

# **Risk Assessment Methodology For Selecting Contribution Recipients to Audit**

**April 2005**

***Audit and Evaluation Directorate***

### Report Clearance Steps

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### Acronyms used in the report

DAEC	Departmental Audit and Evaluation Committee
Gs&Cs	Grants and Contributions
OGD	Other Government Department

### Acknowledgments

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- other departments who have been consulted;
- the two recipient organizations where the proposed methodology has been tested; and
- the Services and Regions of Environment Canada, and especially the Financial Services Directorate.

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## Executive Summary

### Project Objectives and Results

The need to develop a methodology to support program managers in assessing risks and determining which contribution recipients should be audited was identified as a priority in the Audit and Evaluation Plan approved at the Departmental Audit and Evaluation Committee (DAEC) on November 4<sup>th</sup>, 2004.

The approach taken for this project was based on: a comprehensive document review of key policies, frameworks and guides regulating the audit of contribution recipients; knowledge gained through contacts established and interviews held within the department and with other departments known for their best practices; and on an analysis of the information captured on contributions for 2003-2004 and 2004-2005.

Based on this work, the project team developed a three-step risk assessment methodology to identify which contribution recipients to possibly visit and audit:

- a) **high level criteria** to select a broad sample of contribution recipients who would be the subject of more examination, such as a generic document review;
- (b) **comprehensive criteria** to provide a narrower selection of contribution recipients to possibly visit and audit;
- (c) **site visits** to evaluate risks in key areas.

The proposed methodology is supplemented with tools (checklists provided in Annexes I & II) to support managers in performing their risk assessments.

Subsequently, the project team tested the proposed methodology and tools via site visits with two contribution recipients, respectively from the Ontario Region and the National Capital Region (NCR), that had received funding during the 2004-2005 fiscal year. As a result of these tests, the project team was able to conclude that the methodology developed performs well and can support program managers in identifying risks related to the management of contributions agreements. Its application can also contribute key information to continual auditing and to the annual departmental risk-based audit and evaluation planning. As well, the testing allowed the team to identify the following issues for consideration related to the management of contribution agreements.

#### 1. Improved information on contributions

*Observation:*

- At the time of the project, there were considerable limitations to easily extract relevant information on a contribution agreement basis from the departmental financial database modules.

*Suggestions:*

- The introduction of Merlin Version 11i is making possible the establishment of a comprehensive central list of contribution agreements. Services and Regions were asked to populate this mandatory inventory, starting for Fiscal Year 2004-05.

- It is suggested that the Financial Services Directorate develop a comprehensive report on contributions agreements and provide a broad-based and easy access to managers, financial analysts and auditors. The list of information fields already provided by the Audit and Evaluation Directorate can be used as a starting point.

## 2. Active Guidance to Program Managers

### *Observations:*

- Very few contribution recipient audits have been performed to date; program managers expressed the need for more support and guidance in the selection and conduct of contribution recipient audits.
- Presently, there is no departmental policy to determine the need for, and conduct of contribution recipient audits; limited guidance is provided via the “*Accountability, Risk and Audit Framework for the Departmental Class Grants and Contributions*” (ARAF) and the “*Environment Canada Manager’s Guide to Grants and Contributions*”.

### *Suggestions:*

- Based on the work already done, it is suggested that a departmental *Contribution Recipient Audit Policy* be developed and implemented, along with a process for determining priorities for contribution recipient audits, including techniques for performing these audits; this policy and process would provide additional guidance and support to program managers.
- Under the umbrella of a departmental *Contribution Recipient Audit Policy*, the following priorities could be considered:
  - the need to clarify roles and responsibilities;
  - the need to provide more active guidance, training and tools to managers (such as the ones proposed in this report);
  - the advantages of implementing an “*Initial Visit*” process - along with a reference manual for conducting such visits;
  - the need for mandatory audits of high risk agreements selected on the basis of objective criteria.

## **Management Response from the Financial Services Directorate**

The Financial Services Directorate agreed that this methodology represents a good starting point to evaluate risks related to recipients. The departmental grants and contributions management framework, including the audit of contribution recipients, will be entirely reviewed. This new framework will be submitted to the *Executive Management Council (EMC)* when completed.

## 1 Introduction

This report has been prepared with the intent to develop and test a methodology to assist managers in assessing risk as well as determining which contribution recipients are possibly subject to a site visit and audit. The proposed methodology can also support the departmental effort to continual auditing and annual departmental risk-based audit and evaluation planning.

