



National
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Chief Review Services Chef - Service d'examen

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Audit of Government-Furnished Equipment Issued to Contractors

February 2011

7053-71 (CRS)



Canada 

Caveat

A portion of the analysis in this report relies on prices recorded in the Canadian Forces Supply System (CFSS). Previous Chief Review Services (CRS) audits have highlighted significant inaccuracies in this pricing. As a result, no assertion is made as to the accuracy of reported values, and caution must be exercised in using these results for management decision making without further confirmation.

This audit is not intended to assess the performance of contractors; rather, it is an internal assessment of departmental processes and practices.



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Acronyms and Abbreviations

ADM(Mat)	Assistant Deputy Minister (Materiel)
CFAO	Canadian Forces Administrative Order
CFSM	Canadian Forces Supply Manual
CFSS	Canadian Forces Supply System
CHI	Contractor-Held Inventory
CRS	Chief Review Services
DAC	Departmental Audit Committee
DGAEPM	Director General Aerospace Equipment Program Management
DGLEPM	Director General Land Equipment Program Management
DGMEPM	Director General Maritime Equipment Program Management
DGMSSC	Director General Materiel Systems and Supply Chain
DND	Department of National Defence
DSAL	Disposal, Sales, Artefacts and Loans
EPM	Equipment Program Manager
GFE	Government-Furnished Equipment
MMI	Materiel Management Instruction
NDQAR	National Defence Quality Assurance Representative
NSN	NATO Stock Number
OPI	Office of Primary Interest
PA	Procurement Authority
R&O	Repair and Overhaul
SLA	Supplier Loan Account
SPT-STE	Special Production Tooling and Special Test Equipment
TA	Technical Authority

Synopsis

To facilitate the timely, economical repair and maintenance of equipment, the Department of National Defence (DND) provides government-furnished equipment (GFE) to contractors under the terms of a loan agreement. The loaned items are generally not commercially available and may be unique to the repair or maintenance of a specific military platform. As of 31 March 2010, based on CFSS records, approximately 37,000 items with a recorded value of \$378 million were on loan to contractors. Additional items, known as non-catalogued items, are on loan but are not recorded in the CFSS.

This audit was completed to assess the adequacy of governance and controls relating to GFE issued to contractors, and to determine whether accurate complete information concerning GFE is available for decision making.

Overall, the audit noted that the Department would benefit from developing a more risk-based strategy for managing GFE. For example, by focusing oversight on the 7 percent of line items that account for 78 percent of the recorded value, and by recovering or disposing of unneeded or inappropriately loaned items, the management and oversight of GFE could be achieved more efficiently and economically. In addition, policies should be updated to reflect current requirements and accountabilities, and management information requirements should be reviewed. Finally, steps should be taken to ensure policy requirements are enforced and that information regarding these assets is accurate and complete.

CRS is satisfied that the Management Action Plan will address the recommendations presented in this report. Follow-up to ensure effective implementation of the action plan will be completed as required.



Results in Brief

To facilitate the timely and economical delivery of contracts, DND loans equipment to contractors. These assets, referred to as GFE, are items that are integral to the completion of the contract, but that the contractor typically would not hold because they are unique to the repair or maintenance of a specific military platform or because they are not commercially available.

A contractor's responsibility regarding GFE is specified in a loan agreement. Loaned items with a NATO stock number (NSN)—referred to as catalogued items—are recorded in a supplier loan account (SLA) within the CFSS. As of 31 March 2010, the total CFSS recorded value of GFE was \$378 million,¹ comprising approximately 8,500 line items and 37,000 items dispersed over 150 SLAs. A significant number of non-catalogued items (i.e., items without an NSN) are also on loan. These assets are not recorded in the CFSS, and therefore, it is difficult to determine the overall quantity and value of these loaned items.

CRS conducted an audit to assess the adequacy of DND's governance and controls related to GFE and to determine whether accurate, complete information is available for decision making.

The Disposals, Sales, Artefacts and Loans (DSAL) section, within the Assistant Deputy Minister (Materiel) (ADM(Mat)) group, is the departmental administrator for loan agreements. In addition to DSAL, the Procurement Authorities (PA), Technical Authorities (TA), and National Defence Quality Assurance Representatives (NDQAR) all play a significant role in ensuring the proper management of GFE.

