



Service Alberta Contract Management Processes

November 2018

Guidance to Reader

The Department of Service Alberta has been delegated responsibility for oversight and management of selected large and complex contracts on behalf of the government. We expect the department to have all components of an effective contract management system over these large and complex contracts. The department confirmed to us that it applies the same processes to manage all of its large and complex contracts, including the Alberta SuperNet contracts. We expect that the department can apply any findings or learnings from this audit to all similar contracts or to those portions of the process that are required on less complex department contracts.

About this Audit

Procurement of goods and services is a fundamental activity in the daily operation of the Government of Alberta. Each year, the government spends hundreds of millions of dollars contracting goods and services for large and complex projects. To ensure that Albertans realize the benefit of this spending, departments need to follow effective contract management processes.

An effective contract management system includes:

- performance measurement—setting targets, monitoring progress, and reporting on results
- compliance with contractual obligations—understanding the responsibilities and obligations of all parties and ensuring compliance
- contract evaluation—knowing what is working effectively and identifying where changes are required

Processes in each of these activities need to be working effectively and in harmony with each other to have an effective contract management system.

In order to examine each of the processes above, we needed a contract of sufficient length and complexity. The Government of Alberta's contracts related to the Alberta SuperNet have these characteristics. In 2001, the government entered into a series of long-term contracts to build and operate the SuperNet, a telecommunications network that provides capacity for high-speed broadband services to rural Albertans.

The SuperNet is not the Internet. It provides the infrastructure for the delivery of Internet services to rural Albertans, as well as the underlying connectivity to enable public sector services across the province. See Appendix A for further details on the background and history of the SuperNet. Department management has estimated total government spending to construct and operate the SuperNet to be over the contract to be \$1 billion.

Audit Objective and Scope

Our audit objective was to assess whether the Department of Service Alberta has effective contract management processes to achieve desired results. We focused on existing SuperNet contracts to which the government is a direct party. The SuperNet has been operational since 2005; however, we focused our audit on contract management processes applied by the department in more recent years. We did not examine processes to procure initial contracts from 2001 to 2005, and we did not examine the government's analysis of the strategic direction of the SuperNet going forward or procurement processes for a new operating agreement in 2018.

We developed our audit criteria specifically for this audit, using our office's Results Management Framework¹ and the Government of Alberta's Procurement Accountability Framework developed under the leadership of the department in 2015. We obtained acknowledgement from management that our criteria were suitable for this audit.

What We Examined

We examined the department's processes to manage the SuperNet contracts. To assess the effectiveness of these processes we:

- interviewed key staff and those responsible for management and oversight of the SuperNet contracts
- examined the department's processes to oversee and manage the contracts
- examined documentation related to the SuperNet such as agreements, risk assessments, monitoring reports, change orders, and related correspondence
- assessed the department's processes to evaluate and incorporate change management and lessons learned where required

We conducted our field work between June 2017 and November 2017 and substantially completed our audit in January 2018.

Conclusion

We conclude that the Department of Service Alberta did not in all significant respects have effective processes to manage the SuperNet contracts.

Processes related to performance measurement, compliance with contractual obligations, and contract evaluation were deficient and not working together. As a result, the department needed to extend the SuperNet operating agreement because it was not prepared for any other option.

Parties to the contract are not interpreting the terms and conditions in the contracts consistently. Inconsistent interpretation results in wasted time and increased cost, a higher risk of contract non-compliance, and a higher risk that the department will not achieve its desired results from the contracts.

The Department has been delegated responsibility for oversight and management of selected large and complex contracts on behalf of the government, including the SuperNet contracts. We expect the department to have all components of an effective contract management system over these large and complex contracts. The department

¹ Report of the Auditor General of Alberta—October 2014, page 223.

confirmed to us that it applies the same processes to manage all of its large and complex contracts. We expect that the department can apply any findings or learnings from this audit to all similar contracts or to those portions of the process that are required on less complex department contracts.

