



Defence Construction (1951) Limited

Presented to the Board of Directors
4 December 2008

Special Examination Report



Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Ce document est également publié en français.



Office of the Auditor General of Canada
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4 December 2008

To the Board of Directors of
Defence Construction (1951) Limited

We have completed the special examination of Defence Construction (1951) Limited in accordance with the plan presented to the Audit Committee of the Board of Directors on 3 December 2007. As required by Section 139 of the *Financial Administration Act* (FAA), we are pleased to provide the attached final special examination report to the Board of Directors.

I would like to take this opportunity to express my appreciation to the Board members, management and the Corporation's staff for the excellent co-operation and assistance offered to us during the examination.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R. Flageole'.

Richard Flageole, FCA
Assistant Auditor General

Attach.

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Defence Construction (1951) Limited

Main Points

What we examined

Defence Construction (1951) Limited, commonly known as Defence Construction Canada (DCC, or the Corporation) is a Crown corporation that provides the Department of National Defence—its only client—with contracting, contract management, and other property-related services that support defence construction projects. It reports to Parliament through the Minister of Public Works and Government Services.

The Corporation had revenues of about \$56 million in the 2007–08 fiscal year, a growth of almost 130 percent since our last special examination in 2003. In the same period, its staff has more than doubled to over 600 employees.

We examined DCC's systems and practices for corporate governance, risk management, strategic planning, performance measurement and reporting, service delivery, human resource management, information technology management, and environmental management. Our objective was to determine whether those systems and practices provide the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

We paid particular attention to the management of security risks in service delivery, given our Office's recent audit of industrial security in government contracting (October 2007 Report of the Auditor General of Canada, Chapter 1, Safeguarding Government Information and Assets in Contracting). That audit had reported that thousands of defence construction contracts were awarded without verification of the contractors' security clearance. The House of Commons Standing Committee on Public Accounts met to discuss this matter as we were completing this special examination.

Why it's important

Defence Construction Canada's mission is to deliver infrastructure and environmental projects and services required for the defence of Canada. It serves as an intermediary between National Defence and the contractors and suppliers hired to complete the projects.

What we found

We found no significant deficiencies in the systems and practices we examined. We found sound systems and practices in a number of areas we examined. For example:

- Effective processes and procedures are in place to monitor performance against set timelines, budgets, and quality standards in delivering services to National Defence, which is critical to the Corporation's success.
- DCC has taken steps to minimize work-related accidents and provide a safe working environment. It also has a well-defined environmental management framework and ensures that the potential environmental impacts of construction projects are taken into account and that, when appropriate, mitigating measures are put in place.

We also noted some areas for improvement:

- Chapter 1 of our October 2007 Report to the House of Commons raised serious concerns about contractor security clearance procedures between DCC and National Defence. Defence construction contracts had been awarded to contractors who had not been cleared to the appropriate security levels. During our special examination, the Corporation launched a comprehensive Security Policy Initiative and developed a detailed action plan aimed at addressing both the management of industrial security with National Defence and broader security issues within DCC. The action plan included addressing security requirements with National Defence through an updated Memorandum of Understanding, clarifying procedures for assessing security requirements prior to awarding contracts, developing a DCC security policy, appointing regional and site security officers and developing and implementing security training. The majority of these initiatives had been completed by the end of our examination. Over time, DCC will need to closely monitor the effectiveness of the corrective actions it has taken and ensure that risks are being assessed, monitored, and mitigated to an acceptable level of tolerance. This will require sustained attention from management and the Board of Directors.
- The significant growth that DCC has undergone since our last special examination, including the doubling of its workforce, has created the need for stronger and more formal systems and practices in a number of areas. Opportunities for improvement include expanding the corporate planning horizon beyond one year and providing better linkages to National Defence's capital

infrastructure expenditure plans. This would also allow for a more strategic approach to human resources management. So far, DCC has been able to react successfully to client needs. However, to compete for skilled workers in a highly competitive labour market, a complete picture of its current workforce and future requirements is needed. DCC would also benefit from a more structured approach to planning and managing information technology initiatives.

***The Corporation has responded.** DCC agrees with all the recommendations. Its responses follow the recommendations throughout the report.*

Special Examination Opinion

To the Board of Directors of Defence Construction (1951) Limited

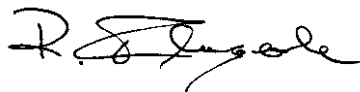
1. Under section 131 of the *Financial Administration Act* (FAA), Defence Construction (1951) Limited is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.
2. Section 138 of the FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every five years.
3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the systems and practices we examined. The examination period was from July 2007 to February 2008, except for the systems and practices referred to in paragraph 7 below, for which the examination period was extended to June 2008.
4. We based our examination plan on a survey and a risk analysis of the Corporation's systems and practices. On 3 December 2007, we submitted the plan to the Audit Committee of the Board of Directors. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.
5. The plan included the criteria that we selected specifically for this examination in consultation with the Corporation. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. Our choice of criteria was also based on guidance provided by The Canadian Institute of Chartered Accountants. The criteria and the systems and practices we examined are listed in **About the Special Examination** at the end of this report.
6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we did not rely

on any internal audits because their findings relate to periods prior to the period covered by our special examination.

7. As more fully described in the Risk Management section of this report (paragraphs 37 to 51), we raised concerns in Chapter 1 of our October 2007 Report to the House of Commons about how contractor security clearances were managed between the Department of National Defence and the Corporation. During the original period of our special examination, the Corporation developed a detailed action plan aimed at addressing both the management of industrial security with the Department of National Defence and broader security issues within the Corporation. The action plan identified a number of tasks that were to be completed by the end of June 2008, including a mandatory requirement to assess security requirements for all projects; the development and issuance of a security policy; the appointment of Corporate, regional, and site security officers; commencement of training of employees on security; and revision of the Memorandum of Understanding with National Defence. We elected to extend our examination period to 30 June 2008 to examine actions taken by management to address our concerns about contractor security clearances. As of that date, the Corporation had the core systems and practices in place to address the security issues previously noted. We encourage the Corporation to monitor these recently implemented systems and practices to ensure their continued effectiveness.

