

2009



Report of the
**Auditor General
of Canada**
to the House of Commons

SPRING

Chapter 6
Selected Contribution Agreements—
Natural Resources Canada



Office of the Auditor General of Canada

The Spring 2009 Report of the Auditor General of Canada comprises a Message from the Auditor General of Canada and seven chapters. The main table of contents for the Report is found at the end of this publication.

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Chapter

6

Selected Contribution Agreements—
Natural Resources Canada

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Selected Contribution Agreements— Natural Resources Canada

Main Points

What we examined

Natural Resources Canada (NRCan) seeks to enhance the responsible development and use of Canada's natural resources and the competitiveness of Canada's natural resources products. It devotes a significant portion of its budget to grants and contributions, some of which are administered by its Office of Energy Efficiency. In fiscal year 2007–08, NRCan's voted grants and contributions accounted for over \$211 million, of which \$28 million or 13 percent was in the Office of Energy Efficiency program area.

Between April 2003 and March 2005, NRCan's Office of Energy Efficiency entered into five contribution agreements with three private sector organizations to deliver programs designed to address greenhouse gas emissions in the transportation sector. The total amount disbursed under the five agreements was about \$5.9 million.

At the request of NRCan senior management, the Department's internal auditors carried out audits of the five agreements. The audits identified material breaches of the terms and conditions of the contribution agreements, which NRCan brought to our attention in August 2006.

We examined NRCan's actions in entering into and managing these five contribution agreements and also considered whether controls the Department now has in place would be adequate to prevent recurrences of the matters identified in the Office of Energy Efficiency program area.

Our conclusions relate only to the management practices and actions of public servants. The policies and requirements to which we refer apply only to public servants and not to private sector consultants or organizations. We did not audit the records of private sector consultants or organizations. Consequently, our conclusions cannot and do not pertain to any practices that private sector consultants or organizations followed or to their performance.

Why it's important

The government has many ways to pursue public policy objectives, including transfer payments to individuals, organizations, and other levels of government. Contributions are transfer payments that are subject to performance conditions specified in a contribution agreement with the recipient. The recipient must show that it is meeting the performance conditions in order to be reimbursed for specific costs over the life of the agreement. The government can audit the recipient's compliance with the performance conditions.

The terms and conditions specified in a contribution agreement detail the government's expectations of the recipient of the funds. It is important for government to establish compliance with these terms and conditions in order to ensure that it is achieving the intended results of the agreement. Similarly, an essential control over the expenditure of public money is contained in section 34 of the *Financial Administration Act*, which requires certification that amounts are paid in accordance with the terms and conditions of an agreement.

It is important that government business be conducted openly and fairly, and that conflicts of interest, in fact and in appearance, be avoided.

What we found

- Before signing the five contribution agreements, NRCan knew that a consultant who had provided services to the Department relating to the contribution programs would also be working for the organizations that received NRCan funding under these programs. In our view, this is a conflict of interest that NRCan did not identify.
- Payments totalling about \$3.2 million that NRCan made under the contribution agreement with CEEA Transport were not in accordance with the terms and conditions of the agreement. Similarly, payments to the Canadian Energy Efficiency Alliance and the Canadian Natural Gas Vehicle Alliance were not in accordance with the terms and conditions of their contribution agreements. The Department also did not satisfy its obligation under section 34 of the *Financial Administration Act*, which, in the case of a contribution agreement, requires certification that amounts are paid in accordance with the terms and conditions of the agreement.
- In response to the findings of its internal audits, NRCan has since implemented a number of changes and improvements in its management practices for contribution agreements. However, the practices still do not include adequate independent monitoring to ensure that the management of contribution agreements respects the requirements of the *Financial Administration Act*, the Treasury

Board of Canada Policy on Transfer Payments, and the Department's own policy and practices governing contribution agreements. Nor has the Department developed policies and guidance on conflict of interest in contribution agreements to prevent recurrences.

The Department has responded. The Department agrees with both of our recommendations. Its detailed responses follow each recommendation in the chapter.

Introduction

6.1 The government has many ways to pursue public policy objectives, including legislation and regulation; information and advice; and transfer payments to individuals, organizations, and other levels of government, to carry out activities that support its objectives. Transfer payments to individuals and to organizations are generally made as grants or as contributions.

6.2 Contributions are conditional transfer payments. They are subject to performance conditions specified in a contribution agreement between the department and the recipient. The recipient must continue to show that it is meeting the performance conditions in order to be reimbursed for specific costs over the life of the agreement. The government can audit the recipient's compliance with the agreement's performance conditions.