Why this Conclusion Matters to Albertans

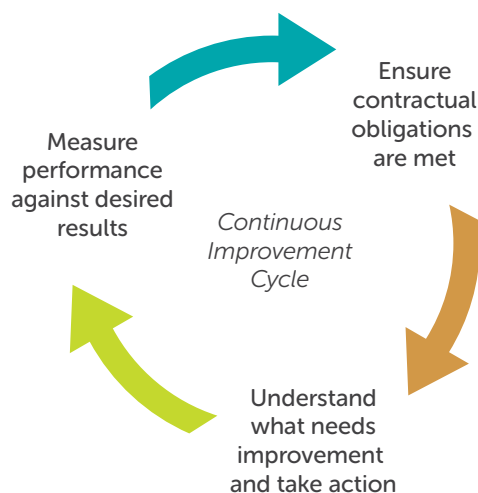
The government makes significant investment of public funds through large and complex contracts. Albertans need assurance that the department is continuously monitoring and realizing benefits and opportunities from these contracts. Ineffective contract management increases the likelihood of wasted public spending and lost opportunities for improvement.

Findings and Recommendations

Context

Effective contract management processes should focus on achieving desired results and continuously improving systems and processes where deficiencies or non-performance exist. This continuous improvement cycle is especially relevant for large and complex contracts. Organizations should:

- identify desired results and strategies to achieve the results, and assign responsibilities accordingly
- create relevant performance measures, and monitor and report on results
- monitor contract terms and ensure obligations of all parties are met
- manage risks and relationships and take corrective action where required



The effective contract management processes described above align with our Results Management Framework, introduced in 2014.² We based the criteria for our audit on this framework.

We have grouped our findings on the department's related processes into three sections: performance measurement, compliance with contractual obligations, and contract evaluation.

² Report of the Auditor General of Alberta—October 2014, page 223.

Performance Measurement

Context

Performance measurement includes collecting information and analyzing, monitoring, and reporting on performance against desired results. Effective contract management should include performance measurement processes that allow the organization to identify what needs to improve to achieve desired results. In particular, contracts should define minimum performance requirements and targets. Targets are management tools that help to drive change and continuous improvement or help to ensure that established, acceptable standards are maintained.

Criteria: performance measurement

The Department of Service Alberta should have:

- clearly stated objectives and desired results from contracted projects
- performance reporting to evaluate whether desired results are being achieved

Our audit findings

Key Finding

The department does not have processes to monitor and report on the performance of the SuperNet. For some operational goals in the SuperNet contracts, the department did not define related performance measures.

Goals and objectives

The department clearly stated goals and objectives of the SuperNet in planning documents and initial contracts. The main goal in 2001 was to develop and implement a high-speed telecommunications network infrastructure in Alberta. Rather than build this infrastructure itself, the government decided to contract third parties that already had the resources needed to construct the network. The department concluded it met this goal in 2005 with completion of construction.

With the network infrastructure in place, the government's desired results from operations were:

- promote competition and rural economic development and ensure that affordable and timely services are available
- continue growth and maximize use of the SuperNet
- leverage the SuperNet to provide value to all Albertans
- ensure the quality and sustainability of the SuperNet
- provide internet connection and service to public sector end-users, including government buildings, libraries, health and learning facilities, and municipalities

Although the government relies on the private sector to achieve the operational goals above, it has a vested interest in monitoring performance toward those goals.

Performance reporting

The contracts did not define performance measures and targets related to competition, rural economic development, and the growth and use of the SuperNet throughout

the province. As a result, the department does not report on desired results in these areas. Since the completion of the network in 2005, government annual reports and business plans have not included reporting on actual results against established or proposed performance measures. These documents only report strategies and examples of advancements in areas such as e-learning and distance learning, e-justice, and e-commerce, as well as improved library and online health applications.³ The department should work with contract parties to set targets, continuously identify needed improvements, and report publicly on progress.

The only performance measures in the contracts relate to minimum service levels to be provided to end-users. The department is responsible for overseeing and managing the delivery of services through the SuperNet to public sector entities including ministries, boards, and agencies. The government has an operating agreement that defines the terms and conditions of these services, including minimum service levels to be provided and rates to be paid.

Although minimum service levels are defined in the operating agreement, they are defined for the network as a whole rather than being location-specific. The department receives periodic reporting from the operator on network service levels, but this reporting is also not location-specific. The operator's reporting does not identify whether performance is consistently met for all users throughout the province. As a result, the department cannot rely on service levels from the contract or the periodic performance reporting received to identify where, geographically, performance needs to be improved.

