Internal Audit Report: Contract Management

To: Chief Financial Officer
Cc: Manager, Supply Chain Management
From: Senior Manager, Internal Audit
Audit Ref. IA-2021-09
Subject: Contract Management Audit Report

In terms of the approved Internal Audit Work Plan, an audit of the Contract Management was conducted. The audit focused on determining if Supply Chain awarded, monitored, and closed contracts in accordance with ELRC policies and applicable regulations. Additionally, determine if the Supply Chain business unit maintained adequate and valid contract management records to evidence the effectiveness of contract management.

The review was conducted in accordance with Generally Accepted Auditing Standards, the International Standards for the Professional Practice of Internal Auditing and in line with the Code of Ethics. The standards require that we plan and perform the audit to obtain enough, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Yours sincerely

Senior Manager, Internal Audit
23 November 2020
Internal Audit Report

Contract Management

Internal Audit Reference: IA-2021-09
SECTION A - EXECUTIVE SUMMARY

1. Introduction

An audit of Contract Management has been undertaken in accordance with the approved 2020/21 audit plan. Good Contract Management ensures that the ELRC maximises savings and quality of service, while ensuring that all parties involved in the contract fully understand their obligations and responsibilities and fulfil them as efficiently and effectively as possible.

Contracts are used by the ELRC for assisting and implementing program delivery. ELRC is permitted to have contracts funded not only from the operation budget, but also from the capital budget.

Contracts by ELRC are subject to Contract Policy and Standard Operating Procedure. Supply Management unit reporting to Chief Financial Officer is mandated to provide contracting support to ELRC and to ensure that contracting management practices comply with business policies, regulations, and standards.

The functions of the SCM unit, includes, amongst other things:
- Formulate and advise on policy and ensure that SCM policies, guidelines, norms, standards, and best practice requirements are implemented in an appropriate, consistent, and systematic manner,
- Efficiency of procurement and effectiveness in implementing policies,
- Ensure transparency using an effective data management system,
- Establish and maintain a comprehensive database of suppliers, service providers and contractors, and
- Support end-users in carrying out supply chain management policies, regulations, instructions, and guidelines.

2. Objective

The objective of this audit was to provide reasonable assurance that adequate key management controls are in place and operational to ensure that ELRC’s contracting activities comply with Contract Management policy, procedures, regulations, and standards.

3. Scope

The audit focused on identified control measures in managing the ELRC’s contract activities in accordance with contracting policies and procedures, and the efficiency and effectiveness of its contracting controls.

The audit tests were based on information provided by Supply Chain Management through contracts awarded from 01 April 2020 to October 2020. Audit population and
sample included all service contracts in support of program delivery. On-going and planned developments were also taken into consideration.

4. **Approach and Methodology**

Based on identified and assessed key risks and internal controls associated with the related business processes, the methods used to gather audit evidence included:

- Reviewing contract management related policies and guidelines.
- Reviewing and analysing previous reviews and audits in relation to contracting management.
- Reviewing selected contract files and related documentation.
- Conducting interviews with various levels of officers and managers; and
- Analysing non-financial information.

5. **Audit Results**

We categorized the findings using the following keys:

<table>
<thead>
<tr>
<th>Classification</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant matter</td>
<td>The finding is a result of non-compliance with laws and regulations, internal policies, and requirements of the reporting framework; a misstatement that will have material impact in the financial statements</td>
</tr>
<tr>
<td>Area of improvement</td>
<td>The finding is a result of control deficiency or lack of control within the control environment.</td>
</tr>
<tr>
<td>Housekeeping matter</td>
<td>The finding has no impact but if not addressed in future might be significant.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control rating</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inadequate control</td>
<td>Laid down accounting and internal control procedures were either inadequate or non-existent. This may indicate a residual risk exposure</td>
</tr>
<tr>
<td>Ineffective control</td>
<td>Employees were performing their duties ineffectively based on the results of tests performed, on a sample basis, for the period under review. This may indicate a lack of performance to achieve objectives.</td>
</tr>
</tbody>
</table>

5.1. **The control standards we considered during this audit and the status of the related control environment are provided in the following table.**

<table>
<thead>
<tr>
<th>General Control Standard</th>
<th>Observations</th>
<th>Control Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>To provide reasonable assurance that adequate key management controls are in place and operational to ensure that ELRC’s contracting activities comply with Contract Management policy, procedures, regulations, and standards.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To ensure that all contracts are valid, properly authorized and approved, adequately documented and monitored</td>
<td>Contracts are approved in terms of the Delegations of Authority and Contract Management policy.</td>
<td>Reasonable to strong control in place</td>
</tr>
<tr>
<td>To ascertain the accuracy, completeness and timely preparation of the payment certificates.</td>
<td>Maintenance of payment certificate is effective and efficient, and this ensures that invoices are paid in line with the contract.</td>
<td>Reasonable to strong control in place</td>
</tr>
</tbody>
</table>
To ascertain the ability of suppliers to meet quality and delivery requirements.

