



Agriculture and
Agri-Food Canada

Agriculture et
Agroalimentaire Canada



Audit of the Hog Farm Transition Program

FINAL REPORT

Office of Audit and Evaluation

April 27, 2010

Canada 

The Agriculture and Agri-Food Canada Audit Committee recommended this audit report for approval by the Deputy Minister, on April 27, 2010.

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EXECUTIVE SUMMARY

Over the last three years, Canadian hog and pork producers have struggled with a number of significant crises. In the spring of 2009, the Canadian Pork Council (CPC), on behalf of the industry sought assistance from the Government of Canada to facilitate producers exiting the industry. In response, in August 2009, the government announced the Hog Farm Transition Program (HFTP, the Program); a contribution program that would provide financial assistance to producers that committed to leave the industry for a minimum of three years in order to ensure the decline in hog production in Canada reaches an economically sustainable level.

The Treasury Board approved Terms and Conditions which provided Agriculture and Agri-Food Canada (AAFC) the authority to enter into a Contribution Agreement with the CPC to deliver, administer and implement the Program. The CPC, in turn, contracted with a third party service provider to administer the Program on the CPC's behalf.

The total cost of the program is \$82 million over five years and consists of \$75 million for payments to producers, \$4.9 million to the CPC for the cost of administering the program and \$2.6 million in departmental operational costs. The bulk of the spending (\$80M) will occur in the 2009/10 and 2010/11 fiscal years.

In November 2009, an audit of the HFTP was approved as an addition to the AAFC Risk-Based Audit Plan. The objective of the audit was to provide assurance that the governance, risk management and control frameworks for the program are adequate during the early stages of the program lifecycle and provide a reasonable expectation that funds will be used for their intended purpose and that the planned outcomes for the Program will be achieved.

The audit, conducted between January and March 2010, concluded that the governance, risk management and control frameworks developed and implemented for the Program are adequate to provide a reasonable expectation that funds will be used for their intended purpose and that planned outcomes will be achieved. Controls are in place over Program payments, and payments are made in accordance with the provisions of the contribution agreement, Program Terms and Conditions, the Treasury Board Policy on Transfer Payments, and the Financial Administration Act.

The audit did note, however, that a comprehensive analysis of options for program delivery models, recipient eligibility and transfer payment instruments available to meet program objectives was not documented. In addition, the Program did not undertake and document an analysis to determine the appropriate level of recipient administration that would be required to support the Program. As well, the CPC entered into a high dollar value contract with a third party service provider on a sole source basis in contravention of the Contribution Agreement.

1.0 Introduction

1.1 Background

For the three years prior to the spring of 2009, Canadian hog and pork producers struggled with significant crises which included: a strong Canadian currency, record-high feed prices, circo-virus disease, rising energy costs and low pork prices around the world. The outbreak of the Influenza A H1N1 virus in the spring of 2009 resulted in continuing depressed hog prices.

In the spring of 2009, Canada's pork and hog industry sought financial assistance from the federal government to cope with this crisis. In June 2009, the CPC presented a strategic transition plan to the Minister of Agriculture which highlighted that the industry had changed and that producers seeking to exit the industry required transitional assistance.

In response to this request, the Minister of Agriculture and Agri-Food sought and received approval from Cabinet and Treasury Board to establish the HFTP during the summer of 2009. The Program was made retroactive to April 1, 2009. The Program would assist the hog sector with an orderly transition to new market realities by providing compensation to those producers who stopped producing hogs for a minimum three year period in order to ensure the decline in hog production in Canada reaches an economically sustainable level. The total approved cost of the program is \$82 million over five years and consists of \$75 million for contribution payments to producers, \$4.9 million to the CPC for the cost of administering the program and \$2.6 million in departmental operational costs. The bulk of the spending (\$80M) will occur in 2009/10 and 2010/11.