8. In our opinion, there is reasonable assurance that there were no significant deficiencies in the systems and practices we examined with respect to the criteria established for the examination.

9. The rest of this report provides an overview of the Corporation and more detailed information on our examination observations and recommendations.



Richard Flageole, FCA
Assistant Auditor General for the Auditor General of Canada
Ottawa, Canada
29 February 2008, except for paragraph 7 above,
which is as of 30 June 2008

Overview of Defence Construction (1951) Limited

10. Defence Construction (1951) Limited (Defence Construction Canada, DCC, or the Corporation), was created in 1951. DCC is a Crown corporation and is accountable to Parliament through the Minister of Public Works and Government Services.

Mandate, vision, and mission

11. DCC's mandate is to provide a wide variety of property-related services in support of the timely delivery of defence projects. The working relationship between DCC and its only client, the Department of National Defence (National Defence), has been defined in a continuous series of memoranda of understanding (MOUs) since 1951. The existing MOU was updated in June 2008.

12. DCC's vision is to be the leading provider of innovative solutions that add value for its client, foster growth in its employees, and make meaningful contributions to the construction industry.

13. DCC's mission statement is to deliver infrastructure and environmental projects and services required for the defence of Canada. DCC outlines its corporate objectives based on five themes. These themes and their associated objectives are as follows:

- Corporate governance and leadership—to provide strong and ethical leadership.
- People—to maintain a skilled and professional workforce.
- Stakeholder relationships—to be recognized for its competence and value.
- Service delivery—to ensure client requirements are met.
- Support—to support service delivery capability.

Services

14. DCC is a procurement and contract management agency that essentially serves as an intermediary between National Defence and consultants and contractors hired to perform the actual project work.

15. Its four main service lines are the following:

- Contracting services—including procurement of professional services, construction services, and maintenance of services and goods; procurement and solicitation planning; preparation of

tender documents; solicitation and evaluation of bids; awarding of contracts; and market assessments.

- Construction contract management—including contract payment administration, change management, risk management, document and schedule control, quality assurance, quality audit, dispute mitigation and resolution, claims management, performance assessment, and warranty management.
- Environmental services—including environmental assessments and audits, technical support for environmental remediation, range clearance, unexploded ordnance cleanup and decommissioning, waste management programs, environmental management systems, and hazardous material survey coordination.
- Project and program management support—including preparation of scope documents, costing and scheduling of programs, and project and program planning.

16. Other services include technical support, support to deployed operations, and facilities management services.

17. DCC has its head office in Ottawa and supports National Defence out of 36 locations across Canada and abroad.

Strategic challenges

18. In reviewing its operating environment during the preparation of its Corporate Plan 2008–09 to 2012–13, DCC identified five areas where current or evolving events could have strategic impact on the Corporation's business:

- Human resource challenges caused by DCC's changing workforce, including the ongoing shortage of skilled labour in the construction industry.
- Continuing competition for industry capacity, especially in some areas of the country, due to the continued strength of the Canadian construction industry.
- An evolution of the corporate management style due to the growing volumes and variety of services required by National Defence.
- Demands for greater transparency and accountability across government.

- The increasingly important role of information technology to support internal business and innovation initiatives.

Revenues and resources

19. DCC's revenues are from the delivery of services to National Defence on a full cost-recovery basis. They have grown by almost 130 percent since our last special examination in 2003 (Exhibit 1). The mixture of the traditional services of construction contract management and contracting services and other non-traditional services, such as environmental services and project and program management support, has shifted from an approximate 70:30 ratio in the 2002–03 fiscal year to a 60:40 ratio in the 2007–08 fiscal year.

Exhibit 1 The Corporation's revenues have significantly grown since our last special examination

Revenues	Actual 2007–08 (\$ thousands)	Actual 2002–03 (\$ thousands)
Construction contract management	27,499	14,840
Contracting services	6,085	2,600
Subtotal	33,584	17,440
Environmental services	8,144	2,557
Project and program management support	11,983	1,986
Other	2,005	2,552
Subtotal	22,132	7,095
Total revenues	55,716	24,535

Source: DCC's audited financial statements

20. To respond to the growth in demand during this period, the staff levels have more than doubled from 280 employees in 2003 to 606 in 2008. Therefore, the majority of the employees have been with the Corporation for less than five years.

Focus of the special examination

21. We examined DCC's systems and practices in the areas of corporate governance, risk management, strategic planning, performance measurement and reporting, service delivery, human resource management, information technology management, and environmental management. Our objective was to determine whether

those systems and practices provide the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

22. We paid particular attention to the management of security risk in service delivery, given our Office's recent audit of industrial security in government contracting (October 2007 Report of the Auditor General of Canada, Chapter 1, Safeguarding of Government Information and Assets in Contracting). That audit had reported that thousands of defence construction contracts were awarded without verification of the contractors' security clearance. The House of Commons Standing Committee on Public Accounts subsequently met to discuss this matter on 26 February 2008.

23. Further details on the audit objectives, scope, and criteria are provided in **About the Special Examination** at the end of the report.

Observations and Recommendations

Corporate governance

24. Corporate governance refers to the structures, systems, and practices for overseeing how an organization is managed. Sound corporate governance practices are essential to meeting the statutory control objectives outlined in Part X of the *Financial Administration Act* as it relates to Crown corporations.

25. We expected Defence Construction Canada (DCC or the Corporation) to have a well-performing corporate governance framework that enables the Board of Directors and senior management to be accountable for responsibilities assigned to them by governing legislation.

