Chapter 3

Section

3.09 Ontario Power Generation—Acquisition of Goods and Services

Background

As part of the reorganization of Ontario Hydro, Ontario Power Generation (OPG) was created under the *Electricity Act, 1998* and incorporated under the *Business Corporations Act* on December 1, 1998. Wholly owned by the province of Ontario, OPG purchased and assumed certain assets, liabilities, employees, rights, and obligations of the electricity generation business from Ontario Hydro on April 1, 1999 and commenced operations on that date.

The objective of the company is to own and operate generation facilities to provide electricity in Ontario. In the 2005 calendar year, OPG generated approximately 22,000 megawatts of electricity, which accounted for 70% of the electricity produced in Ontario. OPG generates electricity from three operating nuclear stations, five fossil-fuelled stations (that is, stations fuelled by coal, oil, or natural gas), 35 hydroelectric (water power) stations, 29 certified green power stations, and three wind power stations. During 2005, OPG spent $2.5 billion on operations, maintenance, and administration, as shown in Figure 1.

Included in these 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 through master service agreements with selected vendors, a competitive procurement process, or, when justified, single-sourcing. The remaining purchases of goods and services, which amounted to $61 million for the 2005 calendar year, are acquired by OPG staff using corporate credit cards.

Figure 1: Ontario Power Generation's Operating, Maintenance, and Administration Expenditures, 2004 and 2005

Source of data: Ontario Power Generation

	2004 ($ million)	2005 ($ million)
salaries and wages	1,353	1,423
consultants and purchased services	409	435
augmented staff	268	260
materials	207	236
outsourced services	117	103
insurance and licence	44	44
utilities and facilities	26	34
business travel and accommodations	15	11
capital transfers	(67)	(304)
miscellaneous expenses	222	274
Total	**2,594**	**2,516**

Audit Objective and Scope

This was the first value-for-money (VFM) audit conducted at Ontario Power Generation (OPG) under the expanded mandate of the Office of the Auditor General of Ontario, which came into effect November 11, 2004. The expanded mandate allows us to conduct VFM audits of Crown-controlled corporations and subsidiaries of Crown-controlled corporations. We chose to examine procurement practices as a means to gain a broad understanding of the overall expenditures and operations of OPG.

The objective of our audit was to assess whether the corporation had adequate systems and procedures in place to ensure that goods and services were acquired and employee expenses were controlled and spent in compliance with OPG's procurement policies and with due regard for value for money.

The scope of our audit included discussions with OPG staff, review and analysis of documentation provided to us by OPG, and research into the procurement practices and control of employee expenses in other public and private enterprises. OPG's Risk and Assurance Services Branch had conducted some audit work on employee expenses and purchasing in the past three years, which was useful to us in determining the scope of our audit.

Our audit was performed in accordance with the standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances. The criteria used to conclude on our audit objective were discussed with and agreed to by OPG management and related to systems, policies, procedures, and best practices that the corporation should have in place.

Summary

We concluded that, although Ontario Power Generation (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. Our particular concerns were as follows:

- Most of the master service agreements we reviewed were established without an open or competitive process. Instead, OPG practice is to establish a master service agreement with vendors that have carried out business with OPG for some period of time. As well, we found that most of the master service agreements OPG had established with vendors did not have fixed rates for specific services, which is typically a key benefit of master service agreements.
- The single-source purchases we reviewed for such items as temporary staff, equipment, and consulting services, ranged from $110,000 to $2.6 million. We noted that the explanation for single-sourcing such large purchases either was not documented or was inadequate to justify not carrying out a competitive process.
- We noted numerous instances in which goods and services were purchased without either a formal agreement or other signed document indicating that both parties agreed with the terms, pricing, and deliverables of the purchase order. Without a formal signed

agreement, there is a risk that OPG cannot hold the vendor accountable for providing the deliverables at a specific price and under agreed-to terms and conditions. We also noted instances in which the price of the purchase order was increased without an appropriate rationale or the invoices submitted were for amounts greater than the amounts originally agreed on.