Overall Assessment

To support the effective management and oversight of GFE issued to contractors:

- A risk-based strategy for managing catalogued and non-catalogued GFE is required;
- Policies should be updated to reflect desired processes and controls; and
- Steps should be taken to ensure accurate and complete GFE information is available, and to improve monitoring and oversight controls.

¹ Values are based on prices recorded in the CFSS systems. No assertion is made as to the accuracy of reported values, and caution must be exercised in using these results for management decision making without further confirmation.

Findings and Recommendations

Strategy for Managing GFE

The CFSS recorded unit cost of loaned items varied from under \$10 to over \$1 million. Of the 8,500 catalogued line items on loan, 7 percent—with a CFSS recorded value greater than \$100,000—accounted for 78 percent of the total recorded value (i.e., approximately \$297 million). While certain line items have been recently issued to contractors, many others have been on loan for 20 to 30 years. Despite these differences, currently all GFE is managed in the same way. As a result, resources may be spent tracking items of little significance to the contractor or to the Department. By focusing efforts on higher-risk or higher-valued items, and by recovering or disposing of unneeded loan items, the management and oversight of GFE could be achieved more efficiently and economically.

Currently, there is no formal assessment as to whether the issuance or continued use of loaned items is necessary for the effective completion of contracts. Prior to issuance on the loan agreement, items should be reviewed to ensure the loan is in the Department's best interest, and that other approaches, such as requiring the contractor to furnish the item, would not be more cost-effective.

At the time of the audit, each loan account was managed separately and little consolidated information was available. As a result, it is difficult for the Department to determine the existence and total value of loaned items, and to identify best practices or areas of concern.

It is recommended that an overarching strategy or risk-based approach be established for managing GFE, value for money be considered in the establishment of loan agreements and issuance of GFE, and monitoring mechanisms be developed to assess the management of GFE.

GFE Policies

Several key policies and guidance documents regarding GFE require updating as they refer to organizations that no longer exist and processes that are no longer current. In addition, ambiguities exist with respect to certain roles, responsibilities, and processes. These unclear requirements have contributed to inconsistent management of GFE.

It is recommended that policies be updated to reflect current requirements and to clarify roles and responsibilities. The Department should ensure that these are consistently applied.

GFE Records and Managerial Information

Four of the twelve sampled loan agreements did not include the required authorizing signatures or were expired, and over 25 percent of the items sampled during the stocktakes had discrepancies between the quantity of items recorded in DND records and number of items on the floor or in contractor records. In addition, information regarding loans of non-catalogued equipment, such as special production tooling and special test

equipment (SPT-STE) was inconsistently maintained. Interviewed contractors were uncertain as to whether SPT-STE is included in the loan agreements and who is responsible for tracking these items.

Without valid loan agreements and accurate records, it may be difficult to establish accountability for some items. To ensure accurate and complete information is available for decision making, steps should be taken to ensure all loan agreements are current and that GFE records are accurate and complete.

GFE Processes and Controls

Loan agreements include standard terms and conditions that require GFE to be clearly identified and used only for defence purposes. They also stipulate that stocktaking is to be completed every two years, and lost, damaged or surplus items are to be reported to DND on a timely basis. However, DND's current control processes do not easily identify situations where this is not occurring. Furthermore, there is no formal plan or strategy to ensure GFE is periodically reviewed and rationalized or to correct existing discrepancies in GFE holdings information.

It is recommended that additional risk-smart controls be implemented to support the effective management and oversight of GFE. Key controls to consider include an annual confirmation from contractors to verify compliance with the terms and conditions in the loan agreements, and a process to ensure GFE is periodically reviewed for its continued requirement and any items that are not required are returned or disposed of in a timely manner.

Note: For a more detailed list of CRS recommendations and management response, please refer to [Annex A](#)—Management Action Plan.

Introduction

Background

DND provides GFE to contractors under the terms of a loan agreement in order to facilitate the timely and economic delivery of contracts. The loaned items are generally not commercially available and may be unique to the repair or maintenance of a specific military platform. In contrast to contractor-held inventory (CHI), which includes items that are consumed or embodied in a larger platform during the delivery of the contract, GFE is expected to be returned to the Department at the end of the loan agreement in the same condition in which it was originally loaned.