26. In reviewing DCC's corporate governance practices, we looked at important governance elements, such as

- roles and responsibilities, independence, capability, and membership of the Board;
- Board members' orientation and training;
- ethics and values;
- Board self-evaluation and evaluation of the President;
- corporate performance information; and
- the internal audit function.

The Board of Directors follows sound corporate governance practices

27. The Board of Directors is composed of five directors, the Chair, and the President for a total of seven members appointed by the Governor in Council. The Board has adopted a formal Charter that describes how it assumes its stewardship responsibilities. Through this Charter and in its ongoing relationship with DCC management, the Board has clearly defined roles, responsibilities, and authorities, which all parties within the governance framework understand and agree on. The Board is supported by three committees—Governance, Audit, and Nominating—that report regularly to it. Each committee operates under terms of reference that are reviewed, updated, and approved by the Board.

28. The Board of Directors has developed a competency profile that describes the skills, experience, and knowledge that its members should have. This competency profile also identifies business sectors that could provide suitable candidates for Board positions. The profile has been presented to the responsible minister. We noted, however, that while the competency profile requires membership of a senior National Defence officer as a representative of DCC's only client, no such individual is currently on the Board. We also noted that one director position was occupied by an individual whose term expired in May 2005. Furthermore, the terms of three directors, who were appointed in early 2007, will expire at approximately the same time in 2011. The government will need to carefully manage future appointments and reappointments to ensure proper continuity among Board membership.

29. Collectively, Board members have appropriate independence, ability, and skills, as well as access to the internal or external resources they need to meet their responsibilities. The Board communicates regularly with the President and officers of the Corporation. When required, Directors hold part of a meeting without management in attendance, which further enhances the Board's independence.

30. New directors are exposed to a formal in-house orientation program that covers their statutory responsibilities; the *Conflict of Interest and Post-Employment Code for Public Office Holders*; and key corporate information such as a senior management profile, the corporate plan, significant financial, accounting, and risk management issues, compliance programs, and the roles of its internal and independent auditors.

31. The Board has approved a Code of Business Conduct that sets forth the expected standards of values and ethics for its own members, management, and DCC employees. This Code establishes rules of conduct and procedures to minimize the possibility of a conflict arising between anyone's private interests and his or her work for the Corporation. The Code of Business Conduct includes all elements that we would expect in such a document. Upon appointment, individuals must file appropriate declarations confirming their understanding of the Code of Business Conduct and their ability to perform without any conflicts of interest. Subsequently, they are required to review, but not certify in writing, their obligations under this Code at least once a year. We noted that some members of management and employees had not filed the required declarations when they were appointed. In our view, it is important to obtain these declarations on a timely basis.

32. The Board annually assesses the performance of the President and reviews succession planning for corporate executives. The Board also conducted a self-assessment of its performance in December 2007. It reviewed the results in February 2008, and subsequently submitted to the Minister the assessment, which both highlighted the Board's strengths and made suggestions for improvement. The submission also stressed the importance for the Government to ensure proper continuity on the Board in future years.

33. Directors advised us that they receive appropriate, credible, and timely information in order to interpret the Corporation's legislative mandate, provide management with strategic direction, and exercise their oversight responsibilities. If necessary, they request additional information. This information allows the Board to be closely involved in such areas as developing and approving the Corporate Plan and monitoring corporate performance. As noted in the next section of this report, the Board will need to pay close attention to the effectiveness of DCC's new security management strategy.

34. Internal audit is a key element of corporate governance since it provides assurance to senior management and the Board that the Corporation is carrying out key financial, administrative, and operational activities economically, efficiently, and effectively.

35. DCC's Audit Committee Charter outlines the duties and responsibilities of the audit committee with respect to the Corporation's internal audit function, which it has outsourced to an external service provider. The service provider prepares a risk-based, long-term audit plan in consultation with management and provides periodic reports on its activities. This plan and periodic updates

include a list of audits by fiscal year, their budgeted and actual costs, and status. They are discussed with and approved as required by the Audit Committee, and results of individual audits are presented and discussed at the Audit Committee meetings.

36. Based on the observations noted here, we found that the Board of Directors has established and follows sound corporate governance practices.

Risk management

37. Given the nature of its business, Defence Construction Canada must manage risks well, particularly security risks related to the administration and delivery of defence infrastructure-related projects that are geographically dispersed.

38. Consequently, we expected the Corporation to have systems and practices in place to identify and manage risks in a systematic way, particularly those involved in project management. We expected DCC to identify, measure, mitigate, monitor, and report risks so that it can keep them within appropriate levels.

39. In our last special examination, we observed that DCC had recently developed an integrated risk management framework covering financial and non-financial risks. This framework was aimed at identifying and addressing risks in a more systematic way to provide the Board with reasonable assurance that important corporate risks had been identified and that appropriate mitigating measures had been put in place.

40. As required by its framework, DCC subsequently developed and maintains a Corporate Risk Profile covering strategic risks and business risks. DCC has also constituted a Risk Management Committee that is composed of senior managers who are responsible for ensuring that risk management issues are incorporated into the Corporate Plan. Furthermore, the Board seeks information on significant risks and reviews management mitigation strategies.

The Corporation has strengthened security management practices

41. In Chapter 1 of the October 2007 Report of the Auditor General, Safeguarding Government Information and Assets in Contracting, we reported that as a result of weaknesses surrounding security requirements, many federal contracts providing access to sensitive government information and assets have been awarded to contractors whose personnel and facilities had not been cleared to the appropriate security levels, as required by the Government Security

Policy (GSP). These included thousands of contracts for National Defence construction and maintenance projects across Canada awarded by DCC. We found that since National Defence had not provided a security requirements checklist for almost all of those contracts, neither National Defence nor DCC had any assurance that the contractors who received those contracts had been cleared to the appropriate security level. To varying degrees, these contractors had free access to construction sites and project information that in many cases were sensitive. It was unknown whether or not information and assets had been compromised.