The report presents the rationale and context supporting this project, its scope, objectives and methodology. It then discusses the capture of contribution information at Environment Canada and presents best practices from other government departments. Subsequent to this baseline work, the project team proposes a risk assessment methodology for selecting possible contribution recipients to visit and audit, along with the tools to be used by managers in this selection, namely:

- (a) **high level criteria** to select a broad sample of contribution recipients who would be the subject of more examination, such as a generic document review;
- (b) **comprehensive criteria** to provide a narrower selection of contribution recipients to possibly visit and audit;
- (c) suggested **site visits** to evaluate risks in key areas.

As part of this project, the proposed methodology and tools have been tested with two contribution recipients.

## 2 Rationale and Context

### 2.1 Rationale

The need to develop a methodology to support program managers in assessing risks and determining which contribution recipients should be audited was identified as a priority in the Audit and Evaluation Plan approved at the Departmental Audit and Evaluation Committee (DAEC) on November 4<sup>th</sup>, 2004. The methodology can also contribute key information to continual auditing and to the annual departmental risk-based audit and evaluation planning.

### 2.2 Internal Audit Roles & Responsibilities

The objectives and the scope of this assignment are structured around the Treasury Board Secretariat “*Guide on the Audit of Federal Contributions*”, which clearly stipulates roles and responsibilities of internal auditors in relation to recipient audits:

- “Internal audit groups are responsible for the audit of internal management policies, practices and controls of contribution programs.”
- “Internal audit groups shall not assume the account verification responsibilities of program managers in the audit of recipients of contributions.”

Reference: “*Guide on the Audit of Federal Contributions – Part I: Policy; Summary of Directives and Guidelines.*”

The Treasury Board Secretariat further clarifies the roles of internal audit groups, by the following:

- “As noted previously, the audit of a recipient’s operations for the purpose of determining compliance to terms and conditions of contributions agreements is part of the account verification process for which program management is primarily responsible. As such, internal audit groups should not be responsible for the establishment of contribution audit criteria or participate in the administrative arrangements for carrying out regular audits of contribution recipients. Otherwise, internal audit would be participating as a control element in the contributions program management control process, and would therefore be unable to objectively assess that part of the management system at a later date. This assessment by internal audit groups may include auditing the books, records and operations of recipients on a sample basis but only as part of an overall audit of the operations of a particular contributions program to determine the adequacy of management controls.”
- “The purpose of audits of recipients by internal audit groups then is not primarily to determine whether a particular recipient has complied with the contribution terms and conditions, but to determine the adequacy of the contribution control system as a whole.”
- “Internal audit groups may provide, on an exception basis, consultative advice to program managers relative to the audit of recipients...”
- “It is important to note that internal audit’s role is rather different from that of financial services with respect to the above three activities. Consultative advice is to be provided on an exception basis and therefore internal audit does not become part of the ongoing administrative and management control processes.”

Reference: “*Guide on the Audit of Federal Contributions – Part I: Policy; Roles, Responsibilities and Relationships*, section 3, Internal Audit Groups.”

The Treasury Board Secretariat “*Guide on the Audit of Federal Contributions*” also identifies roles and responsibilities of program managers, in relation to the audit of recipients of contributions, which include:

- Selecting appropriate auditors or indicating the acceptability of auditors when retained by the recipient;
- Determining which contribution recipients are to be audited;
- Determining whether the scope, frequency and scheduling of audits meet program requirements;
- Coordinating audits with others involved in the audit of the same recipients; and
- Determining follow-up action required on audit findings.

Reference: “*Guide on the Audit of Federal Contributions – Part I: Policy; Summary of Directives and Guidelines*.”

The Treasury Board Secretariat is in the process of reviewing the Transfer Payment Policy including the guidelines on audit of federal contributions.

### **2.3 Grants and Contributions at Environment Canada**

In the fiscal year 2004-2005 Main Estimates Part II, Environment Canada had a transfer payments budget of \$57.6 million, representing about 7.1% of the Department’s overall budget of \$805.2 million. From previous evaluation work and other assessments, it is



estimated that the department managed approximately one thousand grants and contributions (Gs&Cs) agreements in 2002-03.

Up until March 31<sup>st</sup>, 2004, funding for Gs&Cs was provided through five classes and a number of issue specific programs/initiatives. Each class has a set of terms and conditions, approved by Treasury Board Secretariat, stating the objective of the class, the categories of recipient groups and individuals who may apply for funding, and the maximum amount of funding that can be awarded. It is important to note that the use of the class approach is purely an administrative convenience – enabling individual programs to use Gs&Cs under five general themes to allocate funds. However, the class objectives are too broad to be effectively used for audit or evaluation purposes.

The five classes were:

- 301 – Grants to Support Environmental Research and Development;
- 302 – Contributions to Support Environmental Research and Development;
- 303 – Contributions to Support Environment and Sustainable Development Projects;
- 304 – Contributions to Increase Awareness and Understanding of Environment and Sustainable Development Issues; and,
- 305 – Contributions to Support Canada's International Commitments.