- In the five years that OPG has outsourced its information technology services, OPG has not audited the service provider with respect to its provision of services, setting of fees, and reporting of performance, even though the contract allows 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 service provider is providing 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. Managers may be the only party to review the transaction, which makes effective supervisory review a critical internal control for ensuring that the purchases are appropriate and compliant with policy, yet this review was often not being satisfactorily completed.
- Although there was no corporate policy with respect to employee recognition events and gifts, we noted in our sample of expenses tested that $300,000 was spent on such items. Given the nature of the items purchased and the wide-ranging amounts spent by managers, there is a need for more formal guidance as to what is reasonable in this area. In addition, $120,000 was spent on gift certificates to reward employees. Such gifts are taxable benefits, but, contrary to corporate policy, none of these gifts were reported as taxable benefits.

Detailed Audit Observations

PURCHASES OF GOODS AND SERVICES

Ontario Power Generation (OPG) annually purchases approximately $1 billion in goods and services. These purchases are carried out by OPG's various divisions. In acquiring goods and services, buyers must comply with OPG policies and procedures, which state the key principles for decision-making during the planning, acquisition, and management of purchases. These principles include justification for the purchase, a purchasing strategy (that is, master service agreements, competitive bids, or single-sourcing), contract monitoring, and post-contract evaluation.

We found that the policies OPG had in place for the acquisition of goods and services were sound and comparable to Ontario government policies, which are designed not only to ensure the best value for money expended but also to help ensure accountability. While purchasing authority has been delegated to several individuals within the organization, OPG has delegated accountability for all purchasing commitments to its supply chain department. Supply chain managers are required to ensure that OPG procurement policies and procedures are implemented and complied with.

Master Service Agreements

OPG has established master service agreements with a number of vendors. These agreements are procurement arrangements intended to improve efficiency and lower costs by pre-establishing rates, terms, and conditions for specific services. Where a master service agreement is in place, buyers must use it for purchases unless an alternative arrangement is supported by a business case and properly approved.

The master service agreements we reviewed were for services such as engineering, construction, and information technology. We note below three main areas where master service agreements needed to be improved to reflect the requirements of corporate policies and help ensure that OPG achieves value for money.

First, most of the master service agreements we reviewed were established without an open or competitive process. Instead, OPG practice is to establish a master service agreement with vendors that have carried out business with OPG for some period of time. Consequently, it is difficult for OPG to demonstrate that it is receiving the best value. Also, most of the agreements we reviewed did not have pre-established rates for specific services. Further, even when a rate was pre-established, OPG would still pay whatever the vendor's current price was when a purchase was made.

Second, we noted cases where master service agreements did not have an expiration date or the buyer made a purchase using an expired master service agreement. For example, we found three cases in which purchases were made using master service agreements that had expired five years ago. In these cases, no new agreements had been negotiated.

We did note in our review that, at one generating plant, a good practice with respect to value for money was being applied. Where more than one vendor can provide particular goods or services under a master service agreement, the buyers at this plant ask the vendors to submit a bid for the required work. The bids are evaluated, and the work is given to the vendor with the lowest evaluated price.

Our third concern was that we could not determine the total number of master service agreements in existence at OPG because there is no central registry to track them. Agreements are separately negotiated and maintained at each generating plant and the corporate procurement section. As a result, there is a risk that a number of agreements for similar services exist with the same vendor, each with different terms, conditions, and pricing. A centralized registry would allow OPG to better manage master service agreements. It would also help management to oversee that, when an agreement expires, another agreement either is established using a competitive process or is renegotiated properly and that, when vendors have more than one agreement with OPG generating plants, OPG uses its combined purchasing power to achieve the best price.

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.

