

AUDITOR GENERAL

Halifax Regional Municipality



Contract Management Audit

June 2017

June 21, 2017

Office of the Auditor General
Halifax Regional Municipality

The following audit of **Contract Management** at selected business units, completed under section 50(2) of the Halifax Regional Municipality Charter, is hereby submitted to the Audit and Finance Standing Committee of Regional Council.

Respectfully,

Original signed by

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Auditor General
Halifax Regional Municipality

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Executive Summary

Overall, while we found some positive aspects to Halifax Regional Municipality's (HRM) contract management, there are opportunities for improvement. Although management made sure services were received, there is a need to evaluate how contractors are doing and make those results available to others in the Municipality.

Staff did a good job ensuring the work was complete before the contractor was paid. We also found business units took timely action to deal with contract issues, but this often resulted from informal monitoring or complaints, rather than a formal contract monitoring process.

Although the business units we audited generally complied with municipal policy in managing contracts, the policy did not have a strong contract management framework. A new procurement policy took effect in February 2017 which has more requirements to manage contracts.

We found issues in each of the four business units we audited. The greatest gap in monitoring how contractors did was with standing offer contracts. These were used across a number of business units, often with fewer monitoring requirements than other contracts.

Sixteen of the contracts we tested had specific monitoring requirements, including evaluating contractors when work is done, but these were often not completed. Regularly assessing vendors and keeping those results where all HRM management can access would help with future contracts by identifying potential concerns from past vendor performance.

Additionally, nearly one-third of contracts tested did not have a payment penalty clause. The Municipality could enhance its ability to take action when vendors do not meet contract performance standards by including payment penalties in all contracts.

Why we did this audit

Contract services are a significant cost to the Municipality. Good contract management is necessary to ensure the Municipality receives value from contracted services. Contract terms should help to protect both parties and establish roles and responsibilities. Contract monitoring is necessary to ensure the Municipality receives the services it is paying for.

What we audited

Contract management practices at four business units:

- Finance, Information, Communication, and Technology
- Operations Support
- Parks and Recreation
- Transportation and Public Works

Recommendations and Management's Responses

Recommendation 1

The Operations Support business unit should review current contract terms to ensure terms are reasonable given the amount of staff time management wishes to allocate to ongoing monitoring. New contracts should balance the need to monitor and available resources.

Management Response

HRM Management agrees with and intends to implement this recommendation. On a go forward basis, Operations Support (now Corporate and Customer Services) will apply this recommendation as new contracts are developed and implemented.

Recommendation 2

All business units audited should monitor to confirm that both the Municipality and the vendor comply with all contract terms, including those for standing offers.

Management Response

HRM Management agrees with and intends to implement this recommendation. Administration will work to establish thresholds based on contract value for auditing and oversight on all contract terms. Specific activities initiated in specific areas of the administration include the introduction of Service Level Agreements to evaluate contractor performance, creation of a Vendor Management resource in Information, Communications, and Technology to assist in managing contracts, and performance monitoring. Best practices such as these will be assessed for possible introduction into other areas of the administration.

Recommendation 3

All business units audited should evaluate vendor performance at the end of contracts and, if appropriate, at intervals during contracts.

Management Response

HRM Management agrees with and intends to implement this recommendation. As per section 44(10) of Administrative Order 2016-005-ADM (Procurement Policy), Business Units shall complete a vendor evaluation scorecard at the completion of each contract or as otherwise directed by the Manager of Procurement. Administration will strive to enforce this section of the policy, but the format and comprehensiveness of the evaluation will depend on the size and nature of the individual contract.

Recommendation 4

The Procurement division should establish processes to ensure vendor evaluations are completed and used in later procurements as applicable.