A Treasury Board Submission on the renewal of terms and conditions for departmental class Gs&Cs was approved April 20<sup>th</sup>, 2004. Effective April 1<sup>st</sup>, 2004, the previous five classes of Gs&Cs were reduced to four. This is a result of the combination of two classes: 303 and 304. The new class is entitled "Contributions to Support Environmental and Sustainable Development Initiatives". The approved terms and conditions are in effect from April 1<sup>st</sup>, 2004 to March 31<sup>st</sup>, 2009.

## 2.4 Previous Audits and Evaluations

The Audit & Evaluation Directorate recently conducted the following audits, evaluations and studies:

- *Audit and Evaluation of Class Contributions in Support of Environmental and Sustainable Development Projects, Class 303* (approved by DAEC, March 6<sup>th</sup>, 2002);
- *Audit of Grants and Contributions Classes 301, 302, 304 & 305* (approved by DAEC, May 2003);
- *Evaluation Plan for Grants & Contributions – Results for the Scoping Phase* (approved by DAEC, January 8<sup>th</sup>, 2004).

The first two reports concluded that, while there was an acceptable level of compliance with most of the policy and legislative requirements covering transfer payments, and with the terms and conditions of the contribution agreements, some weaknesses were evident:

- Weaknesses in some areas of the Gs&Cs management control framework and in managers' awareness of requirements;
- Weaknesses in clearly documenting both the rationale for providing funding to a particular organisation, and the impacts / benefits of the contribution to the goals and objectives of a program;
- The lack of a consistent strategy and approach for monitoring progress, assessing risk and linking results to the objectives of a program and, subsequently, to a business line; and

- The difficulty in identifying the number of Gs&Cs administered under each business line and in reporting their impacts on the business lines' stated objectives.

The third report was based on an analysis of 56 individual grant and contribution agreements from the perspective of relevance, outcomes, reasonable costs and recipients. Although this type of analysis has limitations by relying exclusively on judgement, it was felt that it would provide useful information to senior management. It concluded that:

- Contribution agreements were made in accordance with the Treasury Board Secretariat "*Policy on Transfer Payments*";
- Agreements were consistent with the Treasury Board Secretariat policy - no goods or services were directly received;
- Mandates of recipients were compatible with the Government agenda or specific departmental objectives;
- Agreements were aimed at furthering governmental policies and the departmental objectives;
- In most cases, processes were in place within the Programs or Regions to select recipients;
- The way the department captured and categorised its financial data on Gs&Cs responded to program management needs; however, it did not allow for extracting relevant information on a results-based perspective. It did not allow for the conduct of any future analysis and evaluations at the department level.

### 3 Project Objectives, Scope and Methodology

Based on the understanding that there are very few contribution recipient audits being performed by the department, the objectives of this project are twofold:

1. To develop a methodology, including a process and criteria, to support program managers in assessing risk and determining which contribution recipients are to be audited (Phase I). Such methodology would also contribute key information to continual auditing and to the annual departmental risk-based audit and evaluation planning.
2. To apply and test this methodology for fiscal year 2004-05 contribution recipients, to two regions, the Ontario Region and the National Capital Region (NCR). Contribution recipients will be determined based on risk and on the allocated travel budget (Phase II).

The following approach has been applied:

- The project team performed a document review of the key policies, frameworks, guides and data bases linked and/or regulating the audit of contributions programs and more particularly the audits of contribution recipients. A list of documents considered is provided in Annex III.
- Interviews were held with representatives from the Financial Services Directorate and with the departmental experts on Gs&Cs. Contacts were also established with a representative from the Systems, Operation and Support group under the Financial Services Directorate concerning the ability to retrieve key information fields using the available Discover program which helps auditors and managers to assess risks and select contribution recipients for further analysis and/or audits.

- The project team met with a representative from a department known for its best practices in the area of recipient audits, and consulted documentation provided from other departments.
- An analysis of the information captured on contributions for 2003-2004 and 2004-2005 was performed to develop a preliminary set of questions and criteria to support program managers in assessing risk and determining which contribution recipients are to be audited.
- From this analysis, one contribution recipient from the Ontario Region and one from the National Capital Region have been selected and site visited. An analysis of the information systems, reports and notes supporting their claims were performed, in order to test and finalize the proposed methodology and criteria.