Needs Justification

OPG policy states that, when purchasing, business units must clearly identify what is required to satisfy the business need and, in the case of contracted services, must first consider using existing corporate resources. OPG's supply chain department is required to be involved in the initial stage of needs identification. If it is determined that the purchase must be made externally, a request-for-purchasing form indicating this must be completed and forwarded to the supply chain department and maintained on file.

We noted many examples in which OPG did not document the justification for purchases such as consulting services, augmented staff, and machinery. As well, often there was no evidence of assessments of whether internal resources were available before purchasing external contracted services. Staff informed us that relevant assessments may have been performed but not documented and that internal skills and resources were often inadequate to meet purchasing needs because OPG had undergone restructuring and downsizing while, at the same time, undertaking new projects. Nevertheless, conducting a proper evaluation and documentation of staff requirements compared to staff abilities could help central management identify and meet training and hiring needs, which could be more cost effective than engaging outside contracted services, especially over the long run.

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.

Competitive Selection of Suppliers

The corporate purchasing strategy is to purchase goods and services through master service agreements where such agreements are in place. Where they are not, the purchase method is dependent on the estimated cost of the purchase. For purchases in excess of $10,000, a competitive process is to be followed that includes written quotations from vendors. If the estimated cost is $100,000 or more, an open call for tenders is required. Suppliers are to be evaluated on the basis of their ability to meet the identified needs, taking into consideration technical capability; quality assurance; proposed costs and terms and conditions; financial strength; timeliness; and past performance, including safety and environmental records. A further procurement option is single-sourcing in lieu of seeking competitive bids; corporate policy requires that, if this option is chosen, justification for it must be documented.

We concluded that, when vendors were competitively selected, OPG's procedures were generally adequate to ensure that the policy requirements were followed. In addition, the suppliers' bids were generally properly evaluated, and appropriate documentation was on file justifying the selection of the vendor.

However, we found that when a purchase was not competitively acquired, the justification for single-sourcing was often not adequately documented. The single-source purchases we reviewed ranged from $110,000 to $2.6 million and were for purchases such as equipment and consulting services and the engagement of temporary staff. We noted examples in which the justification for single-source purchasing was either not documented in the purchasing file as required or the explanation was inadequate. For example, the reason given for one single-source purchase was that the vendor was the best available source selected by the requisitioner.

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.

Procurement Management and Control

Once a supplier has been selected and terms and conditions have been agreed to, managers are to monitor that the supplier meets all of its obligations. Effective monitoring includes ensuring that all technical specifications, quality and regulatory requirements, scheduled milestones, and stated deliverables are met or completed, as well as reviewing and authorizing invoices for payment. Overall, we noted that there was a lack of documentation in the purchasing files to demonstrate that managers were properly overseeing suppliers' work and that supply chain managers were managing the contract, both of which are required by OPG policy. This lack of documentation of monitoring activities also makes it difficult to effectively evaluate supplier performance. This general concern is described in more detail, with specific examples, as follows.

Normally, when an organization purchases goods and services, a written agreement or contract is signed by all parties involved to formally define the respective responsibilities, terms and conditions, price, and the specific deliverables to be provided by the vendor. A document such as a purchase order can serve as such an agreement provided that it outlines the agreed-upon terms and conditions and is signed by both parties. OPG does require such information and signatures for its purchase orders. However, we found numerous examples involving significant purchases in which the documents OPG used to serve as an agreement did not have any indication that both parties had agreed to the terms, pricing, and deliverables of the purchase order. Without such written confirmation, there is a risk of potential disputes with vendors as to what terms and conditions have been agreed to.