42. We noted that under the GSP, the contracting authority is responsible for ensuring that individuals and corporations have been screened for security at the appropriate level, that sensitive information and assets are safeguarded, and that contract documentation includes the necessary security terms and conditions. While DCC is the contracting authority for government defence projects, as a Crown corporation, it is not subject to the GSP unless it enters into an agreement with the Treasury Board of Canada Secretariat. We found that there was neither an agreement with the Secretariat nor a memorandum of understanding (MOU) with National Defence that clearly established those responsibilities. Therefore, no responsibility or obligation for industrial security had been formally conferred on DCC.

43. We recommended that DCC and National Defence establish an integrated framework for managing industrial security on defence projects according to GSP requirements. Both organizations agreed with our recommendation, and the Corporation committed to pursuing an agreement with National Defence to clarify roles and responsibilities in the management of industrial security and develop internal security policies and procedures to ensure National Defence's security requirements are met.

44. At a hearing of the House of Commons Standing Committee on Public Accounts on 26 February 2008, DCC advised the Committee that it will apply the GSP to all its operations related to the delivery of defence projects. We note that GSP requirements include security measures surrounding both information and people.

45. DCC management took these issues seriously and in response to our findings outlined in the October 2007 report, designated a corporate security officer and assembled a team to assist in the launching and realization of a comprehensive Security Policy Initiative. As part of this Initiative, the Corporation developed a detailed action

plan that addresses both the management of industrial security with National Defence and broader security issues within the Corporation. The action plan identified a number of tasks that were to be completed by the end of June 2008. We elected to extend our examination period to examine actions DCC had taken to strengthen security management practices up to 30 June 2008.

46. Regarding the management of industrial security with National Defence, DCC issued a requirement that, without a completed and signed security requirements checklist, DCC personnel should not proceed to the contract tendering stage unless they have received from National Defence a statement that there are no security requirements for that particular project. The requirement further states that no contract can be awarded until the Canadian and International Industrial Security Directorate of Public Works and Government Services Canada has performed a security screening of the contractor. This requirement was formally incorporated into DCC's internal compliance reviews in May 2008 and will be systematically examined in compliance reviews after this date.

47. In February 2008, DCC requested that all regions conduct a review of all active contracts to verify that the client has done a security review and to identify whether or not there are any security requirements. The results of this review showed that a very small percentage of projects had security requirements and that an even smaller percentage required additional follow-up.

48. The Corporation developed and issued a comprehensive Security Policy in May 2008. This document includes directives on internal operations, contracting, and quality measures. Directives on internal operations include local threat and risk assessments, security clearance of DCC personnel, handling of information, and physical security. The Corporation also appointed regional and site security officers and briefed them around the same time as it issued the policy. Employee training began in June 2008.

49. We also noted that the updated MOU between DCC and National Defence signed on 2 June 2008 has a section on security requirements, which addresses communication of an individual project's security requirements and includes a requirement for both organizations to develop and maintain an integrated industrial security management framework. This framework was intended to further define the respective roles of the two organizations, their responsibilities, processes, and procedures to manage security requirements of defence projects according to all aspects of the GSP

and the National Defence Security Policy. A framework document was prepared and signed by both parties on 2 June 2008. Finally, the Corporation revised its Corporate Risk Profile to include an explicit consideration of security risks.

50. While DCC has undertaken strong action, it will have to closely monitor these recently implemented systems and practices to ensure their continued effectiveness. In our view, sensitivity to security issues will have to become part of the corporate culture to minimize the likelihood of future security incidents. This will require sustained attention from management and the Board of Directors.

51. Recommendation. Defence Construction Canada should

- monitor the effectiveness of its new security management strategy, and
- report results to the Board of Directors.

The Corporation's response. Agreed. Management will monitor the effectiveness of its industrial security processes and procedures, and report the results to the Board of Directors.

Strategic planning

52. Defence Construction Canada's mandate is to provide services relating to infrastructure defence projects, which have historically been initiated and required by one client operating in a number of different locations throughout Canada and some locations abroad. Therefore, DCC's planning essentially requires identification, assessment, and fulfillment of National Defence's needs.

53. We expected DCC to have a clearly defined strategic direction with specific and measurable goals and objectives to achieve its mandate. This strategic direction and goals would take into account identified risks and the need to control and protect the Corporation's assets and to manage its resources economically and efficiently.

The corporate plan provides sufficient short-term direction

54. DCC follows a documented corporate planning process that includes seeking input from various internal stakeholders, including DCC senior management from all regions and service lines, executive management, and the Board of Directors. One of the key steps in this process is the fall strategic planning session, where key managers from headquarters and the regions discuss the assessments of National Defence's needs, risks, and operational and strategic issues. This planning session confirms the corporate mission, vision, objectives, and

initiatives and furthers the drafting of the corporate plan. The plan undergoes additional management group and Board reviews before finalization and approval. It is then forwarded to the Minister for review and government approval. Individual regions and divisions use the final plan to formalize their own operational plans.

55. The corporate plan presents strategic objectives, initiatives, outcomes and key performance indicators under five corporate planning themes. This presentation addresses our 2003 Special Examination observation that DCC's objectives and intended results were not presented clearly since they were embedded in various sections of the plan. This made it difficult for the reader to link the objectives and performance indicators and thereby obtain assurance that the Corporation had identified all the indicators that are relevant to assessing its performance. In our view, the current strategic plan provides sufficient short-term strategic direction to management and employees and presents important success factors for achieving the Corporation's mandate in its current operating context.

The Corporation needs to adopt a long-term financial plan

56. Future revenue levels from services provided to National Defence have a direct impact on the number of employees needed and the type of skills they should have. DCC management discusses National Defence's needs during the strategic planning process and the Corporation is aware of its client's important upcoming initiatives. We noted, however, that DCC's five-year financial plan is based on the assumption that, after the upcoming year, business volume will remain constant; the only growth is attributed to increasing salaries and benefits. This planning assumption effectively makes the financial plan a one-year plan, and history has shown it to be very conservative. The Corporation has significantly exceeded its revenue forecasts for all of the past five years (Exhibit 2).

