

Follow-up to the Audit and Evaluation of Class Grants and Contributions

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Acronyms used in the report

ARAF	Accountability, Risk and Audit Framework
DAEC	Departmental Audit and Evaluation Committee
FAA	Financial Administration Act
FY	Fiscal Year
G&Cs	Grants and Contributions
QA	Quality Assurance

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EXECUTIVE SUMMARY

In 2001, Audit and Evaluation carried out a combined audit and evaluation of *Class 303: Contributions to support Environment and Sustainable Development Projects*. Subsequently in 2003, they completed an audit of the grants and contributions (*Classes 301: Grants to Support Environmental Research and Development, 302: Contributions to Support Environmental Research and Development, 304: Contributions to Increase Awareness & Understanding of Environmental and Sustainable Development Issues and 305: Contributions to Support Canada's International Commitments*). In response to these assignments, the Financial Services Directorate endorsed an action plan that included a number of corrective measures. This follow-up exercise was undertaken to assess the implementation of these corrective measures.

Specifically, management committed to provide Program Managers with better training and access to information and support in managing G&C agreements. Furthermore, management also committed to develop and implement tools (checklists, forms, templates, etc.) to ensure that the approval process for recipients was rational and transparent; to assist Program Managers in the development of a consistent approach and strategy for monitoring the progress of G&C agreements; and to assist them with recipient risk assessment. Finally, management committed to undertake a review of the functionality of existing financial system modules in order to determine where improvements could be made.

Due to the similar nature of the two previous assignments, it was decided that their follow-ups would be combined. This was identified as a priority for 2004-05 under the 2004-2007 Audit and Evaluation Plan approved by the Departmental Audit and Evaluation Committee (DAEC) on July 22nd, 2004.

The follow-up was undertaken to determine the adequacy, effectiveness and timeliness of actions taken by management in response to the recommendations resulting from the initial audits and evaluation. Two main areas were assessed: program management and process improvement.

The scope of the exercise was department-wide and included all programs offering class grants and contributions. Specifically, it examined G&Cs transactions from the beginning of FY 2004-05 (up to and including January 19th, 2005), under the newly approved classes in effect as of April 1st, 2004.

The methodology included a review of the audit reports and management responses. It included a review of a sample of grants and contributions financial files selected across all regions and all programs. It also included a series of interviews with program managers (12 Program Managers selected across all regions) and a series of interviews with Financial Officers exercising payment authority (under Section 33 of the Financial Administration Act) from all five regions and the National Capital Region. An interview with the Financial Planning & Resource Analysis Division of the Financial Services Directorate was also conducted to gain additional knowledge of its plan for the development of a G&C Management Framework.

The review of selected records entailed the examination of a small sample of 25 grant and contribution files for which payments had been made in 2004-2005. The sample size chosen was not statistically representative of the total population of G&Cs; however, measures were taken to ensure adequate level of coverage of G&Cs, by types of recipients, regions, classes, and amounts (levels of funding).

Auditors concluded that solid progress has been achieved with respect to the management of grants and contributions. The department, through the efforts of the G&C Champion, Program Managers, Regional Financial Officers and the Financial Planning & Resource Analysis Division in HQ, has worked toward improving different aspects of the G&C Management Framework. For instance, Program Managers have attested to a positive changing environment with respect to how G&Cs are managed. They acknowledge that greater accountability and stewardship is expected of them in the administration of G&Cs. They indicated spending more time on contribution agreements, in terms of establishing the activities to take place and in negotiating performance management plans with recipients. However, auditors concluded that, currently, there is room for further improvements to the management framework. In particular, Program Managers have indicated a need for more precision and direction with respect to the management of G&Cs.

The Financial Planning & Resource Analysis Division is currently developing a G&C Management Framework to further the management of G&Cs as well as to correct certain weaknesses identified in the current process. There are a few areas that need greater attention. For instance, training and awareness of managers on all facets of the G&C management process is essential. The Division must also strengthen certain aspects of the monitoring component of the framework. This includes active monitoring exercised by Program Managers on an ongoing basis during the life of a project. The monitoring exercised by Financial Officers must also be strengthened to provide assurance that an appropriate verification system of expense claims exists before approval of payments under Section 33 of the FAA. Lastly, the Division must develop a means to obtain greater assurance as to the recipient's financial system for accounting on the disbursement of funds and the effectiveness of their system of internal controls. Very little exists currently to provide such assurance to the department.