We also noted examples where the price quoted in the purchase order was increased without appropriate rationale and documentation, as well as invoices for more than the amounts agreed to in the purchase order. In the absence of adequate supporting documentation, it was not possible to determine if the terms and conditions of the purchase remained unchanged with the same deliverables or whether there was additional work requested and performed under the purchase order. For example:

- In March 2005, a purchase order to review and assess the supply-chain function was issued for $260,000 but was increased to $320,000 in June 2005, with the only justification on file for the increase being that it was to "pay for invoices received."
- In November 2005, OPG hired a contractor to perform renovations at its corporate offices at a cost of $498,000 for the first phase of the work. However, invoices submitted by the vendor and paid by OPG for this work totalled $562,000. There was no documentation on file justifying this increased cost or indicating whether the scope of the work had been increased by OPG. The original request for proposal allowed for an expansion of the work into a second phase, which began in December 2005 without further competition and for which OPG increased the purchase order by $1.8 million. However, there was no documentation on file from the contractor giving an estimate for this second phase, nor did OPG document how the amount was determined and how the reasonableness of the $1.8-million increase was assessed.

  We were informed that the second phase of the work was for electrical and mechanical work and that the scope of the work could not be determined until the contractor began working on this second phase. In situations like this, often the most effective approach is to extend the purchase order only for the initial work and, before awarding the work to the contractor, to have the contractor submit a detailed cost estimate on proposed work to be done that can be validated or compared to a second external quote for the required work.

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.

Vendor Performance Evaluations

OPG policy requires the preparation of a formal evaluation of the vendor once the acquisition of goods and services is completed to ensure that OPG received value for money, that the services were obtained on a timely basis, and that the vendor provided the deliverables as specified in the contract. This information is to be evaluated by purchasing staff to assess the suitability of awarding work to the vendor in the future.

We noted that procedures were not in place to ensure that vendor evaluations were completed at the conclusion of the procurement process. We also found that evaluations were not being completed on a consistent basis, and even when they were completed, that they were not being sent to supply chain managers to review, as required. In addition, there is no central registry of vendor information that would help OPG to evaluate vendors for future work. We were informed that a central registry is being developed that will gather information on vendor capabilities and performance to assist OPG in awarding subsequent contracts. The central registry is being developed in stages and is expected to be completed by winter 2007. However, if evaluations are not being performed, the component of the registry dealing with vendor performance will be ineffective.

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.

OUTSOURCED INFORMATION TECHNOLOGY SERVICES

In 1999, OPG undertook a review to assess the potential for outsourcing its information technology function. A competition was held, bids submitted from vendors were evaluated, and OPG selected the successful vendor based on predetermined criteria. In November 2000, OPG entered into an agreement with the successful vendor and subsequently transferred approximately 520 employees to the vendor. The agreement expires in January 2011, and the total cost of the initiative is estimated to be $1 billion. As of December 31, 2005, OPG had paid the vendor $510 million.

The agreement allows OPG to audit the vendor's provision of services, setting of fees, and reporting of performance. In the five years that the agreement has been in place, no audit of the vendor has been conducted to verify that the fees charged have been appropriate and that the performance reports provided by the vendor, on which a portion of the fees is based, have been accurate and reliable. Specifically, we noted the following three major areas where improvement is needed in the administration of the agreement to help ensure that OPG receives value for money from the outsourcing initiative.