57. Although DCC has demonstrated its ability to react to greater demand than expected by delivering services beyond the planned levels reflected in its corporate plan, the Corporation has grown to the point where it requires a more robust financial planning process that looks beyond the upcoming year to increase the likelihood that the Corporation will satisfy future client needs and operate economically and efficiently. We acknowledge that the quality of such a plan is largely contingent on National Defence's ability to communicate its long-term needs on a timely basis with a reasonable level of certainty. In our view, DCC could better link its financial planning process to National Defence's long-term capital infrastructure expenditure plans

Exhibit 2 The Corporation's actual revenues have significantly exceeded forecasts

Forecasted revenues (\$ thousands)					
Corporate Plan	2003–04 fiscal year	2004–05 fiscal year	2005–06 fiscal year	2006–07 fiscal year	2007–08 fiscal year
Plan 2003–04 to 2007–08	25,690	26,141	26,868	27,709	28,610
Plan 2004–05 to 2008–09		30,879	31,507	32,296	33,256
Plan 2005–06 to 2009–10			35,451	36,874	37,986
Plan 2006–07 to 2010–11				47,783	49,337
Plan 2007–08 to 2011–12					53,604
Actual revenues	29,543	34,734	42,645	48,091	55,716

Source: DCC's corporate plans and audited financial statements

to facilitate, among other things, human resource and information technology strategic planning, which are critical to DCC's success. These areas may require longer lead times for achieving required results due to such factors as market conditions when hiring qualified staff or typically longer implementation time frames for information technology solutions that require longer planning horizons.

58. Recommendation. Defence Construction Canada's five-year financial plan should reflect the expected level of services it will provide to meet client needs.

The Corporation's response. Agreed. Management will re-evaluate the certainty of future service demand estimates by National Defence and modify the Corporation's medium- to long-term operational and financial planning assumptions, as appropriate.

Performance measurement and reporting

59. Measuring and reporting performance is important for sound decision making, holding management accountable for their use of resources, and communicating to stakeholders how well the Corporation is performing and meeting its strategic objectives.

60. We expected Defence Construction Canada's performance measurement framework to provide clear and concrete performance expectations, as well as timely, credible, and balanced information about results. We examined the type of performance measures DCC's Board and executive management use to evaluate its corporate performance.

The Corporation has relevant performance indicators in place

61. Given the nature of its core business, we expected DCC to have measures relating to “on time,” “on budget,” and “quality of service” performance indicators. DCC has various timeliness measures such as the time required to award contracts by types of tendering mechanisms and the number of projects and percentages completed on time. In terms of costs, DCC uses an exception reporting approach, tracking the number of projects that exceeded contract awards and evaluating reasons for these overages. It measures quality directly through client satisfaction surveys and indirectly through evaluation and rating of contractors’ performance. It analyzes unexpected variances further and takes corrective action as deemed appropriate.

62. Overall, we found that DCC has consistently used and presented a set of established, relevant, and reasonable key performance indicators. Nevertheless, we encourage management to keep evaluating current indicators and exploring new ones that may be appropriate to its evolving service lines and client’s needs.

The annual report does not clearly present results against objectives

63. DCC reports its performance to external stakeholders through its annual report. We noted that the Corporation has improved the presentation of performance information in its corporate plan by grouping objectives, initiatives, outcomes, and performance measures under planning themes; however, the annual report does not follow this structure. Because related performance information is dispersed throughout the annual report, it is not easy to link it to the corporate strategic objectives that are summarized only at the beginning of the report. Simple, reader-friendly direct comparison to the planning themes can be done only in the case of status updates on strategic initiatives. In our view, reporting results according to the format used in the corporate plan—linking objectives with related performance measures under their respective areas—would enhance readers’ ability to evaluate corporate performance.

Service delivery—quality management system

64. Defence Construction Canada’s success depends on its ability to deliver quality services on time and within budget. We therefore expected DCC to have a quality management process that provides senior management and the Board with ongoing and reliable assurance that all services meet established quality and delivery standards. Furthermore, we expected DCC to undertake appropriate corrective actions when issues are identified. We reviewed the systems and

practices DCC has in place during and after project delivery to ensure it meets client requirements.

Processes are in place to monitor the delivery of services

65. DCC's Operations Manual is one of the key tools available to project coordinators to ensure compliance with corporate requirements and practices relating to the delivery of infrastructure services to the client.

66. Different controls cover the whole life cycle of a project—from the preparation of a service level agreement (SLA) to the client satisfaction surveys done upon project completion or on an annual basis for longer-term projects. The SLA primarily formalizes the deliverables and financial arrangements for specific services and is agreed upon by both National Defence and DCC representatives. The client satisfaction survey requests National Defence's feedback and rating on DCC's quality of service, value added, timeliness, responsiveness, and communications. Numerous other controls are in place to ensure consistent service delivery throughout its projects.

67. DCC has a set of additional processes in place to evaluate project delivery close to or upon completion. File audits and compliance reviews are related but separate evaluation tools. The use of compliance reviews by regional management in all regions and service lines addresses our 2003 Special Examination observation that some service lines and regions were not subject to a compliance review. File audits are also performed in all service lines, except for the project and program management support service line. The rationale for the use of both file audits and compliance reviews is unclear to us.

68. One of the two vice-presidents of Operations and a member of the head office technical team also annually conduct regional audits. These audits include following up on the previous year's observations, evaluating the way that file audits and compliance reviews were performed by the regional and site management, performing additional file audits based on areas of particular interest, and assessing the region's human resource management.