Under the HFTP, producers are required to submit bids to cease hog production and establish a timeline in which their existing herds will be disposed of. A national auction or tendering system is held that allows producers to propose the minimum amount of assistance they are willing to accept to cease future production. These amounts are based on the individual producer's size, their type of production and their bid rate. There is an obligation that the facility remains out of production for three years even if the ownership of the production facility should be transferred to another owner.

Once a bid has been accepted, producers commit to cease producing hogs within a specified period from the time their bids are accepted. In order for orderly marketing to occur, compensation payments may be advanced to producers who make a business case that their production will be stopped over an extended period of time; otherwise, compensation payments are paid only upon confirmation that the producer is no longer producing hogs.

It was originally intended that a series of transition payment auctions would be held over the 2009-10 and 2010-11 fiscal years; however, as a result of the fourth auction held in March 2010, all of the Program's contribution funds have now been committed and no

additional auctions will be held. Program funding will, however, continue until March 31, 2014 in order to cover the Program's ongoing administration and audit verification processes that are required to be undertaken.

AAFC negotiated a contribution agreement with the CPC to deliver the Program. The agreement assigned responsibility to the CPC for the following: establishing and operating an auction or tendering process; registering producers and verifying records; monitoring and reporting on program activities; and verifying and distributing program funds to producers. The CPC, in turn, engaged the services of an independent third party service provider to be responsible for the auction process including the determination of the purchase price and the calculation of payments to producers. The service provider was also assigned responsibility for managing all financial and auditing requirements and inspection of producers' facilities.

In November 2009, an audit of the HFTP was approved as an addition to the AAFC Risk-Based Audit Plan.

1.2 Audit Objective

As a program under development audit, the objective of the audit was to provide assurance that governance, risk management and control frameworks are adequate during the early stages of the program lifecycle and would provide a reasonable expectation that funds will be used for their intended purpose and that planned outcomes will be achieved.

1.3 Audit Scope

The audit examined the risk, governance, and management control frameworks currently in place to support the implementation of the HFTP.

After having determined the specific lifecycle stage to which the Program and individual agreements had advanced, the audit examined the risks and controls related to the following program level areas:

- Program design and approval
- Program implementation and
- Program monitoring and reporting

and the following contribution agreement level areas:

- Eligibility and evaluation
- Agreement development and awards and
- Agreement monitoring and reporting.

The period under review was from project inception to March 2010. The scope of the audit excluded the audit verification processes and procedures undertaken by the CPC and the third party service provider as it is the responsibility of program management to ensure that these are undertaken in agreement with the Program's and the contribution agreement's terms and conditions.

1.4 Audit Approach

The audit, including the planning phase, was carried out between January 2010 and March 2010 and was conducted in accordance with the *Standards for the Professional Practice of Internal Audit* and the Treasury Board (TB) *Policy on Internal Audit*. These standards require that the audit be planned and performed in such a way as to obtain reasonable assurance that audit objectives were achieved.

The audit included various tests, as considered necessary, to provide such assurance. Audit criteria used to develop the required audit tests were based on Agriculture and Agri-Food Canada's audit criteria for Grant and Contribution Programs. These tests included interviews, observations, review of supporting documentation, sampling of financial transactions and conduct of analytical reviews.

The schedule for the audit was as follows:

Planning Phase	January to February 2010
Conduct Phase	February to March 2010 and
Reporting Phase	March to April 2010

During the planning phase, risks related to the governance and management of the HFTP were identified and assessed. The risk assessment was developed from information derived from:

- interviews with managers and staff responsible for the program design and development and implementation of the HFTP
- review of relevant program documentation and
- analysis of program processes.

Information that emerged from the planning phase led to the development of the HFTP audit program and also served to clarify the audit scope and objectives for the conduct phase of the audit.

Audit work performed included:

- Review of relevant program documentation including but not limited to: Program Terms and Conditions, the AAFC Performance Management Strategy, the program applicant guidelines, and program policies, procedures and work tools

- Interviews with managers and staff in Ottawa in the Farm Financial Programs Branch, the Strategic Policy Branch and the Corporate Management Branch
- Review of relevant program documentation as provided by the CPC and the Program Administrator and
- Review of Section 33 and 34 account verification processes carried out in Ottawa.