Management Response

HRM Management agrees with and intends to implement this recommendation. Some steps will be taken immediately. Currently, Procurement consultants and officers are notified monthly via a contract expiry report of what contracts are expiring and when. These staff will notify the specific Business Units of the end date and request that a vendor evaluation be completed. Vendor evaluations will be sent to the Contract Administrator to be filed. One recommended process is that option years will not be utilized until the vendor evaluation is completed by the Business Unit, nor will re-solicitation be allowed until the vendor evaluation is completed. It should be noted that most service contracts have specified terms so their end date is known.

Recommendation 5

All external services contracts, including those for standing offers, should require a payment penalty clause.

Management Response

HRM Management agrees with and intends to implement this recommendation. However, some contracts may include means other than penalty clauses to encourage contractors to complete work on a timely basis. For example, contracts can be established which put operational risk (and potential costs) on a contractor if work is not done on time. This would not be a specific payment penalty to HRM but may result in a cost to the vendor. Moreover, the municipality can, with low risk, apply liquidated damages. Liquidated damages, which are most easily applied when deadlines are exceeded, are intended to be a fair assessment of financial damages due to lack of performance, but can include reputational costs. Legal Services will be engaged in implementing this recommendation.

Audit Results

Contract management complied with policy but policy should be stronger

We found contracting practices generally complied with the procurement policy in place at the time. However, the policy did not have a strong contract management framework. HRM implemented a new procurement policy in February 2017. It has stronger requirements for managing contracts.

When contracts were amended, we found the business units generally made supported, approved changes consistent with procurement guidelines. However, Operations Support extended one of its contracts for two years after the end date. It is not clear whether extending this contract was in the best interest of the Municipality. Opportunities to explore the market for better value are lost when a contract is repeatedly extended. While the old procurement policy had limited restrictions on who could approve contract changes and extensions, the new policy is stronger, limiting this to business unit directors, the Chief Administrative Officer, or Regional Council, depending on the cost of the change or extension.

Municipality made sure work was completed before payments were made

The Municipality did a good job ensuring work was completed before contract payments were made. We examined 92 invoices from the 30 contracts selected for audit and found all were properly supported and approved.

Timely action was taken when performance issues were identified

There were several good examples of timely action taken as a result of contract performance monitoring. The Solid Waste division of Transportation and Public Works sends out monthly performance results to a contractor in our sample and, if necessary, outlines the escalation process for issues. Transportation and Public Works also evaluates its asphalt contract vendors.

Management of the other business units we audited told us they addressed problems when issues were identified. However, they relied on informal or complaint-driven monitoring to find performance issues, rather than regular, planned monitoring. This is discussed further below.

Contract monitoring practices were not consistent throughout the organization

We assessed contract monitoring for our 30 sample items to determine whether the Municipality received the services it paid for and whether it looked at the quality of those services.

The Transportation and Public Works business unit does a good job completing and keeping vendor performance reports for the majority of its contracts we tested. However, one division could not provide all the vendor evaluations for two contracts. Having all evaluations available and accessible to any supervisor or manager prior to engaging a contractor is important. The new procurement policy should help to address this issue by requiring that the Procurement division keep vendor evaluations.

Operations Support does not complete monthly inspections and meetings with the contractor as required by the janitorial contract terms. Management told us this is because the contracts are large and staff resources are limited. They said they take action if clients report concerns with the contractors. This is a reasonable response to performance issues; however, management had no evidence to support this practice and the contract called for more frequent monitoring.

Recommendation 1

The Operations Support business unit should review current contract terms to ensure terms are reasonable given the amount of staff time management wishes to allocate to ongoing monitoring. New contracts should balance the need to monitor and available resources.

Management Response

HRM Management agrees with and intends to implement this recommendation. On a go forward basis, Operations Support (now Corporate and Customer Services) will apply this recommendation as new contracts are developed and implemented.

Parks and Recreation completes and keeps annual performance reviews for some of the contracts it manages. It considers these reviews at annual meetings with contractors before the season starts, to show improvements or recurring issues. However, the business unit does not complete required contractor reviews for standing offer contracts.

