising and supporting managers in the supplier selection process and is ultimately responsible for issuing the contract with the supplier.

Once a contract (or purchase order) is in place, the departmental director (or delegated manager) is then responsible for managing the contract. The purpose of contract management is to ensure that the supplier delivers the goods and services ordered in accordance with the terms and conditions of the contract. Key contract management activities include accepting the delivery of goods and services in accordance with the terms and conditions of the contract, resolving disputes, managing contract changes, communicating effectively with suppliers, keeping Supply Services apprised of major contract issues, and approving payment of invoices after determining that deliverables are acceptable.

Audit objectives and criteria

The objective of this audit was to assess the effectiveness and efficiency of PWESD’s contract management activities, the extent that these activities are in accordance with City by-laws and guidelines, and whether these activities adequately ensure that the City is receiving “value for money”.

Criteria:

- Provisions to undertake monitoring activities are included in PWESD contracts with suppliers
- There is an established approach to monitor and report on the ongoing performance of suppliers (including supporting tools and documentation for staff)
- PWESD conducts reviews of suppliers to ensure compliance with applicable legislation and relevant City of Ottawa by-laws and policies
- A process has been established for PWESD staff to review or inspect goods/services prior to its acceptance and approval of invoices for payment
- PWESD has established an effective process to manage change orders that include the maintenance of documentation in support of decisions related to the change request
- PWESD has an established dispute resolution process as a means to address any disagreements or other issues regarding fulfillment of contract requirements

Scope

The audit focused on PWESD’s activities related to contract management. The contracts included within the scope of this audit included those contracts issued since the reorganization of PWESD in mid-2016 through to March 31, 2018. It did not include any contracts subject to the 2017 OAG Contract Management Audit on Roads Services Branch.

The audit fieldwork was conducted from March to June 2018.

Audit approach and methodology

The audit work in this report was conducted in accordance with the OAG Audit Standards. While the OAG adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of the Institute of Internal Auditors.

As part of our regular audit process, we obtained management's agreement with the findings in this report.

The audit methodology included the following activities:

- Interviews with staff members of:
 - Public Works and Environmental Services Department, including the Director of Water Services, and staff from:
 - Water Distribution Unit;
 - Technology, Innovation and Engineering Support Services; and
 - Parks, Forestry and Stormwater Services.
 - Corporate Services (Supply Services), including the Chief Procurement Officer and a selection of Procurement Officers.
- Reviews of relevant documentation such as the City's Contract Administration and Reporting on Supplier Performance, Purchasing Manual, General Terms and Conditions for Contracts, and relevant By-laws, and Guidelines and Presentations on Vendor Performance Management);
- Testing of a sample of 35 PWESD contract files (e.g. to identify evidence of monitoring, clearly defined requirements, appropriate approvals, etc.); and
- Other audit techniques as required.

Audit observations and recommendations

1. Monitoring supplier performance

The City ensures “best value” for taxpayers’ dollars, when vendors deliver goods and services on time, and at the agreed price per quantity, quality, and in accordance with the contract requirements. Accordingly, this would be defined as acceptable vendor performance².

To support acceptable vendor performance, PWESD can leverage a number of effective practices and techniques whereby vendor performance is monitored throughout the course of the contract such that any issues or concerns are identified and addressed in a timely manner. Many of these techniques are described in the City’s June 2017 *Contract Administration and Reporting on Supplier Performance* guide. Such monitoring can involve activities ranging from meetings with the vendor to interim reporting or periodic quality testing. While it is understood that effective and efficient supplier monitoring depends on factors such as contract size, duration and complexity, the City has also introduced a Vendor Performance Management (VPM) program that sets out specific expectations for how City departments should approach monitoring their suppliers once the program is fully rolled out. These VPM guidelines address areas such as discussing performance with vendors throughout the project lifecycle, escalations/notification of issues and documentation. The audit team’s examination of these guidelines indicated that they reflected a number of effective and appropriate contract management practices.

VPM is currently being rolled out within PWESD. At the time of this audit, VPM-eligible contracts within PWESD included any new contracts entered into by the Technology, Innovation and Engineering Support Services (TIESS) branch for engineering, design and contract administration contracts >\$15k or any construction contracts >\$100k.

The audit expected that PWESD would include monitoring provisions (including, when applicable, those required under VPM) in contracts with suppliers. Further, that the Department would have a clear and formal approach, including tools and documentation, for monitoring and reporting on the ongoing performance of suppliers.