## 4 Capture of Information on Contributions

Until recently, significant limitations existed in the way the information on contributions was captured and categorized in the Department. Prior to July 2004, there was no comprehensive central list of contributions agreements, and no central registry for managers to retrieve agreements, as the information captured through the financial system was based exclusively on payments made to recipients and not on the contributions agreements themselves. Each manager or distinct group maintained their own records on contributions such as black books or Excel spreadsheets. In addition, the financial information captured did not contain data on planned or achieved results, and did not provide linkage to a specific contribution agreement.

The financial information was nevertheless sufficient to manage adequately the contributions within a specific program and to provide good financial information to management.

A high level analysis of the contribution payments within the departmental financial data base modules for 2003-2004 and 2004-2005 showed that:

- the information was reported in separate modules and folders;
- information fields were not always populated;
- information fields were not all linkable into one report to perform an adequate analysis; and
- there was no inventory of recipient audits done, underway or planned at this date.

The introduction of Merlin Version 11i makes the establishment of a comprehensive central list of contributions agreements possible. Services and Regions were asked to populate this mandatory inventory, starting for Fiscal Year 2004-05. It is only at year end that it will be possible to have some confidence on the completeness of that database, after reconciliation is done by the Financial Services Directorate. Programming the linkages of key information fields across modules and folders will also be required, especially linkages across the “*Purchasing*” and the “*Financial Reporting*” modules, and across fields contained into the following folders: the “*Procurement Order Data*”; the “*Vendor*”; the “*Contract Data*”; and the “*Invoice Data*” folders.

The linkages of information fields across modules and folders are essential to perform any analysis of contributions. Consequently, at the time of this project, there were still

considerable limitations to the application of a methodology for extracting relevant information on a contribution agreement basis, and the conduct of any analysis.

## 5 Best Practices from Other Government Departments

The project team consulted documentation on contribution recipient auditing from other federal organizations and met the representative of one other government department (OGD) known for its best practices in this area. Officials from this OGD have developed and implemented a well documented process for determining priorities and performing contribution recipient audits. The following summarizes their process.

- The OGD process is coordinated under the parameters of a contribution agreements audit policy, which defines roles and responsibilities in the planning and management of contribution recipient audits, and provides the tools necessary for the selection of agreements to be audited and the development of the annual audit plan, along with an initial site visit reference manual.
- Contribution recipient audits are identified, prioritized, selected and coordinated through a central compliance unit, according to an annual plan. The planning and selection process involves:
  - identifying the entire population of contributions for possible audit selection;
  - establishing criteria to assist program managers in identifying contribution recipients to be audited;
  - selecting contribution recipients to be audited, based on dollar value and as per a list of mandatory criteria established under the parameter of a contribution agreements audit policy;
  - providing the opportunity for program managers to identify other contribution recipients they believe should be audited;
  - the possibility for professional auditors to add more potential contribution recipients for audits.
- It is worth noting that the OGD's right to audit or access to external audits is included in all contracts and contributions agreements, and extends to subsidiary contracts and agreements, where necessary.
- The list of mandatory selection criteria contains the following provisions:
  - all contribution agreements over a specific value result in a meeting between the program manager and the designated auditor, followed by an "Initial Visit" to the recipient's premises by the auditor;
  - agreements with annual disbursements over a pre-determined value are subject to an annual assessment for audit; and
  - all agreements over a pre-determined value are, under normal circumstances, automatically audited after the first year of operation.
- Over the years, the OGD noted that several repetitive financial adjustments were required due to misinterpretation of agreement clauses or lack of appropriate supporting documentation or audit evidence. Consequently, "Initial Visits" were instituted in an attempt to clarify the terms and conditions of the agreements as well as expectations with regards to financial reporting, internal controls and supporting documentation. Their goal was also to enhance relationships and communications with the contribution recipients and to foster a common understanding. As a result of

*“Initial Visits”*, recommendations are made to management on any required modifications to the agreement to facilitate the application of the financial clauses, and on specifying acceptable supporting documentation in the event of an audit.

- Contribution recipient audits are performed by the OGD finance group, which will coordinate its planning effort with the audit and evaluation group to avoid potential overlap or duplication. The following specific audits are excluded from the application of this policy: operational audits; value-for-money audits; and audits of illegal acts and potential fraud.
- Contribution recipient audit objectives are to confirm whether:
  - funds are being used in accordance with the terms and conditions of the agreement;
  - costs claimed are allowable, adequately supported, and have been incurred and paid for the goods and services rendered;
  - financial information submitted in claims is accurate, complete and reliable, and financial statements are presented in accordance with generally accepted accounting principles; and
  - the contribution recipient has adequate financial and administrative procedures and internal controls to protect the department's interests.
- Program managers are responsible for ensuring that all aspects of the contribution agreements audit policy are followed by their branch. The results of audits are communicated to the appropriate managers, for timely follow-up of corrective actions, or the recovery of overpayments.
- In general, most frequent adjustments to contribution recipient claims were related to: ineligible expenditures; claims in excess of agreement limits or other directives such as travel; insufficient documentation; absence of time sheets or time records; expenditures claimed twice; overhead expenditures claimed as direct costs; expenditures claimed for which there is no cost or cash outlay by the contribution recipient; amounts recovered by the recipient but not credited to the department; calculation errors; unreported interests earned on advance payments.