Each contract requiring GFE has a single loan agreement that outlines the terms and conditions applicable to all of the items that have been loaned to contractors on the loan account. Loans of non-catalogued items (i.e., items without an NSN) are recorded outside of the CFSS, in independent databases or manual files, while catalogued items are recorded in a SLA within the CFSS. As of 31 March 2010, there were approximately 150 contractor loan accounts in CFSS comprising 8,500 line items and 37,000 items with a CFSS recorded value of \$378 million. Currently, there is no consolidated source of information to determine the quantity and value of non-catalogued items on loan.

Prior to 2003, the Department's loan agreements were administered by Public Works and Government Services Canada. Since that time, the management of GFE has been the responsibility of DSAL. With the assistance of the PAs, TAs, and NDQARs, this group is responsible for ensuring that loan agreements are in place and for enforcing the terms and conditions included in the loan agreement.

Effective management of GFE is necessary to ensure DND resources are appropriately safeguarded, and that cost-benefit is considered in the management and administration of these assets.

Objectives

The objectives of this audit were to:

- Assess the adequacy of governance and controls relating to GFE issued to contractors; and
- Determine whether accurate, complete information is available for decision making.

The criteria for the audit are outlined in [Annex B](#)—Audit Criteria.

Scope

The audit examined loan agreements and catalogued and non-catalogued GFE recorded within and outside of the CFSS and held by contractors at 31 March 2010.

Methodology

Interviews were conducted with key representatives from various ADM(Mat) organizations involved in the administration and management of GFE including:

- DSAL;
- Director Quality Assurance and NDQARs; and
- Director Materiel Policies and Procedures.

ADM(Mat) PAs and TAs were also consulted, as were key contractor personnel responsible for GFE at contractor sites.

CFSS holdings at 31 March 2010 and records maintained by DSAL were analyzed to identify areas of risk to be reviewed as part of the audit.

Twelve loan agreements were selected for review. The selected loan agreements included a cross-section of the following:

- Size, based on both number and value of items on the loan agreement;
- Type of underlying contract (i.e., both repair and overhaul (R&O) and non-R&O contracts);
- Geographical location of the sites where GFE was held; and
- Defence environment supported by the contract (i.e., sea, land, air).

Eight of the twelve loan agreements were reviewed in greater detail by visiting the associated contractor's site. During these site visits, approximately 200 line items were selected for stocktaking purposes. The selection was based on risk factors such as dollar value, quantity on hand, and potential commercial availability. The accuracy of the quantity on hand, description of the item, and general condition of the following items were assessed:

- 84 line items in DND's records were compared to items on the floor and to contractor records;
- 52 line items in contractor records were compared to items on the floor and to DND records; and
- 67 line items on the floor were compared to DND records and to contractor records.

Findings and Recommendations

Strategy for Managing GFE

Implementation of an overarching, risk-based approach to managing GFE could increase the efficiency and effectiveness of the process. Currently, all GFE is managed in the same way, regardless of its nature or value, and there is no formal rationalization of loaned items.

Nature of the GFE Population

The current requirements for managing GFE are not risk-based, and do not consider the diverse nature or value of the items on loan. The following characteristics of the population indicate that adopting a risk-based approach may help the Department focus its resources and efforts, resulting in more efficient management of GFE:

- Of the 8,500 catalogued line items on loan, 7 percent of the line items, with a recorded value greater than \$100,000, account for 78 percent of the total CFSS recorded value;
- 24 percent of the line items and 6 percent of the CFSS GFE value are recorded as consumable;
- 6 percent of line items have been flagged as surplus in CFSS; and
- Interviews with contractors indicated that certain items have been on loan for 20 to 30 years.

Significant coverage could be achieved by focusing stocktaking and other monitoring efforts on critical or high-value items. In addition, by increasing efforts to remove surplus, unneeded, or inappropriately loaned items, the size of the population could be reduced. This would reduce carrying and administration costs and would allow future monitoring efforts to be more appropriately directed at items of greater significance.

Value for Money and Rationalization of GFE

Value for money should be a key consideration in rationalizing the loan requirements for both catalogued and non-catalogued items. Prior to issuing GFE, DND should assess whether it would be more cost-effective to require the contractor to provide the equipment as part of the contract, rather than incurring administrative costs to manage the loan agreement. Within the eight loan accounts reviewed in detail, 30 percent of the CFSS recorded loan items had a list price under \$1,000, accounting for less than 1 percent of the total value of catalogued GFE issued. Some of these low-dollar-value items included commercially available goods, such as multimeters, torque wrenches, and fire extinguishers. This is inconsistent with the intent of the GFE policy and, given the cost of maintaining associated loan records, may not be cost-effective.