² City of Ottawa Vendor Performance Management (VPM) Business Process Guide, Version 8.0

Audit testing of contract files sought to identify the extent to which formal monitoring provisions were included within PWESD contracts. This testing indicated that the existence of such provisions varied depending on the selected contracting mechanism. For example, contracts that were issued as a result of a formal request (i.e. they were related to a formal Tender, Standing Offer or Proposal) were relatively more likely to include adequate monitoring provisions. Conversely, testing of sole-source contracts revealed that monitoring provisions were less common. Even when sole-source contracts were found to include monitoring provisions, they were found to be less robust (e.g. monitoring was established by the supplier's proposal or via reference to the City's General Terms and Conditions for Contracts).

Audit testing also revealed variability in the nature and extent of monitoring activities evidenced in connection with PWESD contracts. There was evidence of formal and effective monitoring activities in 20 of 22 contracts tested, including all five VPM-eligible contracts selected, that were issued as a result of a formal request (Tender, Standing Offer or Proposal). The nature and rigour of these monitoring activities ranged from basic (e.g. minutes of a meeting and/or email chain) to more rigorous (i.e. reflect requirements provided in the VPM Guidelines such as formal meeting agendas, documentation of report review results, use of tracking sheets, on-site quality testing and inspections, formal notifications of contract violations/unacceptable performance, requests for corrective actions, etc.). The audit team's analysis of contracts for engineering services identified that not all such contracts are entered into by TIESS and, therefore, are not subject to the level of contract management required under VPM. It also revealed an example of a contract for engineering, that was entered into by TIESS, but that was not subject to VPM. Though generally less rigorous in nature than the 20 files referenced above, testing also revealed that 12 of 13 sole-source contract files tested contained at least some evidence of contract monitoring.

Review of contract file documentation indicated that the extent of documented monitoring activities is impacted by the nature of the good/service received as well as the size and length of contract. For example, contracts for a one-time delivery of a good is less likely to be subject to more extensive monitoring compared to a multi-year service contract for such services as waste collection or janitorial. In addition, the audit results indicated that the nature and rigour of the monitoring activities undertaken by staff may also be influenced by the working practices of individuals tasked with managing contracts.

The Department has not established requirements and expectations for monitoring for PWESD contracts. As such, there is a range of practices that have been implemented across the Department. This situation increases the likelihood that some contracts will not be sufficiently monitored; resulting in avoidable cost over-runs, quality gaps or delays.

Recommendation #1

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent monitoring of supplier performance (if not already subject to VPM).

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent monitoring of supplier performance. The Departments will work together to examine the existing contracts, with the goal of identifying and establishing criteria that will trigger appropriate monitoring of supplier performance for higher risk contracts.

In the interim, PWESD and Supply Services have developed contract management training in response to the recommendations contained in the 2017 Audit of Roads Services – Contract Management, which addresses best practices – including the effective monitoring of supplier performance. This training is currently being delivered to Roads Services contract managers. Moving forward, PWESD and Supply Services will deliver similar training to the other Service Areas within PWESD.

This recommendation will be implemented by Q2 2020.

Recommendation #2

That PWESD, in conjunction with Supply Services, take steps to accelerate and expand further roll out of VPM:

- Include applicable contracts within all PWESD branches;
- Include a wider range of contracts, such as all professional services; and
- Develop communications and training to support adoption of good practices set out in the VPM Guidelines.

Management response:

Management agrees with this recommendation.

The VPM program will be expanded to include all applicable contracts within all PWESD Service Areas by the end of 2019. The expansion of VPM to other commodities will be undertaken in accordance with Supply Services' VPM Expansion Strategy and associated risk assessments.

Communications and training related to the Contact Administration Policy (which reflect VPM Best Practices) has already been developed for Roads Services and is currently being delivered to its contract managers. This training was developed in response to the recommendations contained in the 2017 Audit of Roads Services – Contract Management. Moving forward, PWESD and Supply Services will deliver similar training to the other Service Areas within PWESD.

This recommendation will be implemented by Q4 2019.