In summary, this OGD has established a well documented process, structured under its departmental contribution agreements audit policy, which comprises clear procedures, criteria and tools to identify, prioritize, select and perform contribution recipient audits. Their entire process is coordinated through a central compliance unit.

## 6 Proposed Risk Assessment Methodology

This section identifies the requirements regarding the database needed for sampling; proposes a risk assessment methodology; and presents the testing done with two contribution recipients that had received funding during the 2004-2005 fiscal year.

### 6.1 Required Database for Sampling

In order for program managers to determine which contribution recipients should be audited, they require a database in which they can consider and examine comprehensive information on contributions. As explained in section 4, despite the current capacity, there are still

important limitations for extracting relevant information on a contribution agreement basis, since the information is spread throughout different departmental financial modules and folders.

The introduction of Merlin Version 11i is making possible the establishment of a comprehensive central information database on contribution agreements. When all contribution information fields will be populated, a possible tool for managers will be to run a pre-programmed report which would access the various modules and folders in the departmental financial system, allowing linkages of key information fields required to perform an adequate analysis of contributions.

At this time, there is no pre-programmed report to perform this function. The Financial Services Directorate analyst responsible for developing this program confirmed that it is feasible, but it has not yet been done. In the absence of such a pre-programmed report from Merlin, managers should compile their own information. Such a pre-programmed report on contribution agreements, relating key information fields, would also assist other users, such as auditors and financial analysis.

A list of all contributions with key information fields is an essential element for managers to assess risks and identify contribution recipients that will be audited during the upcoming fiscal year.

## 6.2 Proposed Risk Assessment Methodology

As indicated above, program managers require a starting point, a database providing comprehensive information on contributions, including pre-selected key information fields. Using the database as a starting point, managers would apply a three-step approach to identify contribution recipients to possibly visit and audit:

- (a) **high level criteria** to select a broad sample of contribution recipients who would be the subject of more examination, such as a generic document review;
- (b) **comprehensive criteria** to provide a narrower selection of contribution recipients to possibly visit and audit;
- (c) **site visits** to evaluate risks in key areas.

- a) The **high level criteria** could be applied to data viewed from Discover reports or other databases on contribution recipients, to the extent that any are made available in Environment Canada's services and regions. The **high level criteria** would be as follows:
  - Contribution agreements where there is a significant financial limit or large annual cash flow to the same recipient;
  - Significant number of projects with the same recipient;
  - Significant number of projects for the same recipient administered by different Environment Canada offices.
- b) The **comprehensive criteria** are examples of possible flags that might warrant a site visit and an audit of a contribution recipient. They would be applied by program managers and would require gaining a better understanding of the recipient and the agreement. This may involve any or all of the following:

- Reviewing the contribution agreement;
- Reviewing claims submitted to date;
- Gaining working knowledge from other program managers who have worked with this recipient;
- Reviewing any past audit reports of the contribution recipient; and
- Ensuring dialogue with the recipient's program or financial personnel.

The *comprehensive criteria* are submitted in Annex I of this report.

- c) **Site Visits** would be performed to contribution recipients selected above, to more closely examine both the program delivery and financial management of the project being funded, in order to evaluate risks in key areas. To support managers in performing site visits, the project team developed suggested financial management questions, submitted in Annex II.

### 6.3 Site Visits to Test the Proposed Methodology

In order to test this methodology for fiscal year 2004-05 contribution recipients, two transactions were selected based on a random judgmental sample from the Ontario Region and the National Capital Region (NCR). The two regions were chosen to limit travel expenses. The project team was unable to apply the high level criteria identified in Section 6.2 since, as explained in Section 4, there was no comprehensive central list of contributions agreements, and the payments database presented information fields in separate modules and folders which were not always populated, and not always linkable into one report. Therefore, due to the absence of a complete centralised database on agreements, the project team selected the sample from the payments report provided, and a limited number of information fields.

Subsequent to the site visits, the project team was able to conclude that the methodology developed performs well and can support program managers in identifying risks related to the management of contribution agreements. Its application can also contribute key information to continual auditing and to the annual departmental risk-based audit and evaluation planning.

## 7 Observations Overview and Suggestions

The testing of the proposed risk assessment methodology allowed the team to identify some issues for consideration related to the management of contribution agreements.