While interviews with contractors, PAs and TAs indicated that typically there are valid reasons for the issuance of GFE, the rationale for providing the equipment is not recorded within the loan file. Documentation and approval of the rationale would allow the cost-benefit of loan arrangements to be analyzed, and could mitigate potential exposure if the loan arrangement is ever challenged.

The issuance of GFE should also be reviewed when contracts are transferred between contractors. Some contractors indicated that they received GFE that they do not require, simply because the previous contractor had it on the loan agreement. A portion of GFE recorded on six of the eight reviewed loan agreements was not in use and was being held in storage at the contractor's site.

The issuance of unneeded GFE increases departmental costs. In addition to the actual cost of the loaned asset, the Department must bear additional administration costs for recording and tracking the loaned items. By reviewing the rationale for the issuance of GFE, the Department can ensure that the decision to loan equipment considers value for money and that loans are restricted to only those assets that are necessary to support the contract. Reductions in the volume of GFE may reduce both contractor and DND administration costs.

Recommendation

DND should establish a risk-based framework for managing GFE that considers:

- Reviewing and documenting the rationale for the issuance and continued use of GFE;
- Placing emphasis on higher-risk (i.e., critical or high value) holdings and loan agreements; and
- Improving the strategy for managing non-catalogued loan items.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

GFE Policies

Current processes for administering and managing GFE are not reflected in existing GFE policies and certain requirements, as well as the associated roles and responsibilities are unclear. As a result, GFE administration and oversight activities are not consistent across the Department.

Current Status of Policies

Several departmental policies and procedural documents must be consulted to obtain a full understanding of the roles, responsibilities and processes related to GFE. At the time of the audit, some of these policies were either out-of-date or were being revised. For instance, the annexes to the Canadian Forces Supply Manual (CFSM), Chapter 14 Loans were under revision and refer the user to Canadian Forces Administrative Order (CFAO) 36-30 Loans of Materiel by and to DND.² CFAO 36-30 was last updated in 1969 and refers to organizations and processes that no longer exist. Materiel Management Instruction (MMI) 1257 – Loan Procedures also references organizations and information that are no longer relevant based on current processes.³

Without current and complete policies, it is difficult for stakeholders to have a full understanding of the processes related to GFE. Consequently, key policies and documents should be updated to ensure consistency in practices related to GFE.

Roles and Responsibilities

Review of policies and interviews with key stakeholders indicated that certain roles and responsibilities required clarification. Furthermore, accountabilities need to be reviewed to ensure individuals are aware of their responsibilities and are only accountable for aspects of the process that are within their control.

According to MMI 1500 – Repair and Overhaul of Centrally Managed Materiel, DSAL is responsible for the loaned equipment and for enforcing loan terms and conditions listed in the loan agreement.⁴ Given the size of the group, the number of existing loan agreements, and the fact that DSAL does not have any physical presence at the contractor sites, this would be difficult for DSAL to fully achieve. Rather, DSAL relies on the contractors, the PAs and the NDQARs to report instances of non-compliance. As a result, the activities DSAL performs to enforce the terms and conditions are limited and adequate risk-based monitoring may not be occurring.

² CFAO 36-30 Loans of Materiel by and to DND, 23 May 1969.

³ MMI 1257 – Loan Procedures, 18 January 1990.

⁴ Ibid.



MMI 1500 also indicates that the NDQARs are responsible to “provide oversight of the use and abuse of DND equipment on loan at the contractor’s site and report incidents to the PA.”⁵ The A-LM-184 Contractor Repair and Overhaul Guide⁶ indicates that NDQARs are to review DND-owned materiel at contractor sites. However, several interviewed NDQARs indicated that their responsibilities do not include the management and control of these assets.

DSAL is responsible for approving all loans, including temporary ones. The CFSM, however, indicates that temporary loans (with duration less than 35 days) must be processed by the bases;⁷ the CFSM does not specify whether these temporary loans must also be approved by DSAL. Consequently, responsibility for these loans is not clear. At the time of the audit, at least one wing was issuing temporary loans to contractors without obtaining DSAL approval, in some cases for durations significantly more than 35 days.