Selected contribution agreements managed by Natural Resources Canada

6.3 In 2003, the government approved a measure called the Commercial Transportation Energy Efficiency and Fuels Initiative as part of its efforts to reduce greenhouse gas emissions. The Initiative included the National Fleet Challenge. Also in 2003, the government approved the Natural Gas Vehicle Market Transformation Measure, intended to increase the demand for natural gas vehicles, reduce their upfront cost in urban fleet applications, and improve economies of scale for vehicle manufacturers. Natural Resources Canada (NRCan) was authorized to enter into contribution agreements with organizations that would carry out both programs.

6.4 Between April 2003 and March 2005, NRCan's Office of Energy Efficiency signed five contribution agreements with three organizations to carry out the two programs. Three agreements were signed with the Canadian Natural Gas Vehicle Alliance (CNGVA) under the Natural Gas Vehicle Market Transformation Measure for a total of \$2.2 million. An agreement was signed with the Canadian Energy Efficiency Alliance (CEEA) in the amount of \$298,000 and an agreement was signed with CEEA Transport (CEEA-T) worth \$6.9 million, both under the National Fleet Challenge. All amounts were disbursed to the recipients under the CNGVA and CEEA contribution agreements. The actual amount paid by NRCan under the CEEA-T agreement for work performed up to the date of the agreement's early termination on 19 July 2006 was \$3.5 million.

6.5 In August 2005, at the request of NRCan senior management, these five contribution agreements were audited by NRCan's internal auditors. The audits identified material breaches of the terms and conditions of the contribution agreements. In August 2006, NRCan informed the Office of the Auditor General of its concerns regarding these five contribution agreements.

Focus of the audit

6.6 We examined NRCan's management of the five contribution agreements to determine the process by which they were issued and to review the actions NRCan had taken as a result of its internal audit findings. We also considered whether the changes the Department made to its control and management practices in the affected program area as a result of the internal audits would be adequate to prevent a recurrence of similar problems.

6.7 It should be noted that our conclusions about management practices and actions refer only to those of public servants. The policies and requirements to which we refer apply only to public servants and not to private sector consultants or organizations. We did not audit the records of the private sector consultants or organizations. Consequently, our conclusions cannot and do not pertain to any practices that private sector consultants or organizations followed or to their performance.

6.8 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Selecting the recipients of contributions

Natural Resources Canada did not identify a conflict of interest

6.9 We expected that Natural Resources Canada (NRCan) would exercise due diligence in selecting and approving recipients of transfer payments through contribution programs, in accordance with the Treasury Board of Canada Policy on Transfer Payments.

6.10 We found that a consultant provided services to NRCan relating to two contribution programs. That consultant also provided services to organizations that received funding from NRCan under those contribution programs.

6.11 Specifically, in 2003, NRCan entered into contracts with Bronson Consulting Group (Bronson) to develop a proposal for the Natural Gas Vehicle Market Transformation Measure. The Department also entered into contracts with Bronson to develop fleet strategies and delivery infrastructure for the National Fleet Challenge. Bronson retained the services of a consultant, Peter Middleton, to carry out some of this work. NRCan paid at least \$110,000 to Bronson for the consulting services of Mr. Middleton and/or his company (Conseillers Messier Middleton) under these contracts.

6.12 Conseillers Messier Middleton was also retained by the Canadian Natural Gas Vehicle Alliance (CNGVA) to provide services related to the three contribution agreements that it received under the Natural Gas Vehicle Market Transformation Measure. Before it signed these contribution agreements, NRCan knew that Mr. Middleton would be working for CNGVA under the agreements.

6.13 Similarly, Mr. Middleton and/or his company participated in the development of draft funding proposals for the Canadian Energy Efficiency Alliance (CEEA) and CEEA Transport (CEEA-T), which eventually received contribution agreements with NRCan under the National Fleet Challenge. For one of these organizations, CEEA-T, Mr. Middleton signed the \$6.9 million contribution agreement as the organization's President.

6.14 Before it signed the contribution agreement with CEEA-T, NRCan knew that Mr. Middleton had provided services to the Department under the previously mentioned contracts with Bronson for the National Fleet Challenge, and that he would be signing the contribution agreement as CEEA-T's President.

6.15 After the contribution agreement between NRCan and CEEA-T was signed, CEEA-T retained the services of Conseillers Messier Middleton to assist with the implementation of the National Fleet Challenge. The contract with Mr. Middleton's company provided that up to \$712,000 could be paid for professional services.