Finally, a number of isolated issues need to be addressed as part of the development of the G&C Management Framework, including the use of Order-in-Councils, the increased use of collaborative arrangements, and the proper valuation of in-kind contributions.

In our professional judgement, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusions contained in this report. The conclusions were based on a comparison of the situations as they existed at the time the follow-up audit was undertaken with the management responses provided to each of the audit and evaluation recommendations of the two previous engagements.

Recommendations:

General Management Response

We are in agreement with the findings and the recommendations of this report. As the report notes, we have been developing a Grants and Contributions Management Framework that we expect will address all the areas of concern noted in the report. We are anticipating obtaining senior management approval of the framework this autumn, with implementation of some elements beginning in January 2006 and with all elements of the framework being rolled out by 2007-08. Our responses to the recommendations as provided below detail the elements of the Management Framework being developed.

Grants and Contributions Management Framework:

The Chief Financial Officer should:

- a) Develop a training program aimed at various levels (Senior Management, Program Managers, Administrative Assistants, and Financial Officers) with a focus on new Program Managers. This training program should involve several courses addressing various topics surrounding the management of G&Cs and be offered to all regions on an ongoing basis;

Management Response:

Finance agrees that training is a key component of the Grants and Contribution Management Framework. Finance is in the process of creating a Centre / Network of Expertise that will be responsible for developing, maintaining and updating appropriate training programs so that they are available and offered on an ongoing basis.

- b) Strengthen the approval process (including consultation with legal services) and internal monitoring by Regional Financial Services by providing sufficient resources to monitor the quality of the grants and contributions files as specified in the Manager's Guide on G&Cs; and

Management Response:

Finance agrees that the approval process and internal monitoring should be strengthened. The Framework being proposed, defines the life cycle management of an agreement into seven stages which include assessment, recommendation and approval, and monitoring.

- c) Introduce a Recipient Audit Program with the necessary funding.

Management Response:

Within the context of the Framework, Finance is proposing to implement, though a Centre of Expertise, a program of recipient audits beginning in 2006-07. Finance agrees that a centrally led and funded program of recipient audits is the most appropriate approach for the department.

Common Approach to FAA Section 33 and 34 Sign off for G&Cs:

The Chief Financial Officer should:

- a) Implement a process whereby the department would gain assurance for the recipients' system to account for the disbursement of funds and the effectiveness of their internal controls. There are various ways of achieving this goal including:
 - o On-site visits to review financial systems and information;
 - o Requiring recipients to forward supporting documentation and proof of payments made (as a percentage of the total value of the claim);
 - o Requesting recipients to conduct and report on the results of any external audits undertaken and their degree of compliance with the Contribution Agreement with EC; and
 - o Implementing a Recipient Audit Program.

Management Response:

Finance agrees that there are various ways to achieve this goal and notes that the ways must be adaptable to the capacity of the recipient and the nature of the initiative. Finance has included a number of measures in the proposed Framework that will strengthen the department's capacity to gain assurance for the recipients' systems and the effectiveness of their internal controls.

To that end, tools will be developed and will be accompanied by guidelines (and the training referenced above) that will outline best practices for different types and capacities of recipient organizations and assist the manager in tailoring requirements to the specific recipient capacity. Guidelines and documented processes will be provided including more detailed information on monitoring approaches and their use in assessing recipient capacity and compliance with the agreement.

The capacity of Financial Management Advisors to assist managers in performing these responsibilities and in assessing the adequacy of systems and controls also will be enhanced through the Framework.

- b) Implement a Contribution Verification Checklist to be completed by the Program Manager to document the verification steps that the manager has carried out prior to approving the claim(s) under Section 34 of the FAA;

Management Response:

The Framework will include a process to be followed by the Program Manager to attest to progress against set objectives and compliance with requirements of the agreement prior to providing Section 34 certification. Signature of Section 34 will also be supported by a verification of expenditures incurred to date, in support of further funding disbursement.