The roles and responsibilities of the PAs, TAs, and NDQARs require clarification, as there are no standard procedures amongst these groups for processing, managing and monitoring GFE. As a result, while some stakeholders appear to be exercising diligence by performing activities such as stocktakes and reviewing returns from the contractor, others have little or no involvement in the process.

It is necessary to clearly define roles and responsibilities to support an effective GFE management process. Any revisions to policies and procedures, and related roles and responsibilities should reflect the overall risk-based strategy for managing GFE.

Recommendation

After clarifying the approach to managing GFE, policies should be updated to reflect current requirements and to clarify roles and responsibilities. The Department must ensure these policies are consistently applied.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

⁵ MMI 1500 –R&O of Centrally Managed Materiel, 26 January 2007, Annex K.

⁶ A-LM-184-001/JS-001 R&O Special Instructions for Contractors.

⁷ Canadian Forces Supply Manual, Chapter 14, 3-14A-001. Outward loan records, paragraph 5.

GFE Records and Managerial Information

Improving the accuracy and completeness of loan agreements, GFE records, and other loan-related information would enhance decision making and the management of GFE.

Loan Agreements

Loan agreements outline the standard terms and conditions for the use of GFE by contractors. Signed by the contractor, the PA and DSAL, these agreements establish the duration of loan—typically the life of the underlying contract—and are an essential tool for ensuring that all parties have consented to the included terms and conditions. MMI 1500 states that DSAL is responsible for ensuring that the loan agreements are in place and current.⁸

Of the twelve reviewed loan agreements:

- Two had not been signed by the contractor or PA and therefore the terms and conditions of the loan agreement may be difficult to enforce;
- One was not signed by a DSAL representative; and
- One had expired but the loaned equipment was still on-site.

GFE Records

Loaned items with an NSN are recorded in SLAs within the CFSS. These accounts are controlled by DSAL and are the primary mechanism for tracking subsequent adjustments to the items on the loan agreement. The SLAs are updated by DSAL as line items are removed or added or the quantities of a line item on loan are adjusted.

DND and contractor records regarding the items on loan are not always accurate. Discrepancies existed between the Department's records, the contractor's records, and the observed quantity on site for 25 percent of the approximately 200 sampled line items.

In particular, 84 of the sampled items were selected from CFSS SLAs in order to verify the accuracy of these records. Of these:

- 26 percent had discrepancies between the number of items that could be located on the floor and the CFSS recorded quantity; and
- 23 percent had discrepancies between the quantity recorded in the contractor's records and the CFSS recorded quantity.

As contractor records are not reconciled to DND records on a regular basis, these discrepancies are typically outstanding until the contract has expired and the loan is closed. One interviewed contractor noted that the most recent loan close-out process was significantly delayed as a result of such discrepancies.

⁸ Ibid.

Loaned items that do not have an NSN are recorded outside of the CFSS. One common example of such an item is SPT-STE,⁹ which typically consists of manufactured jigs, moulds and fixtures. Although the standard loan agreement indicates that SPT-STE must be maintained and tracked by the contractor, an official listing of this type of GFE is not attached to the loan agreement. In addition, during interviews, contractors did not consider SPT-STE to be part of GFE. While DSAL has some information regarding SPT-STE items on loan to contractors, the information is not regularly reviewed or updated. Consequently, there is no complete and accurate source of information for the SPT-STE. Without such information, it is difficult to ensure adequate monitoring, oversight and control.

Contractor and departmental GFE records should be regularly reconciled to ensure that the Department has an accurate and complete picture of total GFE holdings. This reconciliation should consider both catalogued and non-catalogued GFE, to include SPT-STE holdings.

Managerial Information

Consolidated information regarding GFE is difficult to obtain. CFSS SLAs only record loans of catalogued items, and reports based on this information can only be obtained on an account-by-account basis. DND has no official record of non-catalogued items on loan. In addition, while there are stocktaking requirements associated with catalogued GFE, these requirements do not apply to non-catalogued items. Furthermore, as temporary loans are currently tracked by the issuing unit, rather than by DSAL, the Department has no centralized record of any temporary loans that occur. Consequently, it is difficult to get a complete and accurate picture of total GFE issued by the Department.