1.5 Conclusion

It is the opinion of AAFC's Internal Audit Directorate that based on the results of our audit work, the governance, risk management and control frameworks established for the HFTP are adequate to provide a reasonable expectation that funds will be used for their intended purpose and that planned outcomes will be achieved. Controls are in place over Program payments, and payments are made in accordance with the provisions of the contribution agreement, Program Terms and Conditions, the Treasury Board *Policy on Transfer Payments*, and the *Financial Administration Act*.

Our examination revealed, however, that there is an opportunity for improvement in a few areas when AAFC is designing and obtaining approval for a new program. The opportunities are discussed in Section 2.0 of the report.

1.6 Statement of Assurance

In the professional judgment of the Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the opinion provided and contained in this report.

The opinion is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria that were agreed on with management. The opinion is applicable only to the entity examined. The evidence was gathered in compliance with TB policy, directives and standards on internal audit, and the procedures used meet the professional standards of the Institute of Internal Auditors. The evidence has been gathered to be sufficient to provide senior management with the proof of the opinion derived from the internal audit.

Original signed by:

Graham Barr
A/Chief Audit Executive

Date

1.7 Acknowledgements

The Office of Audit and Evaluation would like to thank those individuals who contributed to this project and, in particular, departmental interviewees who provided insights and comments useful to this audit.

2.0 Detailed Observations, Recommendations and Management Responses

2.1 Program Design and Approval

The *Directive on Transfer Payments* requires that departmental managers with responsibility for the design or redesign of a transfer payment program are to assess a number of elements in the design of these programs and document evidence of their consideration. These elements include the identification of eligible recipients, determination of funding levels and the rationale used in the selection of the appropriate transfer payment instrument. In addition, the Treasury Board's *Guide to Preparing Treasury Submissions* requires that for new or updated initiatives, the rationale for the program design is to be explained.

In designing the HFTP, the Department faced tight deadlines to develop and implement a program that would be responsive to the needs of the industry. Although program management discussed a number of program delivery options, a comprehensive analysis of the possible program delivery models (e.g. direct vs. third party, contribution arrangement vs. contract for service delivery), eligibility criteria and transfer payment instruments available to meet program objectives was not documented in the design of the Program.

In addition, the Terms and Conditions (Ts & Cs) of the HFTP specified that AAFC will transfer a maximum of \$4,916,864 to the CPC for the delivery and administration of the HFTP. Discussions with the Program indicated that these costs were based on the CPC's experience in administering the Cull Swine Breeding Program, an AAFC program similar in design to the HFTP. No detailed information or analysis was available, however, as to how these costs were determined.

Such analysis by program management would have assisted the Department in ensuring that the Program met AAFC priorities in the most efficient and effective manner possible.

Recommendation:

In the future, the ADM, FFPB and the ADM, Strategic Policy should ensure a comprehensive analysis is conducted and documented to support decisions on delivery models, recipient eligibility, transfer payment instruments and the required levels of funding for recipient administration.

Management Response: Agreed

While Program Management did carry out an assessment of various delivery and transfer payment models and believes the option selected was the best and most cost effective available given the program objectives and extremely short timelines for implementation, it agrees that there should have been more comprehensive documentation on the delivery and transfer payment options that were considered

and on the justification for the options selected, including estimates of program delivery costs associated with the delivery models analyzed.

Action Plan

- 1) Management will ensure that all staff are aware of these requirements and lessons learned by incorporating them into the next version of the Department's mandatory training module for program staff administering Grants and Contribution Programs.

Lead Responsible

ADM FFPB

Target Date for Completion

December 31, 2010

- 2) The Centre of Program Excellence (COPE) will inform all branches of this recommendation through the Grants and Contributions Working Group, which includes program development and delivery staff throughout AAFC.