69. Overall, we found that DCC's quality monitoring processes and procedures have numerous types of controls, including the necessary controls to evaluate the "on time," "on budget," and "quality" elements of individual project delivery. However, some of these processes assess the same control elements, so there is risk of duplication. In our view, there are opportunities for streamlining to ensure more efficient and

systematic coverage by clearly identifying what the key control mechanisms are and how their effectiveness will be monitored and measured. Management engaged a consultant in mid-2007 to review its quality assurance processes. As at the end of the examination period, the consultant was drafting its final report and recommendations.

70. We encourage DCC to complete the mapping and evaluation of its quality management system and to increase its efficiency by identifying and systematically monitoring key control mechanisms required to maximize client satisfaction.

Human resource management

71. Defence Construction Canada's ability to fulfill its mandate depends on the availability of enough employees with the appropriate skill sets. DCC has experienced significant growth in recent years in all of its service lines. Since our last special examination, the Corporation's workforce has more than doubled; therefore, more than half of its employees have been with the Corporation for less than five years. This highlights the need to ensure that employees understand the corporate environment, culture, ethics, and values, and receive sufficient training and development to build and maintain required skill sets. An additional challenge that management has identified relates to the shortage of skilled labour due to the health of the construction industry in certain regions of the country. Consequently, DCC has articulated a separate People theme in its 2007–08 to 2011–12 Corporate Plan, where it specifically identified strategic initiatives for recruitment and retention, and training and development activities.

72. We expected DCC to have a workforce with the key competencies needed to achieve its strategic and operational objectives. We looked at DCC's human resource planning, recruitment and retention, training and development, and activities aimed at ensuring safety in the workplace.

A strategic human resource plan needs to be developed

73. We expected DCC to have a strategic human resource plan in place that assists in the achievement of strategic and operational objectives. The plan would outline strategies to fill the Corporation's workforce gaps in the short-, medium-, and long-term and be aligned with its objectives and priorities. It would also address the composition and competencies of its current staff and indicate future staffing needs.

74. We found that DCC has no formal strategic corporate human resource plan beyond the initiatives outlined under the People theme in its Corporate Plan.

75. Although DCC has been able to consistently provide levels of service in excess of those planned in the past, in our view, its human resource management could be strengthened by developing a formal strategic corporate human resource plan. This plan needs to incorporate and link all key human resource objectives and the activities to achieve them, and provide means to assess their progress.

76. Recommendation. Defence Construction Canada should develop and implement a strategic corporate human resource plan that clearly defines its current and future human resource needs, as well as the strategies to ensure it will have qualified staff in the right place at the right time to achieve its strategic and operational objectives.

The Corporation's response. Agreed. Management will strengthen its current human resource planning process by formally documenting its Corporate human resource strategies and planning practices. This will assist the Corporation to continue to effectively manage the size, technical diversity and geographic distribution of its workforce, and to achieve its strategic and operational objectives.

The Corporation is developing a formal recruitment and retention strategy

77. We expected DCC to have systems and processes aimed at recruitment and retention of employees.

78. Traditionally, the Corporation has largely delegated recruitment and retention activities to the regions and individual sites, while its Human Resource Department provided support functions such as assistance with job classifications, advertising, and development of a recruitment guide.

79. The Human Resource Department currently tracks recruitment initiatives across the Corporation and reports to the executive management on the overall status of unfilled jobs. It also set a 30-day target to hire an employee. The latest available information shows that meeting this target has been a challenge since it takes closer to 50 days to hire an employee.

80. To assess its competitiveness, the Corporation commissions compensation comparability studies. The last study completed in December 2007 compared DCC's job families with comparable job

groups in both the public and private sectors. Management assessed the results and undertook actions it deemed appropriate.

81. DCC also periodically monitors its retention ratio—one of its reported Corporate performance indicators. It has met its 90 percent corporate target in recent years. All employees leaving voluntarily undergo an exit interview and the resulting information is compiled, consolidated, and reported to the executive management on a quarterly basis.

82. During our examination, DCC had just begun formalizing these various processes by developing a formal recruitment and retention strategy.

The Corporation is implementing a more formal approach to training and development

83. Ongoing training and development is important in an organization such as DCC, considering its growth and the fact that the majority of the employees have been with the Corporation for less than five years. Continuous training and development ensures that employees are able to provide quality services consistently. Therefore, we expected DCC to have systems and processes in place to ensure that employees are receiving sufficient training and that their skills are being developed to provide a satisfactory level of service.

84. The Corporation has traditionally managed training and development activities at the local level through the assessment of employee needs during performance reviews by their supervisors. To ensure that training and development activities take place, the Corporation set a target of a 3 percent expense-to-salary ratio and reports on the results as one of its performance indicators. In recent years, DCC has spent 2 percent of the expense-to-salary ratio for its traditional training and development activities, while it set aside 1 percent for the implementation of a formalized corporate training and development initiative.

85. This initiative emerged as a result of the 2004–05 corporate planning and risk management activities. It included revising the training and development policy, developing in-house training courses and online training tools, and developing a training and career development matrix. By the end of the 2008–09 fiscal year, management expects that the training and development activities developed through this initiative will become institutionalized and part of an ongoing corporate-wide program. Since this initiative will result in a greater amount of in-house training, we encourage management to reassess the

meaningfulness of its training and development performance indicator, which currently measures inputs as opposed to results.

Satisfactory processes are in place to ensure a safe working environment

86. We expected DCC to have systems and practices in place to provide a safe workplace and to manage safety-related risks effectively.

87. DCC has an Environment, Health and Safety Committee, a safety policy, and a health and safety manual. Employees can readily report accidents and incidents and are required to complete the annual safety re-orientation and environmental awareness training. The performance evaluation of site managers is also based on safety management, and their sites are subject to safety audits. Regions report to the vice-presidents of Operations on a quarterly basis any safety issues relating to both DCC employees and external contractors. Safety incidents are included as a performance indicator in the corporate plan, and the number of incidents and lost hours are reported and explained in the highlights section of the annual report. The number of incidents over the past several years has been low, thus indicating that DCC's safe working environment processes are effective.