Finance and Information, Communication, and Technology often uses contractors from a standing offer list. This is a significant cost to the business unit which we estimated to be \$3.7 million in 2016-17. (We have not audited this total.) While the business unit tracks engagements and the time consultants work, it does not keep vendor performance information. Although the standing offer requires a review when a project is finished, these are not completed.

The Information, Communication and Technology division developed a business case supporting the need for additional staff as a cost-saving alternative to the high use of IT consultants. It estimated \$4.4 million in savings from 2017-18 to 2019-20 by creating nine full-time-equivalent positions. An internal report supporting the business case identified other concerns, including

disengaged staff due to lost career opportunities and a loss of corporate knowledge when consultants are finished. Staff told us five new positions have been approved but not yet filled.

While we did not attempt to confirm the estimated savings to the division in hiring new staff, we noted contracted consultants cost an average of approximately \$800 per day (based on data provided by the division). There could be considerable savings to the Municipality by relying less on external consultants to do ongoing operational work.

Across the business units we audited, we found standing offer contracts had the greatest gap in performance monitoring. These contracts generally included less monitoring requirements than other contracts. However, just because a contractor is listed on HRM's standing offer, does not mean monitoring is not necessary to make sure there are no major issues. In fact, since staff across different business units and divisions may use the standing offer list, documenting concerns is important.

Recommendation 2

All business units audited should monitor to confirm that both the Municipality and the vendor comply with all contract terms, including those for standing offers.

Management Response

HRM Management agrees with and intends to implement this recommendation. Administration will work to establish thresholds based on contract value for auditing and oversight on all contract terms. Specific activities initiated in specific areas of the administration include the introduction of Service Level Agreements to evaluate contractor performance, creation of a Vendor Management resource in Information, Communications, and Technology to assist in managing contracts, and performance monitoring. Best practices such as these will be assessed for possible introduction into other areas of the administration.

Municipality did not consistently evaluate vendors

While we found some vendor evaluations were performed, these were not consistently done across all contracts we tested.

- Solid Waste Resources, and Streets and Sidewalks (Transportation and Public Works business unit) consistently completed evaluations at the end of contracts.
- Snow and Ice (Transportation and Public Works) only had evidence that one of four evaluations was completed.
- Traffic Management (Transportation and Public Works) told us they do not always complete evaluations.
- Parks and Recreation evaluated some of the contracts we tested, but not all.

- Operations Support; and Finance and Information, Communication, and Technology did not evaluate contract performance regularly.

When business units fail to monitor and evaluate companies, HRM does not have complete information on contractor performance. Other divisions in the Municipality may contract with problem vendors because they do not know there have been concerns. Vendor evaluations could help reduce the risk of hiring contractors who failed to deliver quality service in the past.

A new procurement policy, which took effect in February 2017, requires vendor evaluations once contracts are complete. The procurement division will keep the evaluations. The policy also requires business units to make sure contract requirements are met. Management will need to monitor and document how vendors are doing to comply with the policy.

Recommendation 3

All business units audited should evaluate vendor performance at the end of contracts and, if appropriate, at intervals during contracts.

Management Response

HRM Management agrees with and intends to implement this recommendation. As per section 44(10) of Administrative Order 2016-005-ADM (Procurement Policy), Business Units shall complete a vendor evaluation scorecard at the completion of each contract or as otherwise directed by the Manager of Procurement. Administration will strive to enforce this section of the policy, but the format and comprehensiveness of the evaluation will depend on the size and nature of the individual contract.

Recommendation 4

The Procurement division should establish processes to ensure vendor evaluations are completed and used in later procurements as applicable.

Management Response

HRM Management agrees with and intends to implement this recommendation. Some steps will be taken immediately. Currently, Procurement consultants and officers are notified monthly via a contract expiry report of what contracts are expiring and when. These staff will notify the specific Business Units of the end date and request that a vendor evaluation be completed. Vendor evaluations will be sent to the Contract Administrator to be filed. One recommended process is that option years will not be utilized until the vendor evaluation is completed by the Business Unit, nor will re-solicitation be allowed until the vendor evaluation is completed. It should be noted that most service contracts have specified terms so their end date is known.