The department could more effectively monitor service levels if it had continuous, remote, real-time access to information on SuperNet system performance, availability, and service levels. The operating agreement gives the government the right to that real-time access. However, we found no evidence that the government has that access or, if it does, that it is making use of it.

The operator is also required to report on SuperNet performance benchmarked against similar North American communications networks. These sources of information would enhance the department's ability to measure and monitor the performance of services provided to its end-users. We were unable to find evidence that the department was receiving this information or asking contract parties to provide it.

RECOMMENDATION:

Improve performance measurement processes

We recommend that the Department of Service Alberta develop processes to improve its measuring, monitoring, and reporting of the performance of its large and complex contracts.

Consequences of not taking action

The department may continue to spend money without knowing the true extent to which desired results are being achieved. If targets are not set, the department cannot effectively weigh costs against the benefits of its investments or take action where required to ensure all potential benefits are realized.

³ Service Alberta website, <http://www.servicealberta.gov.ab.ca/Benefits-and-use.cfm>.

Compliance with Contractual Obligations

Context

Contract compliance entails parties doing and providing what they are required to. Each party to a contract is obliged to comply, but it should ensure that the other parties are complying as well. Monitoring compliance can tell a party where to amend contract terms and conditions, if possible, or how to revise them in a future contract.

Ensuring compliance can be difficult if the contract's terms and conditions are unenforceable, if there are unclear roles and responsibilities, or if parties do not have adequate resources or expertise to deliver on their obligations. Therefore, the need to ensure compliance underscores the importance of setting clear roles and responsibilities.

Criteria: compliance with contractual obligations

The Department of Service Alberta should have:

- clearly defined roles and responsibilities in its contracts
- processes to ensure it has adequate expertise to oversee its contracts and make key decisions
- processes to manage compliance with contract terms and conditions

Our audit findings

Key Finding

Parties to the contracts are not interpreting terms and conditions consistently, so they disagree about whether contract terms and conditions are being complied with.

Contract structure

The roles and responsibilities of each party are defined in the SuperNet agreements. The Government of Alberta's role is essentially as a tenant in the SuperNet agreements, meaning it pays a third party a fee to provide the services through the network infrastructure. This fee is an ongoing financial commitment for the government, which is also responsible for other costs, such as maintenance fees.

The government delegated responsibilities related to the design, construction, operation, and maintenance of the network to independent third parties, having concluded that those third parties have the appropriate technical expertise and resources to execute those responsibilities. The department relies significantly on the other parties to deliver network capabilities and services as required. To gain assurance that the other parties are delivering as expected, the department needs to ensure that the terms and conditions of the agreements are complied with.

As a result, the department needs to oversee compliance with contractual obligations from two perspectives: ensuring that it has processes to manage its financial commitments and ensuring that other parties comply with contract terms and conditions.

Managing financial commitments

The government is required under the operating agreement to pay an ongoing fee for internet connections and services provided to public sector end-users. The cost for these services is approximately \$40 million per year, which is the fee minus credits received for disruptions in service.

Credit amounts are based on the duration of disruptions. The department provided us with the formula for the calculation of these credits, but management could not give us details of the methodology for the formula—how the credit amounts and other inputs in the formula were developed. Based on our examination of monthly invoices from the contracted operator, credits received were minimal.

The department does not receive reporting on total credits received each month tied to disruptions in service. Department staff indicated that total credits received are too immaterial to justify resources and time spent on recalculation or on verification that credits for all disruptions have been received. The risk to the department is that it could be overcharged if the contracted parties do not properly identify and record service credits. A better-defined service credit structure, including more stringent penalties for non-performance and relevant reporting from the contracted operator, would allow for better oversight by the department and incentivize stronger performance of the network if required.

The department must also pay for annual infrastructure maintenance fees. The agreements require the department to pay about \$16 million per year to a third party to maintain the network fibre and wireless infrastructure. We found evidence that the department disputed the maintenance fees because of its interpretation of contract wording around when the fees were to become payable. We examined evidence to support that the department followed the dispute resolution process, as defined in the master agreement, regarding payment of these maintenance fees. Processes to resolve disputes over contract execution often require one of the parties to seek specialist assistance. The department, as part of its process, sought legal advice on its options before concluding on its position to resolve the dispute.