Information technology management

88. Defence Construction Canada recognizes that its dependence on information technology (IT) is increasing. Many of its internal initiatives have a significant technology component.

89. We expected the planning, development, implementation, and management of information technology and information management systems to support DCC's strategic and operational objectives, safeguard sensitive assets, ensure business continuity, and satisfy informational needs. To assess DCC's performance in this area, we looked at IT planning, management of IT projects, the reliability of systems, and provision of quality IT service.

The Corporation needs to strengthen information technology management

90. In April 2005, DCC received findings and recommendations from a comprehensive assessment of its technology environment by an external consulting firm. This report included a vision and migration plan for IT solutions and services. The consultants suggested developing an IT professional services model based on the IT function working more closely with other business functions, implementation of IT strategic planning and prioritization, and rationalization of IT capability. The consultants' recommendations and a proposed action plan became one of DCC's key IT planning documents. Other inputs

to its planning exercise include IT Steering Committee decisions, a list of the previous year's uncompleted initiatives, and the corporate direction and priorities set through the overall corporate planning process.

91. DCC recognizes that it requires a more strategic approach toward planning and carrying out IT activities. Without a long-term strategic plan, the Information Services Department prepares an upcoming year operational plan. We found that this plan can be strengthened by further clarifying planned initiatives and ensuring that they are appropriately resourced and have set timelines.

92. Individual IT projects should be planned, organized, structured, and managed to ensure success. The model recommended in the consultants' report included the need for the short-term development of business planning strategies and the formalization of IT project management procedures. We found that the Information Services Department does not currently have a documented project management methodology; however, we were advised that this is being developed at the same time as some projects are being implemented. Use of formal project plans or business cases would allow the Corporation to monitor and ensure that projects stay on track.

93. One of the Information Services Department's performance indicators for the availability of the information systems is the percentage of time that the network is available, which it has consistently exceeded. DCC also has a detailed business resumption plan, which includes a section related to information services. We note that risk management in this area could be strengthened by more systematic and regular testing of information systems that DCC identifies as critical to its service delivery. The results of those tests should be reported to senior management. The Information Services Department also measures the quality of some of its services using metrics related to its IT Help Desk activities and timeliness in providing computers to new hires. Results of those activities are favourable.

94. While DCC's IT activities currently satisfy its operational needs, the Corporation would benefit from stronger planning, more structured project management, and regular testing to ensure reliability.

95. Recommendation. Defence Construction Canada should strengthen its management of information technology by developing

- an information technology strategic plan aligned with Corporate strategic and operational objectives,
- a project management methodology, and
- systematic procedures to test and report on the restoration of critical systems in case of failure.

The Corporation's response. Agreed. The Corporation will develop an IT Strategic Plan. The comprehensive system development life cycle (project management) methodology has been completed and is now being applied to IT upgrades and new development projects. The Corporation will develop information system continuity testing procedures.

The Corporation is updating its human resource information system

96. In our 2003 Special Examination, we commented on the benefits of better human resource information. At that time, management expected that the upgrade of its automated system, which was to be completed by the middle of that year, would fill that requirement. That system was effectively implemented in 2003, but due to the growth in the number of employees, it became clear that a more robust system was required. The new human resource information system (HRIS) started to evolve at the beginning of 2006 and plans were to implement two modules—payroll and human resource management. The payroll module came online in January 2008, and the human resource management module is expected to follow in upcoming months. DCC expects that the management module will provide a means to monitor more systematically various human resource elements, including movement of employees and training and development activities.

Environmental management

97. Operationally, Defence Construction Canada administers or manages on behalf of the client contracts where a possibility for environmental degradation exists, such as construction projects. It also offers environmental services, such as technical support for environmental cleanup activities.

98. We expected DCC to have considered and assessed the environmental impacts and associated risks of its operations, activities, and strategies. Furthermore, we expected that it would manage these risks as appropriate, consistent with government expectations and applicable laws, regulations, and other requirements. We looked at

how DCC mitigates environmental risks, both operationally while acting on its client's behalf and for its own internal operations.

The Corporation has systems and practices in place to manage environmental risks effectively

99. To mitigate environmental risks on behalf of its client, DCC ensures that potential impacts are taken into account in the delivery of services. An environmental review has to be completed by DCC contract coordinators for all construction contracts and approved by environmental coordinators. A key consideration in this review is whether an environmental assessment has been completed, with mitigating measures incorporated into contract documents. If this assessment is not required, the contract coordinator has to record this decision and get it approved by appropriate National Defence officials. DCC also offers environmental training to its employees.

100. The Corporation offers environmental services to National Defence through its internal network of environmental experts. Environmental incidents are formally reported to the vice-presidents of Operations on a quarterly basis and these reports include an indication of whether issuing lessons-learned bulletins on its Intranet is warranted. The Intranet also provides the opportunity for any DCC employee to report environmental incidents, thus contributing to DCC's environmental accountability and management.

101. DCC's internal operations do not pose a significant threat to the environment. Regardless, DCC developed an environmental management framework, the structure of which is consistent with the elements of a good environmental management system. DCC's Environment, Health and Safety Committee is responsible for the system's implementation and the maintenance of a continuous improvement program. DCC is also committed to reducing office paper consumption, conserving water and energy, and reducing waste in general.

Conclusion

102. We examined Defence Construction Canada (DCC or the Corporation) systems and practices for corporate governance, risk management, strategic planning, performance measurement and reporting, service delivery, human resource management, information technology management, and environmental management. Our objective was to determine whether the Corporation's systems and

practices provide reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

103. We found no significant deficiencies in the systems and practices we examined. The Board of Directors follows good governance practices. DCC also has systems and practices in place to monitor the quality of services provided to National Defence, to provide a safe working environment, and to manage the potential environmental impacts of construction projects.