Some contracts did not have project-specific performance terms

The business units identified and managed risks associated with contracted services. The contracts we tested had clauses which protect the public interest, including: skills required; permits and inspections; and information for compliance with relevant legislation (such as the Nova Scotia Occupational Health and Safety Act, Noise Control By-laws, Canadian Standards Association guidelines for playgrounds, and the Environment Act).

However, we found 11 of the 30 contracts did not have specific payment penalty clauses included in the terms. Payment penalty clauses should be included in contract terms in case vendors do not meet performance standards. Without a payment penalty clause, there is less incentive for the vendor to comply with contract terms, including required response times.

Recommendation 5

All external service contracts, including those for standing offers, should require a payment penalty clause.

Management Response

HRM Management agrees with and intends to implement this recommendation. However, some contracts may include means other than penalty clauses to encourage contractors to complete work on a timely basis. For example, contracts can be established which put operational risk (and potential costs) on a contractor if work is not done on time. This would not be a specific payment penalty to HRM but may result in a cost to the vendor. Moreover, the municipality can, with low risk, apply liquidated damages. Liquidated damages, which are most easily applied when deadlines are exceeded, are intended to be a fair assessment of financial damages due to lack of performance, but can include reputational costs. Legal Services will be engaged in implementing this recommendation.

Other business units

Management of the business units which were not included in this audit should review the recommendations against their contract practices and make any changes needed to improve their practices.

Background

Halifax Regional Municipality spent approximately \$128 million on external services in the 2016-2017 fiscal year. (Based on the general ledger; we have not audited this number.)

Halifax Regional Municipality – External Services Expenses (fiscal year ended March 31, 2017 – \$ millions)	
Transportation and Public Works	\$61
Operations Support	5
Parks and Recreation	5
Finance and Information, Communication, and Technology	2
Other business units*	55
Total	\$128

*Includes outside police services of approximately \$25 million

External services include consulting fees, professional fees, janitorial services, snow removal, and other contracted services. The amount paid for external services (based on HRM's accounting system) provides an estimate of how much the Municipality spends annually on contracts. There may be additional costs which are not captured; we noted some contract expenses were included in other accounts such as equipment, vehicle expenses, or building costs.

A new procurement policy, which came into effect in February 2017, outlines how goods, services, construction, and facilities should be purchased.

The Procurement division of Finance and Information, Communication, and Technology (now Finance and Asset Management) is responsible for enforcing the procurement policy. Procurement staff told us they help business units with contracting for external services. Once a contract is awarded, contract management is the business unit's responsibility.

Audit Objectives and Scope

We completed a performance audit of contract management at four business units.

- Finance and Information, Communication, and Technology
- Operations Support
- Parks and Recreation
- Transportation and Public Works

The audit examined a range of contracts, including smaller ones.

The purpose of the audit was to determine whether Halifax Regional Municipality effectively manages contracted services to achieve value-for-money across the business units we audited.

The audit was conducted in accordance with performance audit and quality assurance standards of the Chartered Professional Accountants of Canada. Our staff follow the Chartered Professional Accountants of Nova Scotia Code of Conduct.

The objectives of the audit were to determine:

- whether contract management practices are governed by an adequate management control framework which complies with Halifax Regional Municipality policy;
- how Halifax Regional Municipality assesses the effectiveness of the contract management process in meeting its objectives; and
- if contract terms are established and monitored to ensure value-for-money is achieved.

We developed criteria for the audit. These were discussed with, and accepted as appropriate by, the directors of the business units we audited.

We picked the business units and contract sample items based on contracted services during the audit period: April 1, 2015 to December 31, 2016. The contracts we tested were awarded and managed under the procurement policy which was in effect before February 2017.

Our audit approach included: reviewing the new and previous procurement policies; examining contract terms and contract management processes; and testing contracts and monitoring.

Contact Information

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