- The agreement sets out performance standards by which the vendor is to be held accountable for its provision of information technology services. These performance standards deal with the vendor's availability, response time, success in problem resolution, and daily system performance. The vendor submits monthly reports to OPG on its performance in relation to these standards. If the vendor fails to meet the performance standards, OPG is to receive a credit on its payment, and if the performance standards are exceeded, OPG is to make incentive payments to the vendor. At the conclusion of our audit, OPG had not verified that the information submitted by the vendor was sufficiently accurate and reliable to determine the quality of performance, and it therefore could not ensure that credits and incentive payments had been calculated correctly.
- The outsourcing agreement stipulates that the period from January 1, 2003 to December 31, 2004 is a "gain-share" phase, during which OPG and the vendor are to share in the cost savings generated through the pursuit of new initiatives. The vendor informed OPG in November 2005 that OPG's total portion of the gain share was $11.9 million. However, at the completion of our audit in March 2006, this payment had not been made because OPG had not yet verified that the amount determined by the vendor was correct. Given that it has been over three years since this initiative began, more timely verification of vendor information is warranted.
- Starting January 1, 2005, and for the remainder of the agreement, OPG is to be charged a unit price for information technology services. We noted, however, that this phase of the contract has not yet been implemented because, before OPG and the vendor can agree on an appropriate price, the vendor has to collect and aggregate relevant information on service volumes, and it has not yet done so. Consequently, during 2005, OPG made payments based on the pricing terms that were in place prior to January 1, 2005. We were advised that, once the unit price for services is negotiated with the vendor, a retroactive adjustment will be made. Nevertheless, given that the costs of information technology services are currently uncertain, it is difficult for OPG to effectively manage these costs. As well, given the magnitude of these costs, it may be prudent for OPG to engage specialized consulting expertise to assist in negotiating the unit price with the vendor.

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.

CORPORATE CREDIT-CARD PURCHASES

To pay for certain types of expenditures incurred in its day-to-day operations, OPG staff use three different corporate credit cards: a purchasing card, a travel card, and a fleet card. The purchasing card is to be used to procure goods and services under $10,000. The travel card is the preferred payment method for all travel- and business-related expenditures, such as meals, hotels, car rentals, airline tickets, conferences, and other low-cost business-related expenses. The fleet card is to be used to pay for maintenance, repairs, and fuel for corporate-owned and leased vehicles. Each card is to be used only for its designated purpose—thus, for example, travel and purchasing cards are not to be used to pay any costs relating to vehicles.

For the 2005 calendar year, expenditures using the three corporate credit cards totalled $61 million: $30.1 million on purchasing cards, $28.6 million on travel cards, and $2.3 million on fleet cards.

Submission of Supporting Documents

Corporate policies and procedures, for both travel and purchasing cards, require that cardholders maintain original receipts detailing expenditures and submit them to their supervisors for review and approval. Such documentation is to include the name of the vendor, item or service purchased and, in the case of travel expenses, the names of the participants in any event or meal and the purpose of such expenditures.

Before approving any expenditures, managers are required to review the documentation submitted and ensure that appropriate receipts support the expenditures. Managers often may be the only party aside from the purchaser to review the transaction, which makes this supervisory scrutiny a critical internal control for ensuring that the purchases are appropriate and compliant with policy. We found that managers' scrutiny was not adequate—that is, for purchases on both travel- and purchasing-card purchases, we found many instances in which the proper documentation was not submitted to support the expenditures. Specifically, we noted the following:

- From our sample of credit-card purchases, we noted $790,000 of expenses that were paid without original receipts. Instead of the original receipt, the documentation provided included credit-card slips, credit-card statements, packing slips, and photocopied or faxed receipts. For example, employees used a credit-card statement as documentation for travel-related expenses such as airfare, hotel, gifts, and car rentals. Documentation of this nature does not contain the detail a supervisor needs to determine whether expenditures were incurred for business purposes and were reasonable in the circumstances. In addition, the submission of such documentation instead of original receipts increases the risk of duplicate payments.
- Corporate policy requires that all purchasing-card receipts be submitted to accounts payable, which records whether supporting documentation has been received. We found from our sample of purchasing-card expenditures that accounts payable had made $1.3 million in payments without the supporting documentation necessary to validate the dollar amount, quantity, and nature of the items purchased. Merchant descriptions from the corporate-card database identified these purchases as items from department, home-furnishing, and sporting-goods stores; office and industrial supplies; personal and educational services; medical equipment; services supplied by heating and air-conditioning contractors; construction materials; and services supplied by employment agencies. We reviewed the entire purchasing-card database for the 2005 calendar year and noted that the purchases for which employees had not submitted any receipts to accounts payable totalled $6.5 million. The sheer volume of inadequate supporting documentation makes it difficult for corporate

management to effectively identify and follow up on questionable expenditures.