Contract performance is monitored monthly through the process of vendor performance management.

Reasonable to strong control in place

5.2. The following issues were cleared and resolved prior the finalisation of the audit:

<table>
<thead>
<tr>
<th>Description</th>
<th>Corrective Action Implemented</th>
<th>Auditors Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Service Level Agreement (SLA) not duly signed off by parties concerned</td>
<td>The signed copy was with the supplier, who mentioned that they forgot to submit to the ELRC.</td>
<td>No transactions has occurred from 01/02/2020 to date, therefore no irregular expenditures was incurred.</td>
</tr>
<tr>
<td></td>
<td>The signed off SLA was submitted to Internal Audit.</td>
<td>The audit team satisfactory checked the duly signed-off SLA.</td>
</tr>
<tr>
<td></td>
<td>The SCM standard procedure guideline, a contract is only valid where it is signed by both</td>
<td>The audit recommended SCM to ensure that contracts are properly perused for completeness before they are filed and the SCM Manager should inspect all new contracts for completeness and accuracy.</td>
</tr>
<tr>
<td></td>
<td>parties, therefore the above is invalid.</td>
<td></td>
</tr>
<tr>
<td>2. Monthly contract report not properly updated</td>
<td>The contract Register for May 2020 has since been properly updated with the two contracts</td>
<td>An updated Contract Report for May 2020 was submitted to the audit team and satisfactory reviewed.</td>
</tr>
<tr>
<td></td>
<td>that expired during the month.</td>
<td>A reconciliation should be performed between the Contract Register and the Contract Report to confirm that information is properly captured, complete and accurate.</td>
</tr>
<tr>
<td>3. Shortcomings over the monthly vendor evaluation reports</td>
<td>The IPT Vendor Evaluation form was submitted to the end user for ratings and signing off.</td>
<td>The valid and complete Vendor Evaluation Reports were satisfactory reviewed by the audit team.</td>
</tr>
<tr>
<td></td>
<td>The Vendor Evaluation Reports for April, May, June, July, August and September 2020 have</td>
<td>The IPT Evaluation form has been properly completed: (1) ratings provided and (2) form is signed off by the end user. The SCM Officers should ensure that for all Vendor Performance Forms duly completed by the end users are submitted to the responsible personnel for Consolidation into the Monthly Vendor Evaluation Reports.</td>
</tr>
<tr>
<td></td>
<td>been updated in line with the information as per the Vendor Evaluation Forms.</td>
<td></td>
</tr>
</tbody>
</table>

ELRC has a contract with IPT Holdings for backup data and cloud replication, disaster recovery, unified communication and onsite IT support and server maintenance.

3.1. We noted a payment of R45 157 for April 2020 and a Vendor Evaluation form dated April 2020. However, upon inspection of the documentation of this transaction, we the following shortcomings:

- The outcome of the IPT evaluation is excluded from the April 2020 report.
- The Vendor Evaluation form submitted for audit purposes is not fully completed, for example, the performance ratings are not indicated.
- The Vendor Evaluation form lacks evidence of signing-off by the ICT Manager.
3.2. The audit identified other transactions where Vendor Evaluation forms were duly completed, however, the evaluation outcome from these transactions is not included on the monthly Vendor Evaluation Reports.

5.3. **Areas of concern for the internal auditor (observations for management’s attention):**

<table>
<thead>
<tr>
<th>Finding Description</th>
<th>Control Rating</th>
<th>Management Response / Agreed Actions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Significant matter</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 1  Contract Management Standard Operating Procedure not updated | Ineffective | • The Contract Management SOP is currently in draft stage for revision and update, in line with the Contract Management Policy that has also been revised.  
• The SOP not being revised timeously created the disparities (absence of clear guidelines).  
• The SOP is currently being updated to be aligned with the policy. The draft will be finalized once the policy is approved.  
Furthermore, a Policy and SOP Register will be kept and updated to give an overview of documents that are due.  
• The approval of quarterly reports by CFO will be made clearly outlined on the revised policy and SOP.  
• The reported changes (under observation) will be incorporated to the revised SOP.  
• Management will review the process and ensure that we are compliant and make notes were applicable. |
| **Housekeeping matter**                   |                |                                      |
| 2  Implemented Service Level Agreement is not duly signed | Ineffective | • The documents did not provide for witnesses’ space hence no witnesses for the documents.  
• Management will make provision for this in the Contract Management Policy and SOP. |

6. **CONCLUSION**

To assist management in using our reports we categorize our opinions according to our assessment of the controls in place and the level of compliance with these controls.