Recommendation

To ensure accurate and complete information is available for decision making, steps should be taken to ensure that:

- All loan agreements are current;
- Higher-risk holdings are accurately and completely reflected in GFE records; and
- Processes and record-keeping requirements surrounding temporary loans and SPT-STE are clarified and records are updated accordingly.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

⁹ DSAL records indicate SPT-SPE valued at \$24.5 million has been issued on loan; however, this amount is currently under review.

GFE Processes and Controls

Improved controls would better enable the Department to identify and resolve instances of non-compliance with the loan agreement or discrepancies in holdings information.

DSAL has made efforts to develop a standardized loan agreement which includes consistent terms and conditions governing the use of GFE, and the associated stocktaking and reporting requirements.

Within the sampled loan agreements, there were several instances noted where the terms and conditions were not adhered to.

- **GFE used for commercial purposes:** The loan agreement stipulates that GFE is to be used for defence purposes only. However, situations were observed where GFE was interchanged with contractor-owned equipment for use on both DND and commercial contracts. DND had not formally evaluated or approved these arrangements.
- **Stocktaking not performed:** According to the loan agreements, stocktaking is to occur once every two years. The agreements, however, do not all clearly indicate that confirmation or results of the stocktaking must be reported to DND. While DSAL is responsible for ensuring compliance with this requirement, there is no formal process in place for them to track the status of stocktakes. Stocktaking had not occurred in the required timeframe for four of the eight loan agreements reviewed in detail during the audit. When stocktaking had taken place, DND did not participate to ensure that it was completed in accordance with the agreement terms. In addition, DND's GFE records were not always updated to reflect adjustments required as a result of the stocktaking exercise.
- **GFE is not clearly identified:** Loan agreements require that the contractor specifically label GFE as the property of the Government of Canada. This was not consistently occurring. Furthermore, labels affixed by the contractor were not always legible or durable, suggesting that perhaps the Department should be responsible for identifying its loaned assets.
- **Surplus items are not regularly identified:** Loan agreements require that contractors report lost or damaged GFE within two days of detection. At least one contractor is also required to report any surplus GFE. Among the reviewed loan agreements, GFE holdings were not reviewed on a periodic basis to ensure their condition or continued requirement, and DND was not taking any steps to ensure this occurred. While some contractors reported surplus GFE to DND, others simply placed the unneeded items in a quarantine area instead. In some cases, the items were not reported as contractors felt they might have future use. However, in one instance, the contractor stopped reporting surplus or damaged GFE as no action was taken by DND to process returns or disposals.

Enhanced controls would better ensure compliance with the loan agreements. These controls could include review by the NDQARs during site visits, or review by the PAs or TAs prior to the annual contract review meeting. A periodic review of GFE for its continued requirement and the timely disposal or return of assets that are no longer needed would help ensure only required items are held by contractors.

Currently, contractors are required to report CHI holdings not recorded in CFSS to the Department on an annual basis. GFE, however, is specifically excluded from this process. Including GFE in an annual confirmation process would provide an opportunity for the Department to confirm information such as existence, quantity, condition and use of GFE on loan, and that the terms and conditions of the loan agreement have been met.

Recommendation

Additional controls should be implemented to support the effective management and oversight of GFE. Key controls to consider include:

- An annual confirmation from contractors that the terms and conditions of the loan agreement were adhered to. The confirmation could be completed in conjunction with the CHI confirmation process and should include key requirements such as the appropriate use of GFE, completion of periodic stocktaking, condition of GFE, specific identification of GFE at the contractor's site, and timely reporting of issues with respect to GFE; and
- A process to ensure GFE is periodically reviewed for its continued requirement, and the timely return or disposal of items that are not needed.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

Annex A—Management Action Plan

Strategy for Managing GFE

CRS Recommendation

1. DND should establish a risk-based framework for managing GFE that considers:
 - Reviewing and documenting the rationale for the issuance and continued use of GFE;
 - Placing emphasis on higher-risk (i.e., critical or high value) holdings and loan agreements; and
 - Improving the strategy for managing non-catalogued loan items.