104. The Corporation has invested considerable efforts in recent months to address weaknesses in its security management systems and practices. It will be important for DCC to closely monitor the effectiveness of its recently implemented security management strategy, and for management and the Board to pay sustained attention to security risks. The Corporation also needs to strengthen and formalize its systems and practices in a number of areas, including strategic and human resource planning, and the management of information technology initiatives.

About the Special Examination

Objective

Under section 138 of the *Financial Administration Act (FAA)*, federal Crown corporations are subject to a special examination once every five years. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the Auditor General provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 7 of this report.

Special examinations answer the following question: Do the Corporation's systems and practices provide reasonable assurance that assets are safeguarded, resources are managed economically and efficiently, and operations are carried out effectively?

Key systems and practices examined and criteria

At the start of this special examination, we presented an audit plan to the Audit Committee of Defence Construction Canada that identified the systems and practices, and related criteria that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. These are the systems and practices that we examined and the criteria that we used for the examination.

Key systems and practices examined	Criteria
<p>Corporate governance</p> <ul style="list-style-type: none"> • Appointment and functioning of the Board and its committees • Information and decision making • Ethics regime • Internal audit 	<p>DCC has a well-performing corporate governance framework that enables the Board of Directors and senior management to be accountable for the responsibilities assigned to them by governing legislation.</p>
<p>Risk management</p> <ul style="list-style-type: none"> • Risk management framework and its implementation • Follow-up: Industrial security requirements on defence projects 	<p>DCC has a risk management framework that supports the realization of its mandate, business goals, and objectives. Risks are identified, measured, mitigated, monitored, and reported in order to be kept within a level appropriate to the nature of the business.</p> <p>DCC has analyzed all implications of the industrial security requirement and implemented, in collaboration with National Defence where applicable, corrective measures to address identified weaknesses.</p>
<p>Strategic planning</p> <ul style="list-style-type: none"> • Strategic planning and decision-making processes 	<p>DCC has a clearly defined strategic direction with specific and measurable goals and objectives to achieve its mandate. Its strategic direction and goals take into account identified risks and the need to control and protect its assets and manage its resources economically and efficiently.</p>

<p>Performance measurement and reporting</p> <ul style="list-style-type: none"> • Performance measurement framework and reporting 	<p>DCC's performance measurement framework provides clear and concrete performance expectations as well as timely, credible, and balanced performance information. This framework promotes good accountability to Parliament and stakeholders.</p>
<p>Service delivery—quality management systems</p> <ul style="list-style-type: none"> • Corporate policies, practices, and guidelines pertaining to key service lines • Compliance review processes • Management information on performance for each service line 	<p>DCC has a systematic quality process that provides senior management and the Board with ongoing and reliable assurance that all services meet established quality standards. DCC undertakes appropriate corrective actions when issues are identified.</p>
<p>Human resource management</p> <ul style="list-style-type: none"> • Human resource planning • Recruitment and retention • Training and development • Safety in the workplace 	<p>DCC has a workforce with the key competencies needed to achieve its strategic and operational objectives. DCC provides a safe workplace environment that supports its workforce in meeting its objectives.</p>
<p>Information technology management</p> <ul style="list-style-type: none"> • IT strategic and operational planning • IT project management • IT security and business continuity • Quality of IT service 	<p>DCC's planning, development, implementation, and management of information technology and information management systems support the organization's strategic and operational objectives, safeguard sensitive assets, ensure business continuity, and satisfy informational needs.</p>
<p>Environmental management</p> <ul style="list-style-type: none"> • Environmental practices related to internal and contractor operations 	<p>DCC considers environmental impacts and risks associated with its operations, activities, and strategies. DCC manages these risks as appropriate, consistent with government expectations and applicable laws, regulations, and other requirements.</p>

Audit work completed

Audit work for this special examination was substantially completed on 29 February 2008, except for our examination of the risk management systems and practices, the work for which was substantially completed on 30 June 2008.

Audit team

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Appendix List of Recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Risk management	
<p>51 Defence Construction Canada should</p> <ul style="list-style-type: none"> • monitor the effectiveness of its new security management strategy, and • report results to the Board of Directors. (37–50) 	<p>The Corporation’s response. Agreed. Management will monitor the effectiveness of its industrial security processes and procedures, and report the results to the Board of Directors.</p>
Strategic planning	
<p>58 Defence Construction Canada’s five-year financial plan should reflect the expected level of services it will provide to meet client needs. (52–57)</p>	<p>The Corporation’s response. Agreed. Management will re-evaluate the certainty of future service demand estimates by National Defence and modify the Corporation’s medium- to long-term operational and financial planning assumptions, as appropriate.</p>
Human resource management	
<p>76 Defence Construction Canada should develop and implement a strategic corporate human resource plan that clearly defines its current and future human resource needs, as well as the strategies to ensure it will have qualified staff in the right place at the right time to achieve its strategic and operational objectives. (71–75)</p>	<p>The Corporation’s response. Agreed. Management will strengthen its current human resource planning process by formally documenting its Corporate human resource strategies and planning practices. This will assist the Corporation to continue to effectively manage the size, technical diversity and geographic distribution of its workforce, and to achieve its strategic and operational objectives.</p>

Recommendation	Response
<p>Information technology management</p> <p>95 Defence Construction Canada should strengthen its management of information technology by developing</p> <ul style="list-style-type: none"> • an information technology strategic plan aligned with Corporate strategic and operational objectives, • a project management methodology, and • systematic procedures to test and report on the restoration of critical systems in case of failure. (88–94) 	<p>The Corporation’s response. Agreed. The Corporation will develop an IT Strategic Plan. The comprehensive system development life cycle (project management) methodology has been completed and is now being applied to IT upgrades and new development projects. The Corporation will develop information system continuity testing procedures.</p>