### 1. Improved information on contributions

#### *Observations:*

- At the time of the project, there were considerable limitations to easily extract relevant information on a contribution agreement basis from the departmental financial database modules. There was no comprehensive central list of contributions agreements; the information was reported in separate modules and folders; fields

were not always populated; and the information fields were not all linkable into one report to perform an adequate analysis.

- There was no pre-programmed report in Discover to extract and connect into one report the required information on contributions to perform an adequate analysis. A list of information fields that would assist managers in assessing risks and identifying possible audits have already been provided to Financial Services Directorate to create such a report.

*Suggestions:*

- The introduction of Merlin Version 11i is making possible the establishment of a comprehensive central list of contribution agreements. Services and Regions were asked to populate this mandatory inventory, starting for Fiscal Year 2004-05.
- It is suggested that the Financial Services Directorate develop a comprehensive report on contributions agreements and provide a broad-based and easy access to managers, financial analysts and auditors. The list of information fields already provided by the Audit and Evaluation Directorate can be used as a starting point.

## 2. Active Guidance to Program Managers

*Observations:*

- Very few contribution recipient audits have been performed to date; program managers expressed the need for more support and guidance in the selection and conduct of contribution recipient audits.
- Presently, there is no departmental policy to determine the need for, and conduct of contribution recipient audits; limited guidance is provided via the “*Accountability, Risk and Audit Framework for the Departmental Class Grants and Contributions*” (ARAF) and the “*Environment Canada Manager’s Guide to Grants and Contributions*”.

*Suggestions:*

- It is suggested that a departmental *Contribution Recipient Audit Policy* be developed and implemented, along with a process for determining priorities for contribution recipient audits, including techniques for performing these audits; this policy and process would provide additional guidance and support to program managers.
- Under the umbrella of a departmental *Contribution Recipient Audit Policy*, the following priorities could be considered:
  - the need to clarify roles and responsibilities;
  - the need to provide more active guidance, training and tools to managers (such as the ones proposed in this report);
  - the advantages of implementing an “*Initial Visit*” process - along with a reference manual for conducting such visits;
  - the need for mandatory audits of high risk agreements selected on the basis of objective criteria.



## 8 Management Response from the Financial Services Directorate

The Financial Services Directorate agreed that this methodology represents a good starting point to evaluate risks related to recipients. The departmental grants and contributions management framework, including the audit of contribution recipients, will be entirely reviewed. This new framework will be submitted to the *Executive Management Council (EMC)* when completed.

## 9 Conclusion

The project team developed and tested a methodology to assist program managers in assessing risks as well as determining which contribution recipients should possibly be subject to a site visit and audit, along with the tools to be used in this selection, namely:

- (a) **high level criteria** to select a broad sample of contribution recipients who would be the subject of more examination, such as a generic document review;
- (b) **comprehensive criteria** to provide a narrower selection of contribution recipients to possibly visit and audit;
- (c) suggested **site visits** to evaluate risks in key areas.

As part of this project, the proposed methodology and tools have been tested with two contribution recipients. It was found that the methodology performs well and can support program managers in identifying risks related to the management of contribution agreements, and in determining which recipients should be possibly visited and audited. Its application can also contribute key information to continual auditing and to the annual departmental risk-based audit and evaluation planning. In the end, the testing allowed the team to identify some observations for consideration and suggestions related to the management of contribution agreements.

The Financial Services Directorate agreed with this methodology as a starting point and indicated their intent to review entirely the departmental grants and contributions management framework, including the audit of contribution recipients, for submission to the *Executive Management Council (EMC)* when completed.



## Annex I Comprehensive Risk Assessment Criteria to identify contribution recipients to possibly visit and audit

The following comprehensive criteria are examples of possible flags that might warrant a site visit and an audit of a contribution recipient.

### ***Considerations vis-à-vis the Financial Aspects of the Agreement***

- Projects that have large expenditure amounts for certain line items such as rent, travel, third party services or project deliverables, reoccurring monthly administrative fees, service fees, professional fees, etc;
- Projects where actual expenditures are exactly the same as the planned budget;
- Agreements where there have been amendments to increase the budgeted spending under the contract;
- Any agreements for large dollar amounts;
- Complexity of funding arrangements ( several contributors/shared costs);
- Signs that advances requested by the recipient are greater than the project needs or periods covered; and
- Contribution recipients exhibit signs of weak cash-flow or budget management.

### ***Considerations vis-à-vis the Recipient: Mission, Organization & Management***

- Any contribution recipients whose objective is to make profit;
- Financial viability of the recipient, and its degree of independence vis-à-vis Environment Canada's funding;
- Contribution recipients who have experienced substantial job turnover in program personnel or management;
- Contribution recipients who have experienced substantial job loss;
- Contribution recipients who have weak financial and administrative controls;
- Contribution recipients who have either the same shared telephone number, fax number, address, email address or same administrative/management contacts; and
- Contribution recipients who have the same telephone numbers but different addresses.