Lead Responsible

ADM FFPB

Target Date for Completion

May 15, 2010

- 3) Strategic Policy Branch will ensure that delivery and transfer payment options are considered in the development of the program implementation plan contained in the Memoranda to Cabinet (MC) by including this type of analysis as a standard operating procedure when developing an MC. The analysis will be included as part of the MC or otherwise documented through a note to file.

Lead Responsible

ADM Strategic Policy Branch

Target Date for Completion

May 15, 2010

2.2 Agreement Monitoring and Reporting (Compliance)

Although the contribution agreement with the CPC required that “the Recipient shall only award contracts or hire personnel using a fair and competitive process”, a large dollar value contract was entered into with a third party service provider on a sole source basis.

To assist it in the delivery of the HFTP, the CPC contracted with a third party service provider on a sole source basis to be the administrator of the Program. As the administrator of the Program, the service provider was assigned responsibility for the auction process including the verification of the purchase price and the calculation of payments to producers. The service provider was also assigned responsibility for managing all financial and auditing requirements associated with the Program. The service provider was selected based, in part, on its experience in administering the Cull Swine Breeding Program.

The Department was aware of the CPC’s intention to sub-contract the bulk of the Program’s administration and included a clause in the Contribution Agreement requiring that a competitive process occur. However, the contract was awarded to the third party service provider on a sole source basis.

Recommendation:

In the future, the ADM, FFPB should ensure that contracting by recipients (including delivery agents) for the acquisition of significant goods and services is undertaken through a fair and open competitive process or other generally-accepted sound business process.

Management Response: Agreed

Management agrees that the recipient did not undertake a competitive process to select an administrative service provider as stipulated in the Agreement. The clause in the agreement was not appropriate for the circumstance and needed to provide for other sound business processes to select a competent and qualified service provider.

The service provider selected by the CPC was assessed as the most competent, qualified and a reasonable-cost provider and best able to implement the program quickly. This was based on the successful and cost effective delivery of a similar program with the same end recipients and similar delivery and verification processes. The selected service provider was able to provide initial program information to producers within three weeks and commence the tendering process within two months of the program’s announcement.

Action Plan

- 1) The Department's current template Agreement for Grants and Contributions Programs has been amended to authorize recipients to use either a fair and competitive or other justifiable and sound selection processes.

Lead Responsible

ADM FFPB

Target Date for Completion

Completed

- 2) Management will ensure that all staff are aware that it is the responsibility of the recipient to use fair and competitive or otherwise justifiable and sound selection processes that result in competent and qualified contractors and personnel working on the project or activities and that Program Management will verify with particular recipients, using a risk-based approach that such processes are occurring or have occurred. This will be achieved by including the change in the next version of the Grants and Contributions training module.

Lead Responsible

ADM FFPB

Target Date for Completion

December 31, 2010

- 3) COPE will inform all Branches of this recommendation through the Grants and Contributions Working Group.

Lead Responsible

ADM FFPB

Target Date for Completion

May 15, 2010

Appendix A - Audit Criteria

<p>1. Program Design and Approval - The program is designed based on an actual need, in alignment with defined Departmental mandate and priorities, and is appropriately approved. Expected outcomes, and data collection requirements in support thereof, are well established</p>
<p>2. Program Implementation - Appropriate policy and procedures, resources, systems and supporting tools are developed at the program level to facilitate consistent implementation of the program and to promote the achievement of program objectives.</p>
<p>3. Program Monitoring & Reporting - Sufficient monitoring and oversight activities are conducted on a timely basis by program management to promote the achievement of program objectives. Identified issues that adversely impact program objectives are addressed in a timely manner.</p>
<p>4. Eligibility/Evaluation - Funding requests are assessed in a timely, fair and transparent manner. Only eligible recipients and activities are approved for funding and only at a level consistent with the financial need, expected benefits or results, and risks.</p>
<p>5. Agreement Development - Formal agreements, containing complete, appropriate and compliant terms and conditions, are established with the recipient on a timely basis.</p>
<p>6. Agreement Monitoring and Reporting - Activities are monitored to ensure compliance with program terms and conditions and with the funding agreement. Payments are made only upon fulfillment of requirements</p>