In relation to ensuring that parties comply with contract terms and conditions, we identified three areas where improvements are required: financial and other reporting, change management, and ensuring operator independence.

Compliance by other parties: financial and other reporting

The master and operating agreements require other parties to provide the department with regular financial and other reporting, such as forecasts for service fees, maintenance and repair, and network usage. The department must receive annually each party's financial reporting, as the contract terms and conditions stipulate that every party should maintain certain debt-to-equity and working capital requirements.

We found that, since 2006, the department has not always received this reporting from all contract parties. We also found no evidence of the department routinely requesting this information from the parties. We asked department management why they have not obtained this information as required under the contract. Management stated that they considered the reporting to be more relevant to the initial construction of the network rather than ongoing operations. The department relies on the operator to provide

constant services to SuperNet end-users. It is reasonable that it continue to receive financial information to identify any potential issues with the other parties being able to continue to operate at the levels expected in the contract. Therefore, the department should still ensure it receives this reporting from the other parties.

Compliance by other parties: change management

The master agreement requires all parties to follow a change-management process for, among other things, changes to network design, services, personnel, and costs. Each of the parties to the agreement can initiate a change, but all affected parties need to approve the change before it can be made.

We examined documentation related to change orders submitted during the contract term. We identified a number of change orders that the department did not approve. Some change orders indicated that one party to the contract had already made changes to the network prior to approval. That party indicated that these changes did not require a change order. The department interpreted these changes to be unauthorized, consulted with internal legal counsel, and communicated its position to the party with a request for additional information.

We found evidence of department management assessing these differences in interpretation and concluding on further action. We did not, however, find evidence of how or whether the contract parties would prevent these interpretation differences over the remainder of the contract term. When parties interpret contract terms and conditions differently, contract effectiveness and contract management processes can become significantly weaker.

The master agreement also required the department to maintain a change-management log, and it defined requirements and timelines for reviewing and approving change orders. We found that the department applied a consistent process to assess the validity of change orders, including the use of technical expertise to assess the merits of network design changes. However, the parties did not consistently comply with the contract term to approve change requests within 20 days. Many of the approvals we examined exceeded 20 days, with the longest duration before approval being 249 days. Given the complexity of some of the changes requested and the related analyses required, the department might reconsider whether a 20-day time frame is long enough.

Compliance by other parties: ensuring operator independence

The operating agreement contains a condition requiring the operator not to sell services to an affiliate. The department informed us that the purpose of this condition was to ensure that parties to the agreement separate retail activities from wholesale activities.

In 2011 the department sought legal advice on potential non-compliance with operator independence requirements. The department then sought additional information from the operator on services provided to third parties. We examined communication between the department and the operator, including the department's position that there may be non-compliance. The operator has asserted it is compliant with contract terms and obligations. As a result, again, the parties to the contract did not consistently interpret the terms and conditions.

A strong contract management process would include controls to detect non-compliance with operator independence requirements. The department should have processes to receive reporting from the operator on services sold to all third parties, and it should be able to audit that information if necessary. This reporting condition is not in the operating agreement. As a result, the department does not have processes to conclude whether there is non-compliance with the operator independence requirements in the operating agreement.

Right to audit

The department has the right to audit other contract parties under the master agreement. This is a contract right, not an obligation or requirement. The department attempted to exercise these audit rights in 2015 as a result of a number of contract disputes, including those identified above. The department has not been successful in exercising that right. The department and the relevant parties have disputed the potential scope and confidentiality of the department's audit, again because of differing interpretations of contract terms. We examined evidence that the department has obtained legal advice on this matter and subsequently communicated with the party it is attempting to audit.

Interpreting contract terms and conditions

Parties to the contracts are not interpreting terms and conditions consistently. Our audit did not seek to determine who is right or wrong. However, the department needs to reduce the risk of disputes in its future contracts, and to do so it needs to have processes to ensure it has effective contract language.