- Corporate policy also requires that receipts for hospitality-type expenditures include the number of persons in attendance at an event or meal, the names of those whose expenses are being paid, and the purpose of the event/meal. Such a requirement helps to demonstrate that the costs incurred are for legitimate business purposes and are reasonable. However, in our sample, excluding large groups, we noted over $320,000 of such business expenses for which the required documentation was not provided.

In the past two years, OPG's Risk and Assurance Services Branch has also reported the lack of receipts and inadequate documentation in its audits of travel expenses and made recommendations for corrective action. Given our observations, compliance with policies and procedures in this area still requires substantial improvement.

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.

Minor Fixed Assets

OPG classifies minor fixed assets as those that are portable and used in its administrative, construction, transport, or maintenance activities. They are not used directly for the generation of energy and do not form integral components of a building. When minor fixed assets are purchased, the responsible manager is to provide the asset-processing centre with specific details of the transaction. In addition, he or she is responsible for clearly marking the assets as the property of OPG and safeguarding the assets on site. OPG policy is to record all asset purchases over $2,000 in its fixed-asset system, while those less than that amount are charged to an expense account. These items costing less than $2,000 are not required to be inventoried; however, managers may still choose to do so.

OPG policy prohibits the use of corporate credit cards for the purchase of minor fixed assets. However, in our sample of travel- and purchasing-card expenditures, we noted that travel and purchasing cards were often used to purchase minor fixed assets such as computer printers, monitors, fax machines, digital cameras, projectors, and computer scanners.

In reviewing these purchases, we found that OPG lacked adequate controls for ensuring that such purchases are properly recorded and safeguarded. That is, assets purchased on corporate credit cards are not required to go through a central receiving point to ensure that they are recorded in the fixed-asset system before they are distributed to users. Purchasers generally took delivery of these items directly, with OPG relying on the employees to report these assets to the asset-processing centre for inclusion in its records. However, none of the assets sampled that cost more than $2,000 had been recorded in the fixed-asset system.

For the sample tested, we attempted to physically verify the existence and whereabouts of the minor fixed assets that had been purchased with credit cards. We were unable to locate any of these assets, and OPG could not provide evidence that they were in its possession. Without adequate procedures in place to record and track minor fixed assets purchased with corporate credit cards, there is an increased risk of their loss or theft.

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.

Employee-recognition and Gift Purchases

Although there is no corporate policy with respect to employee-recognition and gift purchases, we noted that such purchases were routinely made within OPG. From our sample of travel- and purchasing-card use, we noted purchases of approximately $300,000 for employee-recognition events and other gifts. Some examples of the purchases made include a $380 telescope for 25 years of service, approximately $3,700 spent on dinner for staff following successful testing at a generating plant, and 40 leather jackets, totalling $8,000, for recognition of five-year safety records.

We acknowledge that purchases of this nature may well be justified. However, given the nature of the items purchased and the wide-ranging amounts spent by managers, there is a need for more formal guidance as to what is a reasonable amount to spend on employee recognition and gifts.

Recognition rewards to employees are considered a taxable benefit to the employee, and, according to corporate policy, these benefits should be paid through the payroll system to ensure that taxes are properly withheld. The manager approving the benefit is to inform the payroll department in writing to ensure that the benefit is properly recorded and the appropriate taxes deducted.

We found many instances of travel and purchasing cards being used to pay for gift certificates to reward employees. These totalled over $120,000. The values of individual certificates ranged from $25 to $300 and were purchased from department stores, electronic stores, hardware stores, and various restaurants. We provided a list of these rewards to the human resources department to determine if they had been reported as taxable benefits as required. We were informed that, contrary to corporate policy, none of the rewards were processed through the payroll system and therefore would not be reported as taxable benefits on employees' T4 slips.

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.