2. Ensuring suppliers comply with legislation, by-laws and policies

The City requires that all contractors and their employees who provide goods, services or facilities to the City comply with applicable legislation, City by-laws, and policies. These are set out in Section 7 of the City's General Terms and Conditions (Ts & Cs) for contracts, which references the Occupational Health and Safety Act, Accessibility for Ontarians with Disabilities Act and requirements of the Workplace Safety and Insurance Board of Ontario (WISB). It also references a number of relevant City policies addressing such topics as Equity and Diversity, Ethical Purchasing, Bilingualism and Codes of Conduct. The Ts & Cs indicate that the City is responsible to ensure contracting documents are in compliance with requirements and that it is the contractor's responsibility to maintain compliance. While the City no longer provides a copy of the Ts & Cs as a part of its solicitation documents, bidders are encouraged to review these online and that, by submitting a bid, they confirm that they have read these Ts & Cs and agree to be bound by them in any resulting contract. For sole-source contracts, suppliers are required to sign a contractual acknowledgement that refers to the City's Ts & Cs. Testing of contracts indicated that such contractual acknowledgements were signed by vendors during contract negotiations.

The audit team expected to find that PWESD would have a formal process and risk-based approach for conducting reviews of suppliers to ensure their compliance with applicable legislation and relevant City of Ottawa by-laws and policies.

Interviews were conducted by the audit team to gain an understanding of the compliance monitoring practices and protocols in place for PWESD contracts. These interviews indicated that responsibilities for assessing compliance are shared between PWESD and Supply Services. For example, the Strategic Procurement group within Supply Services is responsible to ensure that a supplier has appropriate insurance and complies with the WSIB requirements of the solicitation process.

While testing of contract files revealed examples where a PWESD compliance coordinator had been assigned to monitor supplier performance and compliance, none of the files examined contained evidence of identified compliance issues or follow up that would support the existence of effective compliance assessment. Further, interviews with PWESD management indicated that the Department had not developed a formal process to monitor suppliers' compliance with applicable legislation, by-laws and policies. This finding is consistent with other recent audits completed by the Office of the Auditor General and indicates an increased risk that incidents of non-compliance will not be identified and addressed in a timely manner.

Recommendation #3

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent monitoring of supplier compliance with applicable legislation, by-laws and policies.

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent monitoring of supplier compliance with applicable legislation, by-laws and policies. The Departments will work together to examine the existing contracts, with the goal of identifying and establishing criteria that will warrant a periodic review of compliance with applicable legislation, by-laws and policies, as outlined in the contractual documents.

This recommendation will be implemented by Q2 2020.

Recommendation #4

That for sole-sourced contracts, PWESD should introduce a process whereby these contracts are reviewed to determine if specific compliance requirements (i.e. beyond the City's Ts & Cs) should be applied.

Management response:

Management agrees with this recommendation.

PWESD and Supply Services will review the Department's current sole source contracts. Based on this review, the Department will identify criteria to be used to determine whether supplemental terms and conditions may be required during the future procurement of specific goods and/or services.

This recommendation will be implemented by Q4 2019.

3. Acceptance of goods/services prior to payment

One of the specific measures that the City takes to help ensure value for money is to inspect contract deliverable prior to their acceptance and/or payment. This measure is set out in Section 3 of the City's Ts & Cs which clearly states that any and all goods or services provided by to the City under a contract are subject to inspection and acceptance by the City. It also states that the City reserves the right to determine, at its sole discretion, whether the work was performed to the City's satisfaction before advancing any payment to the contractor. Similarly, the City's *Contract Administration and Reporting on Supplier Performance* guidelines state that "To determine that the deliverables provided by the supplier are acceptable, departmental staff should review or inspect the goods and services for compliance with the specifications or work plan described in the contract documents [and]...Before the supplier's invoice is approved for payment, departmental staff must review or inspect the goods, services and deliverables provided."³

The audit team expected that PWESD's contract monitoring would include a process whereby PWESD staff review or inspect goods/services prior to their acceptance and approval of related invoices for payment. As a precursor to this expectation, the audit team also expected to find that contracting documents (i.e. solicitations,

³ Page 3 of the City's Contract Administration and Reporting on Supplier Performance, June 2017

contracts/purchase orders, etc.) would include clear requirements in terms of the City’s specifications and expectations for the required goods/services.

Audit testing of a sample of 35 contract files included a consideration of three questions in connection with the acceptance of contracted deliverables as follows:

- Do the contracting documents contain clearly established specifications and expectations for contract deliverables?
- Is there evidence of an effective program whereby PWESD representatives inspected contract deliverables against the agreed specifications/expectations?
- Are payments made to the contractor only after the completion of a satisfactory inspection of contract deliverables?

The table below provides a summary of the testing results.