### ***Considerations vis-à-vis the Agreements: Delivery and Claims***

- Contribution to recipients who act as brokers and engage third parties for delivering results (beneficiaries/sub-contractors);
- Contribution agreements where the same subcontractor appears;
- Contribution agreements that appear to be split;
- Projects of high risk or complex nature;
- Contribution recipient demonstrating non-compliance with terms of the contract;
- Contribution recipients who submit claims, operational or financial reports that are often late;
- Contribution recipients who often submit claims that are incomplete or incorrect;
- Contribution recipients who submit claims that contain figures that are rounded-off; and
- Contribution agreements that may be renewed, where an audit might be advisable.

### ***Considerations vis-à-vis Environment Canada Managers' Offices***

- Contribution agreements in Environment Canada's offices where a large amount has been issued with either the same supervisor, program manager and/or recipient;
- Contribution agreements in Environment Canada's offices where the following exists:
  - there are no segregation of duties;
  - there are no signs of financial monitoring;
  - the skills sets in that office are not capable of conducting proper financial monitoring; and

- Regional or National offices are not being consulted or involved;
- Environment Canada sits on the Management Board of the recipient;
- Contribution recipients previously audited by the department where there were adjustments or concerns;
- Contribution agreements with recipients new to Environment Canada; and
- Contribution agreements or recipients that had never been audited in the past, but where there has been a long standing relationship with the department.

## Annex II Suggested Financial Management Questions for Site Visits

*Site Visits* would be performed to contribution recipients previously selected using the comprehensive criteria provided in Annex I, to more closely examine both the program delivery and financial management of the project being funded, in order to evaluate risks in key areas. To support managers in performing site visits, the project team developed the following suggested financial management questions.

<b>Background</b>
Is this the first agreement with Environment Canada? If no, <ul style="list-style-type: none"> <li>○ When were other agreements awarded?</li> <li>○ What were the objectives?</li> <li>○ What was the approximate dollar amount?</li> </ul>
Have any of the past agreements ever been audited by Environment Canada? If yes, <ul style="list-style-type: none"> <li>○ When?</li> <li>○ What were the findings and conclusions?</li> </ul>
Can you provide a brief background to this agreement (i.e. the expected outcomes and deliverables)?
How many people work on this agreement?
Do people assigned to this agreement also work on other contracts or projects?
Did someone from Environment Canada explain the terms and conditions of the agreement, specifically the basis of payment?
Can you explain the nature of your in-kind contributions, if any?
Was this contract ever amended? (term, dollar value, etc).

<b>Financial Management</b>
<b><i>Expenditure Controls</i></b>
Who approves all expenditures for this agreement?
Who registers these expenditures in financial records and corresponding claims?
Who has cheque signing authority?
Is there an internal signing authority organization chart, and what would be the signing authority limits?
If there are any changes required (changes in personnel and rates, changes in spending, eligibility of certain expenses, etc), can you explain the process of approval?

**Accounting and Reporting**

Do you maintain separate general ledger accounts for costs associated with this agreement? If not, please explain?

Do you have accounting policies for staff and program managers to follow?

Do you prepare monthly financial statements?

Do you have a designated accountant preparing your submissions and organization's accounting?

**Common Cost Allocation and Cost Eligibility**

Are there any common costs that are allocated to this project?

If yes,

- What method is used to allocate these costs to the project?

Does your organization maintain timesheets for staff working on this agreement?

Do you own or lease the premises?

If you lease,

- Who is the landlord?
- Is the landlord a related party?

Do you allocate leased space costs in your claims and what is the basis?

Do you track in-kind contributions?

If yes,

- What system do you have in place?
- What basis do you use to value these in-kind contributions?
- How are they reported to Environment Canada?

Are any capital assets purchased to conduct the project?

If yes,

- Was a procurement policy followed?
- What is the expected disposition of the equipment?

Do you use other individuals or organizations to perform services or provide goods?

If yes,

- Do you have a procurement policy in place?
- If you do use consultants, are there any mark-ups on their invoices?

Are travel expenses incurred on this contract?

If yes,

- Are you aware of Treasury Board directives/guidelines on Travel?
- How travel expenses are being claimed?
- Is a travel expenses report used?
- Are travel invoices submitted?
- What is the basis of travel expenses eligibility?

**Claims**

Do you submit claims monthly?

When was the last claim submitted?

Are claims submitted based on costs incurred or payments in advance of costs incurred?

