

Chapter 4

Section 4.09

Ontario Power Generation—Acquisition of Goods and Services

Follow-up on VFM Section 3.09, *2006 Annual Report*

Background

As part of the reorganization of Ontario Hydro, Ontario Power Generation (OPG) was created under the *Electricity Act, 1998* and commenced operations on April 1, 1999. The objective of OPG, which is wholly owned by the province of Ontario, is to own and operate generation facilities to provide electricity in Ontario. In 2007, OPG had a generating capacity of approximately 22,000 megawatts of electricity, which accounted for approximately 70% of the electricity produced in Ontario. OPG generates electricity from three operating nuclear stations, five fossil-fuelled stations, 64 hydroelectric stations, and three wind-power facilities. During 2007, OPG spent \$3 billion (\$2.5 billion in 2005) on operations, maintenance, and administration.

Included in OPG's total expenditures are annual purchases of goods and services amounting to approximately \$1 billion. Most of this amount is for goods and services procured through the general purchasing system. Such procurement is to be made in one of three ways—through master service agreements with selected vendors, a com-

petitive procurement process, or, when justified, single sourcing. The remaining purchases, which amounted to \$56 million for the 2007 calendar year (\$61 million in 2005), are acquired by OPG staff using corporate credit cards.

In our *2006 Annual Report*, we concluded that, although OPG had sound policies in place for acquiring goods and services and controlling employee expenses, in many respects its systems and procedures for ensuring compliance with those policies were not adequate. Specifically, there was often insufficient evidence on file to demonstrate that goods and services were acquired with due regard for value for money. Also, although purchases requiring the competitive selection of vendors were generally conducted appropriately in accordance with OPG's policies, we had concerns with other purchases, such as those arranged through master service agreements, which do not require competitive selection. Some of our particular concerns in 2006 were as follows:

- Most of the master service agreements that OPG established with vendors and that we reviewed were made without an open or competitive process. Instead, OPG practice was to establish master service agreements

with those vendors that had carried out business with OPG for some period of time. As well, we found that most of the master service agreements did not have fixed rates for specific services, typically a key benefit of such agreements.

- The single-source purchases we reviewed, of such items as temporary staff, equipment, and consulting services, ranged from \$110,000 to \$2.6 million. We noted that the explanations for single sourcing such large purchases either were not documented or were inadequate to justify not carrying out a competitive process.
- In the five years that OPG had outsourced its information technology services, OPG had not audited the service provider with respect to its provision of services, setting of fees, and performance reporting, even though the contract allowed for this. Given that this contract is worth approximately \$1 billion over a 10-year period, such periodic audits would be a sound business practice to provide assurance that the contractor is furnishing accurate and reliable data to support its fees and performance.
- We noted in our review of travel and purchasing credit-card payments numerous examples where supporting documentation was inadequate for managers to properly assess what was purchased and how much was paid for each item. As well, managers may be the only ones reviewing these transactions, which makes effective supervisory review a critical internal control for ensuring that such purchases are appropriate and compliant with policy. However, these reviews were often not completed satisfactorily.

We made a number of recommendations for improvement and received commitments from Ontario Power Generation that it would take action to respond to the issues raised.

Current Status of Recommendations

According to information received from Ontario Power Generation, a number of significant internal-control improvements have been made to address the recommendations in our *2006 Annual Report*. The Current Status of actions taken on each of our recommendations is as follows.

PURCHASE OF GOODS AND SERVICES

Master Service Agreements

Recommendation 1

To maximize cost savings through the use of master service agreements, Ontario Power Generation should:

- *consider establishing master service agreements through a competitive process;*
- *limit agreements to a defined time period, with set terms and conditions, including pricing;*
- *consider implementing a second-stage competition among vendors, especially for significant purchases where there is more than one vendor with a master service agreement that can provide the required goods and services; and*
- *maintain information on all the agreements from the generating plants and the corporate office in a central registry available to all corporate users.*

Current Status

OPG informed us that it was using a competitive process for all new or renewed master service agreements when there is more than one supplier. These agreements are to include agreed-upon terms such as standards of care, insurance, credit provision, events of default, defined contract period, and termination. The scope of work for services or the specifications for goods, as well as any special pricing terms, completion schedule, quantity, and other such details are agreed to and outlined in a

separate transaction document at the time of each purchase. OPG also implemented a guideline in its procurement-activities policy that defines when a second-stage competitive process must be used.