Management Action

DSAL is in the process of completing a comprehensive review and renewal of its organizational structure, staffing, policies and procedures. In the course of this review, DSAL will examine and implement a risk-based framework to support the audit of contractor-held GFE to ensure compliance with DND policies and procedures. Due to the complete program review that is ongoing within DSAL and the need to create a new organization, identify and recruit the necessary staff to update policy and then create the appropriate risk-based framework to manage contractor-held GFE, the framework will not likely be fully implemented before summer 2013. In the interim, DSAL will adopt a risk-based approach and will focus monitoring efforts on the key GFE loans.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

Target Date: 31 August 2013

GFE Policies

CRS Recommendation

2. After clarifying the approach to managing GFE, policies should be updated to reflect current requirements and to clarify roles and responsibilities. The Department must ensure these policies are consistently applied.

Management Action

As part of the comprehensive review and renewal process, DSAL plans to update loan policies and create a DND training program for loans. This effort will begin once the necessary staff has been recruited and will be complete by spring 2013.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

Target Date: 31 May 2013

GFE Records and Managerial Information

CRS Recommendation

3. To ensure accurate and complete information is available for decision making, steps should be taken to ensure that:
 - All loan agreements are current;
 - Higher-risk holdings are accurately and completely reflected in GFE records; and
 - Processes and record-keeping requirements surrounding temporary loans and SPT-STE are clarified and records are updated accordingly.

Management Action

As part of the ongoing comprehensive review of loan procedures, DSAL will ensure that all loan agreements are updated and that a methodology is developed to ensure high-risk holdings are accurately and completely reflected in loan records. In addition, DSAL will examine and implement policies and procedures to ensure the full scope of loans of GFE to contractors is captured. Due to the complete program review that is ongoing within DSAL and the need to identify and recruit the necessary staff to update loans policy and procedures, a renewed methodology for maintaining GFE records and managerial information will not likely be fully developed and implemented before summer 2013.

In the interim, efforts will be focused on ensuring the accuracy of records relating to high-dollar-value and critical items. In addition, as an interim measure, each of the equipment program managers (EPM) will undertake a verification of contractor-held GFE at selected contractor locations and an action plan will be developed to resolve any discrepancies that may be discovered. ADM(Mat) will report to the Departmental Audit Committee (DAC) on the progress of the targeted verifications on an annual basis.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

Target Date: 31 August 2013

GFE Processes and Controls

CRS Recommendation

4. Additional controls should be implemented to support the effective management and oversight of GFE. Key controls to consider include:
 - An annual confirmation from contractors that the terms and conditions of the loan agreement were adhered to. The confirmation could be completed in conjunction with the CHI confirmation process and should include key requirements such as the appropriate use of GFE, completion of periodic stocktaking, condition of GFE, specific identification of GFE at the contractor's site, and timely reporting of issues with respect to GFE; and
 - A process to ensure GFE is periodically reviewed for its continued requirement, and the timely return or disposal of items that are not needed.

Management Action

As part of the ongoing comprehensive review and renewal of DSAL organizational structure, staffing, policies and procedures, the feasibility of additional controls will be examined. Due to the complete program review that is ongoing within DSAL and the need to identify and recruit necessary staff to update and implement loans policy and procedures, a renewed methodology to support the effective management and oversight of GFE will not likely be fully developed and implemented before summer 2013. As an interim measure, monitoring and review efforts will focus on those contractors with significant recorded holdings. In addition, as an interim measure, each of the EPMs will undertake a verification of contractor-held GFE at selected contractor locations and an action plan will be developed to resolve any discrepancies that may be discovered. ADM(Mat) will report to the DAC on the progress of the targeted verifications on an annual basis.

OPI: ADM(Mat)/DGMSSC/DSAL, in consultation with DGAEPM, DGLEPM and DGMEPM

Target Date: 31 August 2013

Annex B—Audit Criteria

Objective

The objectives of this audit were to:

1. Assess the adequacy of governance and controls relating to GFE; and
2. Determine whether accurate, complete information is available for decision making.

Criteria

- Loaned equipment policy, procedures, and roles and responsibilities are clearly documented and consistently applied;
- The use of loaned equipment by contractors is adequately governed by contract terms and conditions;
- Loaned equipment is periodically reviewed or monitored (e.g., for existence, continued requirement, contract termination, surplus, damage and unauthorized use);
- Loaned equipment information is completely and accurately recorded and reported;
- Information systems and reports are sufficient to allow visibility and oversight of loaned equipment; and
- Cost-effective procedures (approaches) are in place.