- c) Develop a training package focusing on Program Managers' responsibilities for ensuring the appropriateness of entitlements of recipients to receive payment under

Section 34 of the FAA. The training package could be based on the training developed by the Prairie and Northern Region and should be offered to all Program Managers across the department.

Management Response:

As noted above, the Framework will include an extensive national training component to be introduced in 2006-07 in support of the new approach and processes; this element will be included in the training.

- d) Implement the Regional Financial monitoring program referred to in Section 20 of the Manager's Guide to G&Cs, which would provide assurance on the quality of the documentation maintained on file.

Management Response:

Finance believes that once the Framework is fully implemented and a dedicated case management system is in place, the quality and sufficiency of documentation on file will be maintained at a consistently high level.

- e) Implement an Audit Checklist, which would be completed by the Financial Officer to document the verification steps that the officer has carried out prior to authorizing payment under Section 33 of the FAA.

Management Response:

In conjunction with the measures identified in the response to Recommendation 1b and 2b, Finance will implement a verification process to be followed and documented by the Financial Officer to support payment authorization under Section 33 of the FAA.

Process for Aligning G&C Results with Board Objectives:

The Chief Financial Officer should:

- a) Ensure that the key components of the Accountability, Risk and Audit Framework (ARAF) are integrated into the Manager's Guide on G&Cs; and

Management Response:

Finance agrees with the intent of the recommendations, however, we believe that the need to be able to demonstrate clear linkages from individual projects to Departmental results is not limited to the class contributions and that there is an opportunity to update our approaches given the evolution of the Department since the preparation of the ARAF.

- b) Ensure that training is provided to Program Managers regarding key aspects of the ARAF (i.e. risk assessment; monitoring, reporting, recipient audits).

Management Response:

One of the key elements of the Framework will be the assessment stage where program managers will be required to assess proposals against a risk matrix. The results of the assessment will allow program managers to establish the level of monitoring to be performed and will serve to identify the requirement to perform a conformity audit (recipient audit).

Finally, the department should ensure that Program Managers have appropriate reporting requirements to meet. This would strengthen the accountability on the part of managers.

Management Response:

The reporting requirement implies that there is a system in place to capture the information. Finance is exploring the adoption of a reporting system to support grants and contributions management at all stages. Finance believes that the combination of these measures together with the implementation of a system capturing the necessary information on results of the performance of individual agreements will strengthen the accountability on the part of managers.

Other Specific Issues:

The Chief Financial Officer should develop specific guidance on these issues and provide guidance to Program Managers as part of developing the G&C Management Framework. Also, an assessment should be made as to whether collaborative arrangements fall under Treasury Board Policy on Transfer Payments. If not, then guidance must be provided on their use.

Management Response:

- *Finance is aware of the concerns with respect to Orders-in-Council and would ideally like to have this requirement addressed through legislative change to the Department of the Environment Act. Finance does not expect, however, that this will occur within the timeframe envisioned for the implementation of the Framework.*

Greater rigour will be achieved through the committee review process, to be introduced in 2006-07, ensuring that no agreement requiring an OIC approval will be processed until the requirements are met.

- *Finance is equally concerned with the potential misuse of collaborative arrangements. To that end, the Framework proposes that the use of such arrangements be curtailed and be subject to the review by the proposed collaborative arrangements committee, beginning in the last quarter of 2005-06. The Framework will include guidance and training on the appropriate use of collaborative arrangements and will be available during 2006-07.*
- *Finance will examine the issue of Formal Request for Payment and provide appropriate direction by the beginning of 2006-07. Intent of the Framework is to cover all of EC programs under a single process that meets TB Policy requirements.*

- *The appropriate acceptance and application of in-kind contributions is a complex issue that has challenged most contribution funding departments. Through Finance and the proposed national committee on collaborative arrangements processes for funding arrangements, particular attention will be paid to identifying agreements with an "in-kind" component and evaluate their appropriateness. Depending on the results of the evaluation of a number of proposals over a period of six months, it will be determined whether specific direction can be incorporated in the Framework or whether an internal audit is required to further document the extent of practices.*

1.0 INTRODUCTION

1.1 Background

In 2001, Audit and Evaluation carried out a combined audit and evaluation of *Class 303: Contributions to support Environment and Sustainable Development Projects*. Subsequently in 2003, they completed an audit of the grants and contributions (*Classes 301: Grants to Support Environmental Research and Development, 302: Contributions to Support Environmental Research and Development, 304: Contributions to Increase Awareness & Understanding of Environmental and Sustainable Development Issues and 305: Contributions to Support Canada's International Commitments*). In response to the recommendations made, the Financial Services Directorate endorsed an action plan that included a number of corrective measures. This follow-up exercise was undertaken to assess the implementation of the corrective measures.