Ineffective contract language results in wasted time and money spent resolving differences and reinterpreting the original intent of contract terms. There is also a higher risk of not identifying true contract non-compliance and not achieving the desired outcomes of contracts. Before entering into a contract, the department must implement processes to ensure that contract terms and conditions are complete and are written so that all parties interpret them consistently. Having such processes will allow the department to manage compliance over the term of the contract.

Department contract templates state that a review from legal services is required for:

- all service contracts over \$75,000
- contracts where wording changes or revisions have been made to standard templates
- amendments to existing contracts or contract terms

Given the numerous challenges over interpretation of SuperNet contract terms, it is important that the department involve senior advisors within the Department of Justice, as well as subject matter specialists, early on in the contract development. Those advisors and specialists should advise on wording that is open to interpretation by different parties. The purpose of this review is to subject large and complex contracts to an appropriately rigorous review and oversight before terms are finalized.

RECOMMENDATION:
Improve compliance processes

We recommend that the Department of Service Alberta develop processes to improve its monitoring and enforcement of contract compliance to ensure that the desired results of the contract are achieved.

Consequences of not taking action

Without effective monitoring and enforcement of contract terms and conditions, the department will not achieve the desired outcomes of contracts. Ineffective contract management results in wasted time and public funds, unnecessary conflict, and risks that Albertans are not receiving the full benefits of what they paid for.

Contract Evaluation

Context

Effective contract management requires processes to ensure that the department knows what is working well and what needs improvement. This knowledge requires an understanding of the operating environment: the costs and risks related to the contract, and feedback from stakeholders and contract parties. An effective contract management process should allow the department to conclude, at any time during the contract, whether adjustments are required to fully meet desired results, or whether the department needs to terminate the contract because it is not obtaining desired results.

Criteria: contract evaluation

The Department of Service Alberta should have processes to:

- continuously identify and assess the costs and risks associated with its projects
- manage partner and stakeholder relations and resolve conflicts
- manage the project to achieve desired results, including:
 - evaluating performance and leveraging lessons learned
 - incorporating change where required

Our audit findings

Key Finding

The department extended the SuperNet operating agreement by three years despite identified deficiencies and unmitigated risks.

Risk management

Ongoing risk management is a key component of contract evaluation. Within the department, the SuperNet Secretariat is delegated the responsibility to manage the government's risks related to the SuperNet. The Secretariat's risk management processes consist mainly of informal discussions, both internally and through meetings with contract parties. The department also conducted stakeholder consultations and used consultants to complete risk analyses and assessments of the SuperNet operating environment. Through this work, the department identified both strategic and operational risks related to the SuperNet.

The Secretariat does not maintain a risk register that formally tracks, ranks, and prioritizes risks. However, it has developed several mitigation strategies that consider both the operational and the strategic risks.

The department completed most of this mitigation strategy work recently, in anticipation of the expiration of the SuperNet operating agreement on June 30, 2018. We examined evidence that the department has identified:

- technological and operational risks related to capabilities of the network and delivery of services under the current operating model
- financial and economic risks related to current and ongoing operational costs
- stakeholder and customer relationship risks related to communication of the strategic direction of the SuperNet
- legal and procurement risks related to entering into a new operating agreement in 2018
- transition risks related to continuity of services to existing customers and end-users

Department management has incorporated mitigation strategies into planning documents for the expiration of the operating agreement in 2018.

Stakeholder and contractor relationships

Another key source of information on what is working well and what needs improvement comes from ongoing consultation with stakeholders and contract partners. The department has identified a wide range of stakeholders, including public sector customers and end-users, as well as external parties such as Internet service providers. Communication to the department from these end-users, and other stakeholders generally revolves around disruption or non-performance of services. The department, in the majority of these instances, acts as a liaison between the operator and third-party service providers or end-users, communicating the status of problems and corrective action taken.

The department indicated that the operator conducts customer satisfaction surveys. We found no evidence that these surveys were periodic or continuous. The department does not have formal processes to collect or follow up on the results of these surveys. Consequently, the department has limited oversight of the operator taking required corrective actions.

We found evidence of stakeholder consultations conducted by the department that led to improved network performance. These consultations included receiving feedback from various groups regarding broadband needs around the province. Based on feedback received, the department introduced Next Generation Network (NGN) services to SuperNet customers.