6.16 In our view, the facts outlined above constitute a conflict of interest. NRCan knew of these circumstances and permitted the conflict of interest to occur by the way that it managed the contracts and contribution agreements. NRCan did not identify any of these circumstances as a conflict of interest.

Compliance with authorities**Natural Resources Canada made payments to recipients that were not in accordance with the five contribution agreements**

6.17 We expected that the Department would follow the government-approved terms and conditions of the contribution programs, the contribution agreements, the requirements of the Treasury Board of Canada Policy on Transfer Payments, and the requirements of the *Financial Administration Act* in managing and administering the five contribution agreements.

6.18 In August 2003, the government approved the contribution programs that permitted NRCan to enter into the contribution agreements with CEEA-T, CEEA, and CNGVA. The government's approval included a requirement that NRCan determine that applicants for a contribution agreement possess the management, financial, and technical resources to fulfill the proposed undertaking. Three weeks before signing the CEEA-T contribution agreement, NRCan was advised by Mr. Middleton (CEEA-T's first President) that the organization would have a potential shortfall of \$450,000 because certain expenses were not eligible for reimbursement. When it signed the contribution agreement, NRCan knew that CEEA-T did not have other confirmed sources of funding that could cover the potential shortfall. This calls into question whether CEEA-T had the financial resources to complete the project, as required by the terms and conditions that had been approved by the government. Nevertheless, NRCan signed the contribution agreement with CEEA-T.

6.19 In August 2005, NRCan senior management became aware that CEEA-T was not complying with some of the terms and conditions of the contribution agreement. In particular, CEEA-T had not made payments to some of its subcontractors before submitting claims to NRCan for payment as required by the contribution agreement. To that date, NRCan had paid \$1.1 million to CEEA-T under the agreement, and there was sufficient evidence available to NRCan to establish that CEEA-T was insolvent. NRCan did not monitor or assess CEEA-T's financial resources and ability to complete the project on an ongoing basis. Despite the evidence available to establish CEEA-T's insolvency, NRCan paid a further \$1.3 million to CEEA-T between September 2005 and March 2006. The Department advised CEEA-T not to incur expenses after 31 March 2006. NRCan officially terminated the contribution agreement on 19 July 2006.

6.20 The Department believed that CEEA-T's subcontractors deserved payment for the work they had performed. We found that, motivated by its desire to ensure that the subcontractors were treated

fairly, to ensure that work of value was compensated, and to avoid the potential for costly litigation, NRCan devoted a great deal of effort to assessing the extent and value of all the work performed by CEEA-T and its subcontractors over the period of the agreement to the date of termination. Based on that assessment, and after taking into account the payments it had already made to CEEA-T, NRCan issued additional payments to CEEA-T, totalling around \$1.1 million, with the expectation that the money would be used to pay eligible amounts claimed by CEEA-T's subcontractors. In our view, under this approach, there was a risk that the funds would not be used by CEEA-T to pay its subcontractors.

6.21 We reviewed the payment process to determine whether the Department made the payments in accordance with the terms and conditions of the five contribution agreements. Overall, \$3.5 million of the total \$6.9 million contemplated under the CEEA-T agreement was disbursed. We found that approximately \$3.2 million in payments to CEEA-T had not been made in accordance with the terms and conditions of the contribution agreement. Similarly, we found that NRCan made payments to CEEA and CNGVA that were not in accordance with the terms and conditions of their contribution agreements.

6.22 We also found that the Department considered, but did not implement, other available options to resolve payment issues surrounding the CEEA-T contribution agreement. Options considered included the possibility of entering into new contribution agreements, amending the existing contribution agreements, or making payments that would be consistent with the Treasury Board of Canada Policy on Claims and Ex Gratia Payment.

6.23 Under section 34 of the *Financial Administration Act*, the department official with the authority to confirm entitlement for payment must certify that the recipient is eligible for or entitled to the payment. As such, it is an essential control over the expenditure of public money. This certification requirement was not satisfied because the payments discussed above were not made in accordance with the terms and conditions of the contribution agreements.

Departmental controls

Changes made in response to internal audit findings may not prevent a recurrence

6.24 We expected that the departmental controls for managing and monitoring contribution agreements implemented after the internal audits would be adequate to prevent recurrences of the issues identified by the audits.