<table>
<thead>
<tr>
<th>Level</th>
<th>System Adequacy and Control Application</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(positive opinions)</strong></td>
<td></td>
</tr>
<tr>
<td>Full assurance</td>
<td>Full assurance that the system of internal control meets the organization’s objectives and controls are consistently applied.</td>
</tr>
<tr>
<td>Significant assurance</td>
<td>Significant assurance that there is a generally sound system of control designed to meet the organization’s objectives. However, some weaknesses in the design or inconsistent application of controls put the achievement of some objectives at some risk.</td>
</tr>
<tr>
<td>Limited assurance</td>
<td>Limited assurance as weaknesses in the design or inconsistent application of controls put the achievement of the organization’s objectives at risk in some of the areas reviewed.</td>
</tr>
<tr>
<td>No assurance</td>
<td>No assurance can be given on the system of internal control as weaknesses in the design and/or operation of key control could result or have resulted in failure(s) to achieve the organization’s objectives in the area(s) reviewed.</td>
</tr>
</tbody>
</table>

**Evaluation opinion:**

Evaluation opinion: The internal controls for Contract Management as operated at the time of the audit provided a **Significant Assurance**, that is, there is a significant assurance on the consistent application of internal controls. Transactions and activities
of noncompliance with the policies and procedures and monitoring controls were identified.

Overall, we found positive aspects to the contract management, there are opportunities for improvement. Although management made sure contracted services, there is a need to strengthen the administration controls.

7. DISCLAIMER

You are requested to treat the report with confidentiality. The distribution of the report to persons other than staff and those on the distribution list should only be done after consultation with the Internal Auditor.

Any queries relating to the interpretation/factual correctness of the findings within the report must be routed to the Senior Manager, Internal Audit.

8. ACKNOWLEDGEMENTS

We appreciate the assistance of the staff of Supply Chain Management during the audit.

9. DISTRIBUTION LIST

Internal audit distributes the Final Audit Report to the following:

- General Secretary,
- Senior Managers,
- Managers / Supervisors, and
- Audit and Risk Committee.
SECTION B: DETAILED FINDINGS

B.1 - Significant Matter

1. Contract Management Standard Operating Procedure not updated

*Control Rating: Ineffective control*

**Criteria**

Best practice tools include having and maintaining an effective, efficient, and transparent systems of financial and risk management and internal control. The organization deploys control activities through policies that establish what is expected and in procedures that put policies into action.

To ensure compliance with the Council’s regulatory framework in relation to contracting and procurement, the ELRC has developed contract management policy and procedure guidelines accessible to its staff in assisting with day-to-day contracting management needs.

It is important to review of policies and procedures because:

- The review ensures your policies are consistent and effective.
- Regular review keeps your organization up to date with regulations, technology, and industry best practices.

**Observation**

The Contract Management Standard Operating Procedure guideline was last reviewed and updated in January 2016 and post this date there has been several changes effected on contract management processes to enhance the control environment. The following changes were implemented in practice but never procedure manual:

1. Maintenance of contract files (contract identifiers) and the required documentation.

2. Risk management processes under contract management.

3. Month-end procedures and the timeframes for preparation by SCM Officer(s) and the review and approval by the SCM Manager.

   - The confirmed contract management system description/process analysis indicates that month end procedures includes compiling of **Contract Registers**, **Contract Reports**, **Commitment Reports** and **Vendor Performance Reports** by the SCM Officer on/before the 5th day of the subsequent month and reviewed/approved by the SCM Manager by the 7th day.

4. The table below further depicts in details other differences between the Contract Management SOP and the actual contract management processes:

<table>
<thead>
<tr>
<th>Clause or Paragraph</th>
<th>Provision in the Contract Management SOP</th>
<th>Actual Practice Noted by Internal Audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.4.1.</td>
<td>The Contract Register should entail the following information:</td>
<td>The Contract Register provisions for the following information:</td>
</tr>
<tr>
<td>Clause or Paragraph</td>
<td>Provision in the Management SOP</td>
<td>Contract</td>
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<td>---------------------</td>
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<tr>
<td>a)</td>
<td>Contract number,</td>
<td>a)</td>
</tr>
<tr>
<td>b)</td>
<td>Name of service provider,</td>
<td>b)</td>
</tr>
<tr>
<td>c)</td>
<td>Contract type,</td>
<td>c)</td>
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<tr>
<td>d)</td>
<td>Services offered,</td>
<td>d)</td>
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<td>e)</td>
<td>Effective date,</td>
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<td>f)</td>
<td>End date,</td>
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<td>g)</td>
<td>Duration,</td>
<td>g)</td>
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<td>h)</td>
<td>Authorized by,</td>
<td>h)</td>
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<tr>
<td>i)</td>
<td>Date signed,</td>
<td>i)</td>
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<tr>
<td>j)</td>
<td>Responsible personnel,</td>
<td>j)</td>
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<tr>
<td>k)</td>
<td>Payment terms,</td>
<td>k)</td>
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<td>l)</td>
<td>Monthly payments,</td>
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<td>m)</td>
<td>Deposits, and</td>
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<td>n)</td>
<td>Contract Value.</td>
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</tbody>
</table>

7.1.1. SCMO to prepare monthly contract management reports for the review by the SCM Manager and approved by the Chief Financial Officer

The Monthly contract management reports are prepared by the SCMO and reviewed and approved by the SCM Manager.