We would expect the department to have processes to understand emerging risks and problems through discussions with contract partners. The department does have informal communication with partners as they encounter day-to-day problems, and it has held meetings with its partners, generally every month or two months. But the department should formally track lessons learned or areas where improvements are needed and manage relationships with partners through both these channels of communication.

As noted previously, the master agreement details a dispute resolution process to resolve disagreements between parties to the contract. However, there are a number of contract areas not subject to dispute resolution, including termination of agreements, lawsuits, and change management. We also found that some requirements of the dispute resolution process are not clearly defined or are open to interpretation. For example, the agreement refers to “sufficient and continued” communication through negotiations and parties negotiating “in good faith,” and says that the “format for such discussions will be left to the discretion of the contract managers...” Parties are at increased risk of disagreement that could cause relationships to deteriorate if contract terms are open to interpretation.

Contract evaluation failure

Since 2012, the department has engaged external consultants to complete risk assessments and analyses of the operating and contract environments, assist with strategic and operational planning, and help prepare for the expiration of the operating agreement. The department has also accumulated feedback from stakeholders and partners on the operating agreement and other agreements, the current state of the network, and future risks and possibilities of the SuperNet. Through this work, the department identified that:

- improvements were needed in the definition of required service levels and in the reporting of service levels provided
- more significant service credits for disruptions were needed to incentivize strong performance of the network in all areas of the province
- stronger and clearer contract language was required in order to enforce contract requirements, including change-management requirements and the separation of the wholesale and retail activities of the operator
- a number of operating and strategic risks exist related to the current operating structure and the agreements currently in place
- there are not adequate transition mechanisms in place to ensure that the government’s interests are protected as agreements expire

The initial term of the operating agreement was to expire on June 30, 2015. Because of weaknesses in the department’s contract management processes, department management decided it could not completely assess how to improve future SuperNet contracts by the original end date of the contract. The department’s preparation for the expiration of the agreement needed to ensure that a new operating agreement reflected

what was and was not working well in the current agreement. In 2013, the department extended the operating agreement to June 30, 2018, without changing aspects of the contract it was having difficulty managing.

While the department is now more prepared for the expiration of the agreement in 2018 than it was in 2013, Albertans have paid for three more years of a contract that the department assessed was not meeting desired results. The need for department management to extend the contract to make those assessments is the clearest evidence that its contract management processes must improve.

RECOMMENDATION:**Incorporate lessons learned**

We recommend that the Department of Service Alberta develop processes to improve its evaluation of contracts and implement risk mitigation strategies and lessons learned where required.

Consequences of not taking action

If effective processes are not in place to identify what is working well and what needs improvement, and to plan actions required, contract deficiencies or other unmitigated risks will not be corrected in a timely manner. As a result, there could be unnecessary costs to the public, in terms of both money and time spent.

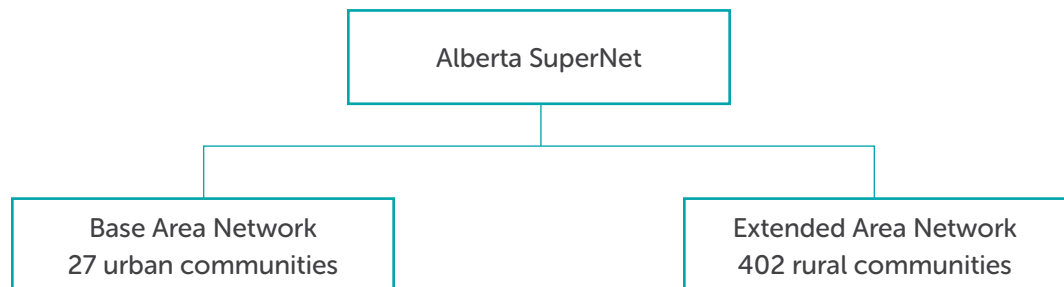
Appendix A: SuperNet Background and History

What is the SuperNet?