Table 1: Summary of testing results

Result of audit testing	Formal requests (RFP, RFSO, RFT)		Sole-source contracts		Total contract files tested	
	Number of files	Dollar value	Number of files	Dollar value	Number of files	Dollar value
Definition of specifications/expectations						
Clearly set out in contracting documents	22	\$32,644,085	11	\$2,402,479	33	\$35,046,564
Set out only in supplier’s proposal and lacked clarity	0	\$0	2	\$644,707	2	\$644,707
Total contract files	22	\$32,644,085	13	\$3,047,186	35	\$35,691,271
Inspections						
Evidence of effective inspection of contract deliverables	20	\$32,054,440	11	\$2,274,160	31	\$34,328,600

Result of audit testing	Formal requests (RFP, RFSO, RFT)		Sole-source contracts		Total contract files tested	
	Number of files	Dollar value	Number of files	Dollar value	Number of files	Dollar value
No evidence of inspection	0	\$0	1	\$616,316	1	\$616,316
N/A – good/service not yet delivered at time of audit testing	2	\$589,645	1	\$156,710	3	\$746,355
Total contract files	22	\$32,644,085	13	\$3,047,186	35	\$35,691,271
Invoice approval and payment						
Evidence provided that invoices approved and paid only after inspection	19	\$28,971,623	8	\$1,609,539	27	\$30,581,162
No evidence provided that invoices approved and paid only after inspection	2	\$3,515,780	3	\$744,224	5	\$4,260,004
N/A – good/service not yet delivered at time of audit testing	1	\$156,682	2	\$693,423	3	\$850,105
Total contract files	22	\$32,644,085	13	\$3,047,186	35	\$35,691,271

The table above indicates that all formal requests (e.g. RFP, RFSO, RFT) examined were found to include clearly established specifications and expectations for contract deliverable within the solicitation documents as well as the resulting Purchase Order (PO). For contracts where technical requirements were established, the audit team identified that applicable standards were also provided in the solicitation documents. For sole-source contracts, the process was found to be less consistent and reliable. POs associated with 2 of the 13 sole-source files examined included only a reference to those specifications and requirements set out directly on the supplier's quote/estimate. Auditors noted that the language set out in these quotes/estimates presented a potential risk insofar as they lacked clear descriptions of the requirements (e.g. vague wording or contained highly technical language).

As referenced earlier in this report, audit testing revealed that inspection of contract deliverables is routinely included as part of PWESD's monitoring of supplier performance. However, audit testing revealed that such inspections vary considerably in terms of their nature and extent. The testing revealed examples of highly effective and sound monitoring that included inspection, at the supplier's facility, prior to delivery to the City. It also yielded examples where inspections activities were poorly documented or did not appear to address all applicable contract deliverables.

In addition to revealing variability in the extent of inspection activities across PWESD, testing indicated a similar variability in terms of evidence demonstrating the results of inspection and approval prior to release of payment. Although it appears that inspection of contract deliverables (i.e. the contractor had reached a milestone or had provided a good or service) is often occurring, examination of a sample of contracts indicated that five contracts (just under 16 per cent) lacked evidence of inspection and approval of the deliverable prior to the payment of the supplier's invoice. While it is conceivable that the inspection and approval occurred but was not documented, there is an increased risk of making payment for deliverables that are later discovered as unacceptable.

Recommendation #5

That PWESD, for sole-sourced contracts, introduce a process whereby such contracts are reviewed to ensure that the City's specifications and expectations are sufficiently clear to support effective performance inspections and payment approval activities.

Management response:

Management agrees with this recommendation.

PWESD and Supply Services will review the Department's current sole source contracts. Based on this review, the Department will determine whether there are specific types of goods and/or services that require more detailed information to be requested by the contract manager during the initial quotation/proposal stage of future procurements with respect to specifications, inspections, and/or payments (e.g. milestone payments).

This recommendation will be implemented by Q2 2020.

Recommendation #6

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent inspection prior to payment of invoices.

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent inspection prior to payment of invoices. While inspection prior to payment is already a standard practice, management recognizes that certain risk-based criteria may necessitate additional measures for inspection and documentation prior to invoice payment.

In the interim, PWESD and Supply Services have developed contract management training in response to the recommendations contained in the 2017 Audit of Roads Services – Contract Management, which addresses best practices – including the inspection of goods and/or services prior to payment. This training is currently being delivered to Roads Services contract managers. Moving forward, PWESD and Supply Services will deliver similar training to the other Service Areas within PWESD.

This recommendation will be implemented by Q2 2020.