Monitoring Card Usage

By using corporate credit cards, employees are able to purchase and directly receive goods and services. Given that $61 million of goods and services are purchased using corporate credit cards, it is especially critical to have appropriate monitoring and oversight procedures in place. Such monitoring should involve tracking the amounts spent on the three corporate credit cards (purchasing, travel, and fleet), analyzing card usage, and carrying out periodic audits and verifications of card transactions. Some of our specific concerns with OPG's efforts to monitor credit-card activity and maintain internal controls are as follows.

One intended oversight control is the production of a monthly purchasing-card report that identifies employees who have exceeded their credit limits, spending on vendors from whom credit-card purchases are supposed to be blocked, food purchases, foreign purchases, and aggregate spending on each merchant category code assigned by the credit-card company. This monthly report is distributed to various directors and managers at OPG. We contacted recipients on the distribution list and were informed that, while they scan the reports, a detailed review is not done to identify and follow up on possible inappropriate purchasing.

OPG policy requires that purchases of goods and services exceeding $10,000 are to be made through a purchase order. We noted numerous purchases exceeding this amount on employee travel and purchasing cards that should have been noted and followed up on but were not. For example, two employees used their travel cards to purchase 1,500 calendars, totalling $17,700, and to pay for flowers and rental of table linens, cutlery, plates, glasses, and other accessories for a conference, totalling $14,300. In addition, in the purchasing-card transactions we reviewed, we noted three purchases totalling $90,300 for gift cards.

We noted frequent instances, totalling $86,000, in which purchasing rather than travel cards were used for travel and travel-related expenses such as conferences, highway road tolls, meetings, and training courses. In addition, purchasing cards rather than fleet cards were used to pay for vehicle maintenance, repairs, and fuel. We obtained from the purchasing-card database a list of purchases identified as "automobile" under the merchant category code classification and had the corporate fleet-services section review the transactions. It was determined that purchasing cards had been used for over $560,000 of expenses that should have been paid for using the fleet card. According to the fleet-services section, having accurate information on actual vehicle expenditures is vital for managing the corporate fleet effectively and making prudent decisions regarding maintenance, replacement, and vehicle warranties.

Limiting the credit available to cardholders is a key factor in managing the purchasing-card program and minimizing OPG's financial risk. The majority of the purchasing-card holders have monthly credit limits of $10,000 to $25,000, with a few in the $100,000 to $300,000 range. We found examples of purchasing-card holders who had credit limits that far exceeded their historical spending levels. In this regard, 93% of the purchasing-card holders spent an average of less than half of their maximum monthly credit limit. For example, one employee had a monthly credit limit of $100,000 but made purchases during the year of only $365. In addition, we noted that 76 employees who had purchasing cards did not have any purchase activity during 2005. Given that each purchasing card increases OPG's financial risk, there should be a periodic review of credit limits that results in adjusting those limits to historical spending levels and cancelling purchasing cards not being used.

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.

ONTARIO POWER GENERATION RESPONSE

Recommendation 1

Ontario Power Generation (OPG) will review its use of master service agreements. Any new or renewed agreements will be established for a finite period and will specify rates for specific services, unless rates will be established at the time of the purchase through a second-stage or other competitive process. OPG will develop plans to establish a central registry for master service agreements. OPG will also consider further use of a second-stage process where there are a number of qualified vendors who can provide the same goods or services.

Recommendation 2

OPG has defined processes and approval requirements for business cases and for the procurement of goods and services. The required level of approval within OPG is dependent on the dollar value of the project or transaction. Any decision to acquire goods or services is based on OPG's expected needs. For example, a decision to engage temporary staff is based on an assessment of cost, risk, the availability of both internal and market-place resources, and compliance with collective agreements. OPG does not require that business cases be included in procurement files. OPG agrees that there is a requirement for appropriate documentation of needs justification, especially for large purchases, and will conduct a review of current documentation practices.