To manage and oversee master service agreements better, OPG established a central registry to which each generating plant and the corporate procurement section is to submit information on all the current and new agreements. This should help reduce the risk of having a number of agreements with the same vendor for similar services at different prices, terms, and conditions.

Needs Justification

Recommendation 2

To ensure that goods and services are acquired in the most economical manner, Ontario Power Generation should, before purchasing goods and services, conduct and document a proper evaluation of its needs and available resources, including an assessment of corporate-staff-resource alternatives before contracting externally for services.

Current Status

OPG informed us that it is the responsibility of the person who requests the purchase to ensure that it is properly justified. OPG uses a “scope of work” document as part of the request-for-quotes and request-for-proposals process. This document includes a description of the need that the good or service to be purchased is to meet and contains specific requirements for potential vendors. OPG uses this document to help it develop evaluation criteria to assess which vendor proposal will best meet OPG’s needs.

OPG informed us that, to assess whether it might already have the internal staff resources to meet a particular need, it reviews current staffing levels against work requirements as part of its annual business-planning process. Each business unit plans for the need to supplement regular employee resources to satisfy periods of peak demand. OPG

believes that it is more cost-effective to hire external contractors for peak-period demand.

Competitive Selection of Suppliers

Recommendation 3

To ensure that goods and services are acquired at the best available price and that all qualified vendors have an opportunity to compete for Ontario Power Generation business, Ontario Power Generation should minimize its single-source purchases, and, where it deems such purchases are necessary, ensure that the reasons for, and costs of, all single-sourcing arrangements are adequately justified and documented.

Current Status

OPG implemented a new guideline that became effective in July 2007 requiring that the requisitioning department justify and document all single-source purchases over \$10,000. This process is then reviewed by supply-chain departments, which either propose alternative purchasing strategies or give approval to proceed. Examples of justifiable single-source situations include:

- unforeseen emergencies where the time required for a competitive process would adversely impact production;
- a declared generation threat where a rapid single-source purchase would prevent or reduce the duration of a forced outage;
- a requirement that goods be purchased from the original equipment manufacturer in order to meet specific or technical requirements; and
- a purchase that is required in order to honour guarantees or maintain warranties.

Procurement Management and Control

Recommendation 4

To better manage and control the procurement of goods and services, Ontario Power Generation should:

- ensure that it has, for each major procurement, a formal signed contract or other documentation that defines the responsibilities of both parties, including the price and specific deliverables to be provided;
- establish monitoring procedures to ensure that payments for goods and services do not exceed contract prices; and
- ensure that any changes to the original contract terms and conditions are adequately justified and properly documented.

Current Status

OPG informed us that it has put procedures in place to ensure that all purchases are supported by a signed contract or purchase order. To help OPG effectively monitor suppliers to ensure that they meet their obligations, the contracts or purchase orders must include the terms and conditions, price, and deliverables to be provided by the supplier. In this regard, all purchases over \$1 million require a formal contract while lesser amounts require only a purchase order. In addition, OPG informed us that the person approving the invoice is responsible for verifying the rate on the invoice against the negotiated rate in the agreement or purchase order before approving and paying the invoice. OPG has also implemented procedures to monitor increases to contract prices. If contract prices are exceeded, OPG now requires that the incremental cost be reviewed prior to issuing a new or revised purchase order to determine if a competitive or single-sourcing process should be followed for the additional cost.

OPG informed us that effective July 2007, it implemented new purchase-order documentation procedures requiring that any changes to the original contract prices and conditions be justified, documented, and included in the purchase-order file. This should help OPG to properly ensure that suppliers provide the stated deliverables according to the signed agreements and amendments.

Vendor Performance Evaluations

Recommendation 5

To help ensure that the proposed central vendor registry fulfills its objectives and that prior experience with vendors is taken into consideration in vendor selection, Ontario Power Generation should implement procedures to ensure that vendors are evaluated upon completion of the procurement process and before awarding any subsequent contracts.