4. Management of contract changes (amendments, change orders or scope changes)

Changes to a contract can involve a number of elements such as a revised delivery date, change in scope of work, amended price quotation or amended proposal for additional work. As stated in the Contract Administration and Reporting on Supplier Performance guidelines, “Changes are a common, and often necessary, aspect of purchasing goods and services. Contract changes may be called amendments, change orders, or scope changes.” Further, the City’s Ts & Cs prescribe that any amendment to the Contract shall be binding only when it is incorporated as a contract amendment, revised purchase order or construction change order executed by the authorized representatives of the City and the Contractor. The City’s Purchasing Manual also requires that project managers complete ‘requisite internal approval forms’ and provide the Contracting Authority (CA) with documentation including a detailed rationale for the change before the CA will proceed with the approval of a Contract Amendment Request (CAR) and a revised PO.

The audit expected to find that PWESD had established an effective process to manage contract changes that included the maintenance of documentation in support of decisions related to the change. Further, as contemplated in the City’s Purchasing Manual, it was expected the PWESD would have implemented internal approval forms for contract changes where appropriate.

Interviews and correspondences with PWESD personnel indicated that the Department did not have approval forms for contract changes that were customized to PWESD’s environment. Instead, the Department followed the requirements set out by Supply Services including the Procurement By-law.

In selecting the sample of contract files for testing, the audit team deliberately selected certain contracts that were identified as being changed since their original issuance. In total, 19 of the 35 files selected for testing included contract changes. The table below provides a summary of selected testing results related to contract changes.

Table 2: Summary of selected testing results related to contract changes

Result of audit testing	Formal requests (RFP, RFSO, RFT)	Sole-source contracts	Total contract files
Documentation (including rationale)			
Fully meets documentation requirements including rationale and spending authority	8	2	10
Some evidence of rationale, but lacking in details or other required documents	6	3	9
Total contract files with changes	14	5	19
Review and approval by project manager			
Contract change was approved by PWESD project manager or equivalent	14	5	19
Total contract files with changes	14	5	19

As noted in the above table, testing revealed that required documentation of the rationale for the change was evidenced in each of the applicable contract files. However, the extent and nature of this documentation varied widely among the contracts (e.g. evidence provide included one or more of the following: letters, emails, additional proposals/quotes/estimates, etc.), and some files did not contain other required documents such as an approved spending authority. Specifically, 9 of the 19 files were identified as missing required documents and other details supporting the change. Failure to apply proper diligence when documenting the support for a contract change can increase the risk that contract changes may not be in the City’s best interest or otherwise properly justified in accordance with purchasing requirements.

Recommendation #7

That PWESD develop a risk-based (i.e. based on dollar-value, nature of good/service, etc.) framework to support consistent requirements for the documentation of the rationale for contract amendments.

Management response:

Management agrees with this recommendation.

PWESD will work with Supply Services to develop a risk-based framework to support consistent requirements for the documentation of the rationale for contract amendments. The Departments will work together to examine the existing contracts in place, with the goal of identifying and establishing criteria that will trigger more detailed information and documentation requirements for future contract amendments.

This recommendation will be implemented by Q2 2020.

5. Dispute resolution processes

As with many relationships, there can be situations where the parties to a contract may not agree regarding the requirements. The City's Contract Administration and Reporting on Supplier Performance guidelines state that "Good communication and a process for dispute resolution are the first and best choice to resolve problems and maintain a good working relationship with the supplier."

While there is a wide range in the significance and materiality of disagreements regarding contract requirements, such incidents typically lead to a number of negative outcomes including delays in fulfillment of the contract and/or additional administrative, legal or other costs incurred by the City. In some cases, contract disagreements can escalate to include costly litigation and judgements that attract considerable public attention.

To mitigate the impact of potential disagreements, we expected that PWESD would have implemented effective dispute resolution processes, featuring good communications, as a means to avoid and address any disagreements or other issues regarding fulfilling the requirements of a contract.

The audit identified that processes for dispute resolution and escalating contract issues are set out in the City's Contract Administration and Reporting on Supplier Performance guidelines. Interviews with PWESD and Supply Services' personnel indicated that

disputes over contract requirements were infrequent and, when they did occur, they very rarely required escalation to Supply Services or the City's Legal Services branch. Further, PWESD interviewees asserted that any such disputes would be addressed in accordance with the City's guidelines.

These assertions were supported by audit's testing of contract files. While the 35 contract files examined were found to include examples of performance issues identified through monitoring, only 2 files contained evidence of a disagreement regarding contractual requirements. For one of these files, the matter had subsequently been resolved, and evidence was provided to support the assertion that PWESD had implemented the guidelines established by the City's Contract Administration Guidelines. For the other file, the dispute was still under discussion between PWESD and the supplier.