6.25 We found that when concerns about the contribution agreements were identified in August 2005, NRCan initiated internal audits of the five agreements. These audits highlighted several problems, including material breaches of the terms and conditions of the contribution agreements, and incomplete selection and monitoring processes and practices for contribution agreements used in the program area at the time. The Department recognized these problems and, in response to internal audit recommendations, implemented a number of new practices and processes that were designed to improve the management controls with respect to contribution agreements, including

- forming a Transfer Payment Review Committee composed of senior officials mandated to provide corporate direction in the selection, design, implementation, and performance monitoring of transfer payment programs;
- improving the tracking systems for contribution agreements, which flag important milestones to the Director General responsible for the program area;
- developing standard templates for drafting agreements; and
- increasing training for program officials in the area of transfer payments.

6.26 We note, however, that the Office of Energy Efficiency program area remains responsible for selecting which recipients of contribution agreements will be audited and it still does most of the monitoring.

6.27 We also found that NRCan's current Departmental Policy on Transfer Payments and its Values and Ethics Framework documents are silent on conflict of interest situations for private sector consultants and for contribution agreements. They are also not supplemented by guidance for staff. We found that the new practices and processes still do not require an assessment of whether a conflict of interest exists when determining a recipient's eligibility for contribution agreements.

6.28 Recommendation. Natural Resources Canada should develop policies and guidance to identify and address conflict of interest situations noted by our audit.

The Department's response. Agreed. Natural Resources Canada (NRCan) respects and adheres to the Values and Ethics Code for the Public Service and the Treasury Board of Canada Policy on Transfer Payments. It acknowledges that, in this isolated case, certain departmental officials failed to identify the potential for conflicting interests with possible advantages for private sector recipients.

When this error was brought to the attention of senior management, numerous corrective actions were taken, including the four action areas identified in paragraph 6.25 of this report. NRCan will continue to develop new guidance and procedures to assist staff in preventing conflict of interest situations involving contribution agreements. Some new measures currently under development will be introduced in 2009.

6.29 Recommendation. Natural Resources Canada (NRCan) should ensure that the management of contribution agreements, and compliance with them by both parties to the agreement, is monitored independently from outside the program area.

The Department's response. Agreed. NRCan is committed to full compliance and improved management regarding all of its contribution agreements. As noted in this report, upon the advice of its internal auditors in 2006, NRCan promptly implemented a series of measures to improve the management and controls surrounding its contribution agreements. Another important measure was the creation of the Centre of Expertise, outside of the program areas, to provide advice and guidance on contribution agreements. In addition, senior management initiated a full review of the five agreements subsequently examined by the Office of the Auditor General (OAG) to ensure and confirm that every dollar spent was for work of value. This review, completed in 2007, confirmed that work of value was completed and that no money was lost. The Department further recognizes and supports the OAG recommendation that the remaining step to improving the management, monitoring, and reporting of contribution agreements is the requirement for independent monitoring from outside the program area. NRCan is developing and will implement a regime for independent monitoring of its contribution agreements.

Conclusion

6.30 A consultant who provided services to Natural Resources Canada (NRCan) relating to particular contribution programs also provided services to organizations after they received NRCan funding under these programs. In our view, this represents a conflict of interest. NRCan knew, before signing the five contribution agreements, that the consultant would be working for these organizations. NRCan did not identify this as a conflict of interest.

6.31 In the contribution agreements with the Canadian Energy Efficiency Alliance, the Canadian Natural Gas Vehicle Alliance,

and CEEA Transport, payments were made by NRCan that were not in accordance with the terms and conditions of the contribution agreements and therefore did not satisfy the requirements of section 34 of the *Financial Administration Act*.

6.32 Changes that NRCan has since implemented in its management practices for contribution agreements in the Office of Energy Efficiency program area do not include adequate independent monitoring from outside the program area to ensure that contribution agreements comply with the *Financial Administration Act*, the Treasury Board of Canada Policy on Transfer Payments, as well as NRCan's Departmental Policy on Transfer Payments. The Department has not developed policies and guidance on conflict of interest for private sector consultants and for contribution agreements to prevent recurrences.

About the Audit

All of the audit work in this chapter 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.

Objectives

The audit focused on the way Natural Resources Canada (NRCan) managed five contribution agreements. The specific objectives were

- to determine whether the Department had proper policies and procedures to avoid conflict of interest situations in issuing contribution agreements;
- to determine whether the Department identified and addressed a conflict of interest situation while setting up these five selected contribution agreements;
- to determine whether the Department had the authority to make payments under the contribution agreements using an approach that was based on an assessment of the value of work provided by recipients and their subcontractors; and
- to determine whether the Department's new management and monitoring practices for contribution agreements are adequate to prevent recurrences of the issues identified in the Office of Energy Efficiency program area.