7.1.2. Update the Contract Register or review and authorization by the Chief Financial Officer

The Monthly Contract Registers are prepared by SCM Officer and reviewed and approved by the SCM Manager.

Root Cause
This is an oversight, in that, the SCM Manager was reviewing all the SCM Policies and Procedure Manual and had thought that the Contract Management SOP was part of the pack being reviewed.

Risk/Consequence
Finding risk rating – High risk
- Efficiency, quality output and uniformity of performance might not be achieved, outdated policies and procedures manual put the organization at risk.
- Old policies and procedures manuals may be non-compliant with new laws and regulations.
- Inconsistencies in the application of policies and procedures create a room for fraudulent activities.

Recommendation
Priority 1
- SCM should not wait for an incident to occur before reviewing and updating policies and procedures. The best way is to build the reviewing of policies and procedures into their departmental calendar.
- The Chief Financial Officer should prioritise and speed up review and updating the Contract Management SOP, to ensure that the SOP is updated with the actual daily practices, and new processes implemented have proper guidelines.
- SCM should review and update of its business policies and procedures when there are departmental or organization changes.
Management Response / Agreed Actions
Management accepts the finding.

- The Contract Management SOP is currently in draft stage for revision and update, in line with the Contract Management Policy that has also been revised.
- The SOP not being revised timeously created the disparities (absence of clear guidelines).
- The SOP is currently being updated to be aligned with the policy. The draft will be finalized once the policy is approved. Furthermore, a Policy and SOP Register will be kept and updated to give an overview of documents that are due.
- The approval of quarterly reports by CFO will be made clearly outlined on the revised policy and SOP
- The reported changes (under observation) will be incorporated to the revised SOP.
- Management will review the process and ensure that we are compliant and make notes were applicable.

Responsible Person
Chief Financial Officer & Manager, Supply Chain Management
Ms. U Ndobeni & Mr. C Mokoena

Completion Date
30 November 2020

Auditor’s Conclusion
The action plan is noted, and the audit team will perform a follow-up in the subsequent quarter to ascertain the implementation and effectiveness thereof.
B.2 – Housekeeping matter

2. Implemented Service Level Agreement is not duly witnessed

*Control Rating: Ineffective control*

**Criteria**
Para. 3.3.1 of the Contract Management SOP state that once the contract has been checked and all the required information completed, both parties, the supplier or service provider and the General Secretary as per Delegations of Authority Policy. All contracts must be witnessed accordingly and dated. A contract is only valid where it is signed by both parties.

**Observation**
The purpose of a witness to a contract is to verify the signature of a person who is a party to a contract. This means that the main function of a witness is to confirm that it is indeed the signature of the party to the contract.

The audit revealed 2 contracts that lacked signatures of witnesses as required by the SOP, namely,
- Midrand Air Services
- Pest Invasion Control Pretoria.

**Root Cause**
- The omission was missed during the review process. The document was filed without proper checking for completeness.

**Risk/Consequence**
*Finding risk rating – Low risk*
- Payments of an invalid SLA are deemed as irregular expenditure.
- The main function of a witness is to confirm that it is indeed the signature of the party to the contract, so if contracts are not witnessed accordingly, then the fraud risk kicks in.
- Non-compliance with business policies and procedures weakens the control environment.

**Recommendation**
*Priority 2*
Contracts are legal documents, which, if not adequately and efficiently managed might cost the organisation a lot of money. Therefore, the Chief Financial Officer and Manager, SCM should strengthen the controls put in place around the management of ELRC contracts. This includes, but not limited to, put a contract checklist in place, which must be signed-off before filing an awarded contract.

**Management Response / Agreed Actions**
- The documents did not provide for witnesses’ space hence no witnesses for the documents.
• Management will make provision for this in the Contract Management Policy and SOP.

**Responsible Person**  
Chief Financial Officer & Manager, Supply Chain Management  
Ms. U Ndobeni & Mr. C Mokoena

**Completion Date:**  
30 November 2020

**Auditor’s Conclusion**  
The action plan is noted, and the audit team will perform a follow-up in the subsequent quarter to ascertain the implementation and effectiveness thereof.