Current Status

OPG informed us that to ensure that evaluations are completed on a consistent basis, it has developed a supplier-performance monitoring and score-card procedure to evaluate vendors. Information so collected is kept on a central registry of vendor performance evaluations. This allows OPG staff to exchange feedback with the vendors, identify performance improvement areas, and develop plans with vendors to improve performance. The system also helps OPG assess its previous experiences with a vendor during the supplier-selection process for new contracts. In evaluating supplier performance, OPG now considers the following areas: environment, health, and safety; price and cost; schedule and delivery; quality performance; technical performance; responsiveness; and management of the supplier.

The frequency of an evaluation will depend on whether a vendor is a company-wide or a strategic supplier. Evaluations must be completed at least once a year for company-wide suppliers—those that provide services to more than one business unit—and for strategic suppliers with a master service agreement for more than \$5 million over the life of the agreement. For other suppliers, each business unit determines the frequency of evaluation.

OUTSOURCED INFORMATION TECHNOLOGY SERVICES

Recommendation 6

To ensure that it receives value for money from its information technology outsourcing initiative, Ontario Power Generation should:

- *implement a periodic audit process to verify the accuracy and reliability of the information submitted by the vendor with respect to costs and performance; and*
- *consider utilizing external consulting expertise to assist with its unit-price negotiations for the 2005–10 portion of the information technology service contract.*

Current Status

In June 2007, OPG engaged an external third party to help conduct an internal audit review to determine the accuracy and reliability of the information provided by the vendor of outsourced information technology services with respect to the two year “gain-share” phase of the contract and the performance standards agreement. The gain-share agreement stipulated that any cost savings realized during the years 2003 to 2005 be split between OPG and the vendor, and then be locked in for the remainder of the agreement through a fixed effective price. The audit recommended that OPG and the vendor should make minor adjustments to the gain-share costs and incentives. In addition, OPG informed us that it will carry out other audits on an ongoing basis to review items such as performance reporting to meet OPG audit and regulatory requirements.

In December 2006, OPG hired a consultant to assist in the unit-price negotiations for the portion of the information technology contract covering the years 2005 to 2010. OPG informed us that negotiations with the service provider concluded that unit pricing could not be implemented as originally contemplated in the agreement, which was to be negotiated on the basis of service volumes and the service provider’s costs. However, unit pricing incorporating market-based pricing remains one of

OPG’s goals for this contract. OPG is working with the service provider to collect the relevant volume data needed to support the negotiation of unit pricing. This approach has been incorporated into a strategy that OPG informed us is being considered to renew or replace the existing outsourcing agreement.

OPG advised us that, as a result, the current pricing model is based on the effective price established as of January 1, 2005, which reflects the results of the gain-share phase of the contract. Costs for growth in services are determined through an open-book process and agreed to by both parties as in previous phases of the contract. The review carried out by the consultant determined that this process was cost-effective and provided OPG with value for money.

CORPORATE CREDIT-CARD PURCHASES

Submission of Supporting Documents

Recommendation 7

To help ensure that only valid expenditures are charged to corporate credit cards and that such cards are used in accordance with its policies, Ontario Power Generation should implement more effective procedures to ensure that cardholders submit the necessary documentation for travel- and purchasing-card expenses and that supervisory oversight and approval controls are working effectively.

Current Status

OPG advised us that, after our 2006 audit, it established a process to locate all missing receipts for travel and goods charged to credit cards. In addition, OPG informed us that it implemented a new control whereby the expense reports will no longer be approved unless receipts are attached electronically. OPG has also established an additional level of audit on a sample basis to verify that receipts are attached to expense reports.

If no receipts are submitted within 60 days for purchases on corporate credit cards, follow-up action is taken with the cardholder. If the cardholder does

not provide the required receipts, the purchase card will be suspended. OPG informed us that to help ensure that only valid expenditures are charged to the corporate purchasing card, it has blocked purchases through the Merchant Category Code for expenditures, such as meals and hotels, that should be charged only to corporate travel cards. OPG was also in the process of implementing a policy requiring two signatures for all exceptions to the blocked Merchant Category Codes.