The Alberta SuperNet is a telecommunications network of fibre optic cables, wireless towers, and other equipment and facilities that provide a high-capacity broadband “highway” to Albertans across the province. The SuperNet’s Base Area and Extended Area networks connect 429 urban and rural communities throughout Alberta. Today, the SuperNet provides the infrastructure to connect over 3,400⁴ public sector entities, including hospitals, schools, libraries, and provincial, municipal, and Indigenous government offices. The SuperNet is not the Internet. It only provides the infrastructure to allow Internet service providers (ISPs) to purchase network services and deliver the Internet to end-users.

History of the SuperNet

In 2001, the Government of Alberta entered into contracts with two parties to construct the SuperNet. The government committed \$193 million to build and own an Extended Area Network to reach 402 rural and remote communities. At that time, the Base Area Network was already in place, connecting 27 urban communities.



Other parties were responsible for any costs exceeding the \$193 million. Other parties were involved in the design and construction phases and were contracted as network operators to provide services to both public sector entities and ISPs.

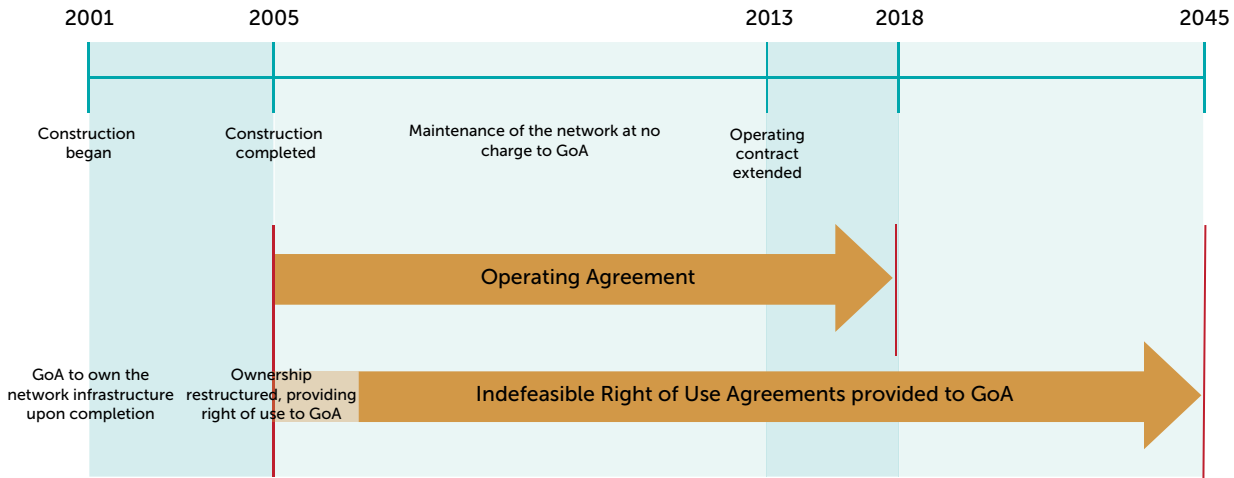
The parties were bound by a master agreement and transaction agreements dictating the terms of the network design and of the construction, ownership, operators, and use.

Construction of the network was completed in 2005. At that time, the government entered into a number of contracts transferring ownership of most of the Extended Area Network fibre and wireless infrastructure to one of the parties. In return, the government received exclusive right of use of the infrastructure until 2045 through Indefeasible Right of Use agreements. These agreements have an initial term of 20 years with four consecutive five-year renewal terms. At the end of the renewal terms, the government has a right to purchase the assets for \$1.

⁴ Service Alberta Annual Report—2016–17, page 15.

In 2005, the parties also renegotiated the operating agreement for one of the parties to provide network services until 2015. Maintenance of the network infrastructure was to be provided at no cost to the government until expiration of the initial term of the operating agreement. This agreement was renegotiated and extended to June 30, 2018.

Timeline of Events Related to SuperNet Contacts



Including the initial investment of \$193 million, the department has indicated to us it estimates the government has spent approximately \$1 billion on the construction and operation of the SuperNet. This investment has provided Alberta with extensive broadband Internet service coverage, especially in comparison to other provinces. As at March 31, 2017, Service Alberta’s recorded value for the Indefeasible Right of Use agreements in its financial statements is \$74 million.