Once a requisition for goods or services has been approved, it is submitted to the supply chain department for procurement of the goods and services.

Recommendation 3

OPG will review its policy and practices with respect to the selection of suppliers to ensure that a competitive request-for-proposal process is conducted where appropriate and where there is value added. OPG will reinforce the requirement to document the justification for single-source arrangements and include this documentation in purchase order files.

Recommendation 4

OPG issues purchase orders to vendors for all purchases to document terms and conditions, price, and specific deliverables. A signed contract is required for all purchases greater than $1 million.

Changes to commercial terms and conditions are required to be conducted by the supply chain department and incorporated in purchase order files and/or contained in electronic form in the purchasing system. Review and approval are required for any changes in the dollar amount of purchase orders, although this information may not always be documented in purchase order files.

Scope changes are documented; however, this information is presently maintained by the requisitioners. In order to improve the documentation included in purchase order files, OPG will document references to scope changes and the rationale for any changes in purchase order amounts in its purchase order files or system.

It should be noted that vendor invoices are not processed for payment until invoice details and amounts are reconciled with purchase order information.

Recommendation 5

OPG will expand its current process for evaluating vendors. OPG will continue to evaluate the practicality of and appropriateness of maintaining a central vendor registry.

Recommendation 6

The structure of the outsourcing contract, which included a joint-venture phase, followed by a gain-share phase, provided OPG with visibility into the outsourcer's operations and costs. In the next phase of the contract, which will include unit pricing, OPG will exercise the contract provision that allows for an independent external auditor to validate the performance and fees charged for IT services. This provision becomes more relevant as the outsourcing contract transitions to unit pricing and the visibility that OPG currently has of the outsourcer's costs and operations diminishes. OPG also plans to re-engage an external outsourcing specialist to help with the transition to the next phase of the contract.

Recommendation 7

OPG's procedures for purchasing cards and employee travel- and business-expense reports require that approvals be made electronically by individuals with approval authorities as defined in OPG's corporate policies. Purchasing-card holders must electronically authorize individual line items on their monthly reports, and their manager must subsequently approve each line item electronically as a valid expense. Managers must also approve employee travel- and business-expense reports electronically. In this manner, managers are able to view each expense item, description, and cost in order to ensure that expenses are reasonable and appropriate, prior to their approval. It is incumbent upon the manager and employee to ensure that expense items are supported by appropriate documentation, which the employee is required to forward to a central processing area for filing.

OPG will reinforce the obligation of employees and management to ensure that appropriate expense-report receipts and documentation are submitted to the central processing area and will implement a more rigourous follow-up for missing documentation. OPG is investigating a receipt-imaging process to facilitate the collection and documentation of expense receipts.

OPG will also reinforce the obligation to provide additional details and explanations for receipts for hospitality-type expenditures.

Purchasing cards are suspended where reconciliations or approvals have not been made for two months.

Recommendation 8

OPG is in the process of reviewing its policy and practices with respect to accounting and reporting of minor fixed assets.

OPG will implement monitoring of corporate purchasing-card expenditures and develop exception reports for management to identify goods or services that should have been acquired using another method.

Recommendation 9

OPG will develop a guideline with respect to guidance on employee recognition and gift purchases.

OPG will enhance procedures to ensure that taxable benefits relating to employee recognition awards are reported to the payroll department as required. OPG is implementing a new version of its expense reporting system that will aid in the identification and reporting of amounts relating to employee recognition.

Recommendation 10

OPG will increase the extent of the review and monitoring of credit-card usage to ensure that each type of credit card is used for its intended purposes and to ensure compliance with the $10,000 limit for credit-card purchases. To facilitate this review, various exception reports will be developed. OPG will also ensure that a review of compliance with corporate policy is included as part of an annual audit of expenditures.

Although OPG is insured against losses resulting from the fraudulent use of purchasing cards, which mitigates financial risk, OPG will monitor card usage and adjust credit limits appropriately.