Scope and approach

Our work consisted of obtaining documentation, conducting interviews, and analyzing data relating to NRCan's management of five contribution agreements. Our audit took place between June and November 2008.

We did not re-audit the selected contribution agreements, conduct audits of recipient organizations of these five contribution agreements, or increase the scope of the audit to include other contribution agreements within NRCan. We did not assess the deliverables under these contribution agreements.

The audit did not assess the performance or the qualifications of private sector consultants or organizations. No comments in the report should be construed as criticism of any private sector consultant or organization.

Criteria

Listed below are the criteria that were used to conduct this audit and their sources.

Criteria	Sources
Selecting the recipients of contributions	
We expected that Natural Resources Canada exercised due diligence in selecting and approving recipients of transfer payments and in managing and administering programs.	<ul style="list-style-type: none"> • Treasury Board of Canada Policy on Transfer Payments, 2000, section 7.1.1 • Treasury Board of Canada Contracting Policy, 2003, section 16.11.5 • Values and Ethics Code for the Public Service, 2003, Chapter 1: Statement of Public Service Values and Ethics • Natural Resources Canada Departmental Policy on Transfer Payments
We expected that Natural Resources Canada has policies and procedures in place to ensure that transfer payments are made to organizations that meet the eligibility and entitlement criteria.	<ul style="list-style-type: none"> • Treasury Board of Canada Policy on Transfer Payments, 2000, section 7.2.1
Compliance with authorities	
We expected that Natural Resources Canada has effective financial and program controls that are designed and carried out within its transfer payment programs.	<ul style="list-style-type: none"> • Treasury Board of Canada Policy on Transfer Payments, 2000, section 7.1.1 • Terms and conditions of the contribution agreements between Natural Resources Canada and the recipients of the contributions • Terms of the Contribution Program approved by the government • The <i>Financial Administration Act</i>, section 16.4
We expected that Natural Resources Canada disbursed funds approved under the contribution agreements in accordance with the <i>Financial Administration Act</i> and the contribution agreements.	<ul style="list-style-type: none"> • Treasury Board of Canada Policy on Transfer Payments, 2000, section 7.5.1 (v) and (vi) • Contribution agreements, section 5 • The <i>Financial Administration Act</i>, section 34
Departmental controls	
We expected that Natural Resources Canada's new management and monitoring practices in the Office of Energy Efficiency program area for contribution agreements are adequate to prevent recurrences of the issues identified in this program.	<ul style="list-style-type: none"> • Treasury Board of Canada Policy on Transfer Payments, 2000, sections 7.1, 7.2, 7.5, 7.11, 8.3, 8.5, and 9.1 • Natural Resources Canada Departmental Policy on Transfer Payments, section 6

Audit work completed

Audit work for this chapter was substantially completed on 5 November 2008.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 6. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Departmental controls	
<p>6.28 Natural Resources Canada should develop policies and guidance to identify and address conflict of interest situations noted by our audit. (6.24–6.27)</p>	<p>Agreed. Natural Resources Canada (NRCan) respects and adheres to the Values and Ethics Code for the Public Service and the Treasury Board of Canada Policy on Transfer Payments. It acknowledges that, in this isolated case, certain departmental officials failed to identify the potential for conflicting interests with possible advantages for private sector recipients. When this error was brought to the attention of senior management, numerous corrective actions were taken, including the four action areas identified in paragraph 6.25 of this report. NRCan will continue to develop new guidance and procedures to assist staff in preventing conflict of interest situations involving contribution agreements. Some new measures currently under development will be introduced in 2009.</p>
<p>6.29 Natural Resources Canada (NRCan) should ensure that the management of contribution agreements, and compliance with them by both parties to the agreement, is monitored independently from outside the program area. (6.24–6.27)</p>	<p>Agreed. NRCan is committed to full compliance and improved management regarding all of its contribution agreements. As noted in this report, upon the advice of its internal auditors in 2006, NRCan promptly implemented a series of measures to improve the management and controls surrounding its contribution agreements. Another important measure was the creation of the Centre of Expertise, outside of the program areas, to provide advice and guidance on contribution agreements. In addition, senior management initiated a full review of the five agreements subsequently examined by the Office of the Auditor General (OAG) to ensure and confirm that every dollar spent was for work of value. This review, completed in 2007, confirmed that work of value was completed and that no money was lost. The Department further recognizes and supports the OAG recommendation that the remaining step to improving the management, monitoring, and reporting of contribution agreements is the requirement for independent monitoring from outside the program area. NRCan is developing and will implement a regime for independent monitoring of its contribution agreements.</p>

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