Do you maintain original invoices to support these expenses?

Have you had any claims challenged by Environment Canada?

If yes,

- What was challenged?

Do you have an internal quality control process to review claims prior to payment, to ensure their compliance with the terms and conditions of the agreement?

**Bank Account**

Do you have a separate bank account for this contribution agreement?

How is interest on the account reported to Environment Canada?

Do you perform bank reconciliations?

If yes,

- What is the frequency?
- Which month is currently complete?

**Access to Documentation**

Please provide us access to

- the general ledger for this agreement
- financial records and corresponding claims
- timesheets
- common cost invoices and cost allocation calculation
- claims and documents substantiating claims
- monthly or periodic financial statements for the project
- monthly or periodic reconciliations of expenditures and claims
- bank reconciliations for the project
- tracking of in-kind contributions
- internal signing authority organization chart, and what would be the signing authority limits
- procurement policy, internal audit process or quality control process and any financial management policies that apply to these claims

**Preliminary Review of Records****Questions for record Analysis – not for Interview**

What is the overall state of the records and claims files?

What is the overall tidiness of the accounting office?

Do reports used to identify and calculate eligible costs and substantiate the claim

- appear to be properly completed? (reports such as time sheets, common cost allocation, depreciation, etc)
- present full days being charged all the time or just partial time?

Do records indicate that

- a substantial amount of work is being performed by subcontractors?
- subcontractors provide services on a regular basis?

Are there large expenditure amounts for certain line items such as:

- rent?
- travel?
- third party services or project deliverables?
- re-occurring monthly administrative fees, service fees, and professional fees?



## Annex III Documentation

### Central Agencies

- *Guide on the Audit of Federal Contributions - Part I & II: Policy, and Suggested Approaches and Procedures*, Treasury Board Secretariat, September 1<sup>st</sup> 1982.
- *Policy on Transfer Payments*, Treasury Board Secretariat, June 1<sup>st</sup> 2000.
- *Risk-Based Audit Framework Guide (RBAF Guide)*, Treasury Board Secretariat, February 6<sup>th</sup> 2004.
- *Guide on Grants, Contributions and Other Transfer Payments*, Treasury Board Secretariat, July 1<sup>st</sup> 2002.
- *Risk-Based Audit Framework Guide (RBAF Guide) - Process for Planning Recipient and Internal Audits*, Treasury Board Secretariat, February 6<sup>th</sup> 2004.
- *A Framework for Identifying Risk in Grant and Contribution Programs*, Office of the Auditor General of Canada, in collaboration with Industry Canada, November 1<sup>st</sup>, 2000.
- 2001 Report of the Auditor General of Canada – Chapter 4 Voted Grants and Contributions.

### Environment Canada

- *Manager's Guide to Grants and Contributions*, Environment Canada, June 2004.
- *Environment Canada Accountability, Risk and Audit Framework for the Departmental Class Grants and Contributions" (ARAF)*, in the context of the renewal of terms and conditions for the classes grants and contributions beginning April 1, 2004 and ending March 31, 2009; March 2004.
- *Evaluation Plan for Grants & Contributions - Results for the Scoping Phase*, Report approved by Departmental Audit and Evaluation Committee (DAEC), January 8, 2004.
- *Environment Canada Report on Plans and Priorities for 2003-2004*.
- *Environment Canada 2004-05 Main Estimates Part II*.
- *Environment Canada Performance Report For the period ending March 31, 2003*.
- *Audit of Grants and Contributions Classes 301, 302, 304 & 305*, Report approved by Departmental Audit and Evaluation Committee (DAEC) May 2003.
- *Audit and Evaluation of Class Contributions in Support of Environmental & Sustainable Development Projects Report*, approved by Departmental Audit and Evaluation Committee (DAEC) March 6, 2002.

### Other Government Departments

- *NRCan Guide to Auditing Recipients of Contribution Programs*, Natural Resources Canada Audit & Evaluation Directorate, June 2003.
- Spot audit program developed by another government department relative to Grants & Contributions.
- Policy and procedures on audit of contributions, and more specifically on recipient audits, as provided by another government department interviewed.
- *Human Resources Development Canada (HRDC) Grants and Contributions Directives and Guidelines - Appendix 3*, January & February 2000.

- *HRSDC Grants and Contributions Assessment of Dormant File Review Report Appendix 4, March 2001.*
- *HRDC The 1999 Internal Audit of Grants and Contributions.*
- *Strengthening Grants and Contributions at HRDC Action Plan Summary, February 2000.*
- *Natural Resources Canada Assessment of Class Grants and Contributions, February 2002.*
- *Canadian Heritage Audit of Single Recipient Contribution Programs - Summary of Findings - TV5, August 2003.*