Minor Fixed Assets

Recommendation 8

To help ensure that all minor fixed assets are properly recorded and safeguarded, Ontario Power Generation should:

- *review corporate credit-card purchases for any minor fixed assets and follow up to confirm that such assets are properly reported to the asset-processing centre; and*
- *reinforce the policy requirements that cardholders and their managers are accountable for the proper reporting and safeguarding of minor fixed assets.*

Current Status

After our audit in 2006, OPG changed its policy with respect to recording minor asset purchases in its fixed-asset system. Originally, all asset purchases over \$2,000 were to be recorded and tracked, but the current policy requires that only purchases over \$25,000 are to be recorded. OPG informed us that the corporate credit cards used by employees have a transaction limit of \$10,000, which is lower than the threshold for recording items in the fixed-asset system. Accordingly, there should be no items purchased on the corporate credit cards that need to be captured in the fixed-asset system. However, it is still the manager's responsibility to safeguard minor fixed assets up to the capitalization threshold.

In addition, to ensure that low-value items below the minor fixed-asset threshold are adequately safeguarded, OPG's internal audit

branch will perform an annual physical existence test on a sample of such items purchased with corporate credit cards that are below OPG capitalization threshold of \$25,000.

Employee-recognition and Gift Purchases

Recommendation 9

To help ensure that employee-recognition practices are consistent among business units, are reasonable, and comply with income-tax requirements, Ontario Power Generation should:

- *provide corporate-wide guidance on employee-recognition and gift purchasing; and*
- *establish procedures to ensure that all employee benefits are reported to the payroll department as required and implement procedures to monitor compliance.*

Current Status

OPG informed us that changes were made to its business travel and expense procedure in June 2007 to address employee recognition and other events. The new procedure requires that recognition programs be approved in advance by the OPG Executive Committee to ensure that they are consistent across OPG and are not excessive. The new procedure further requires that managers and supervisors review specific expenses for eligibility and compliance with policy, and determine any related income-tax implications. In addition, employee-recognition awards with any monetary value are not permitted, except for designated service-recognition gifts and recognition based on pre-approved annual plans.

The revised business travel and expense procedure requires that managers and supervisors approving a taxable benefit inform the Human Resources Compensation and Benefits Department in writing to ensure that a taxable benefit is properly recorded. Canadian income-tax rules consider recognition in the form of cash or "near cash" to be a taxable benefit. Non-cash awards are a taxable benefit where an employee receives more than two

awards in a year or the value of the awards exceeds \$500. To ensure that taxable recognition awards are not given to employees, OPG now requires that recognition awards be limited in number and value, in keeping with income-tax requirements. Furthermore, OPG decided that recognition awards can no longer be in the form of gift cards or other “near cash” items.

Monitoring Card Usage

Recommendation 10

To more effectively manage the use of corporate credit cards, Ontario Power Generation (OPG) should:

- *perform periodic audits to identify any patterns of improper cardholder transactions and lack of compliance with corporate policy;*
- *establish a more rigorous monitoring program to verify that each type of credit card is being used appropriately; and*
- *periodically review purchasing-card usage to reduce OPG’s financial risk, cancel unused cards, and adjust credit limits to appropriate spending levels.*

Current Status

With respect to a monitoring program for corporate credit-card use, OPG indicated that it has implemented several processes to identify and correct

improper usage of the cards and non-compliance with corporate policy. The accounts payable department samples business-expense reports on a daily basis for missing receipts and potential policy violations. In addition, divisional controllers will, at least quarterly, perform a limited review of business and travel expenses and corporate purchasing-card expenditures and provide a report to business unit managers identifying unusual or potential non-compliance cases requiring corrective action. This is in addition to an annual audit by the internal audit department that is scheduled to be completed by December 2008 to determine compliance with corporate policy and identify improper cardholder transactions. For the corporate purchasing card, OPG has also blocked purchases for certain Merchant Category Codes. These processes are in addition to the requirement for line managers to ensure the appropriateness of business expenditures.

To reduce its financial risk for purchasing-card use, OPG informed us that it has implemented a new control procedure to identify unused credit cards and cardholders that normally spend significantly below their approved credit limits. Divisional controllers are to review these cases on a semi-annual basis to determine whether the purchasing card should either be cancelled or have its credit limit reduced to reflect more closely the cardholder’s actual spending level.