In 2003, the department amalgamated classes 303 and 304 and the terms and conditions of all classes of grants and contributions were reviewed and approved by Treasury Board. At the same time, the department also developed an Accountability, Risks and Audit Framework (ARAF) for all class grants and contributions.

Recently, the Financial Services Directorate started developing a G&C Management Framework. These subsequent events have been taken into consideration in the conduct of this follow-up exercise.

1.2 Objective(s)

Due to the similar nature of the two previous audit assignments, it was decided that their follow-ups would be combined. This follow-up audit was identified as a priority for 2004-05 FY under the 2004-2007 Audit and Evaluation Plan that was approved by the Departmental Audit and Evaluation Committee (DAEC) on July 22nd, 2004.

The follow-up was undertaken to determine the adequacy, effectiveness and timeliness of actions taken by management in response to the recommendations resulting from the initial audits and evaluations. Two main areas were assessed: program management and process improvement.

1.3 Scope

The scope of the exercise was department-wide and included all programs offering class grants and contributions. Specifically, it examined G&Cs transactions from the beginning of FY 2004-05 (up to and including January 19th, 2005) under the newly approved G&Cs classes that were in effect as of April 1st, 2004.

1.4 Methodology

The methodology to carry out the follow-up audit included a review of the audit reports and management responses. It included a review of a sample of grants and contributions' financial files selected across all regions and all programs. It also included a series of interviews with program managers (12 Program Managers were interviewed across all regions) and a series of interviews were undertaken with Financial Officers exercising payment authority (under Section 33 of the Financial Administration Act) from all five regions and the National Capital Region. An interview with the Financial Planning & Resource Analysis Division of the Financial Services Directorate was also conducted to gain additional knowledge of its plan for the development of a G&C Management Framework.

The review of selected records entailed the examination of a small sample of 25 grant and contribution files for which payments had been made in 2004-2005. The sample size chosen was not statistically representative of the total population of G&Cs; however, the following measures were taken to ensure adequate level of coverage of G&Cs:

- Inclusion of all four classes (G01, G02, G03 and G05);
- Inclusion of both large and small G&Cs amounts;
- Inclusion of all regions; and
- Inclusion of different types of recipients (cities, universities, NGOs, individuals, etc.).

We excluded from our sampling criteria the following types of agreements:

- Agreements under which Canada is providing regular/ongoing funding to large international organizations in pursuit of Environment Canada's program objectives.
- Agreements under which no payments were scheduled to be made in the FY 2004-5 (including Sub-Class 379); and
- Agreements, under which payments were scheduled to be made, yet had not been made as of January 19th, 2005 (including Sub-Class 312).

2.0 FINDINGS AND RECOMMENDATIONS

2.1 Grants and Contributions Management Framework

The two previous audit and evaluation reports presented several findings on the development and implementation of a contribution agreement. More specifically, the audit concluded that there was a clear need to improve training and awareness of departmental managers and staff; a need to make the project selection process more transparent; improve project monitoring and record keeping; improve access to financial information relative to specific agreements, as well as to make more visible the linkage between grants and contributions and the realization of program and business lines goals and objectives (now Board results). Audit and Evaluation had recommended that the Financial Services Directorate improve the consistency of G&Cs training, especially for managers new to the transfer payment process; improve the administration of G&Cs,

including enhancing the level of assurance that G&Cs selection was in line with the TBS Policy on Transfer Payment; the development of a department-wide approach for monitoring G&Cs agreements; and improving the capability to track and query payments made under specific agreements.

The Financial Services Directorate formulated the following response and commitment to implement corrective measures addressing each finding related to the G&C Management Framework:

Training - All managers would have easy access to information on managing G&C agreements through specialized training, an Intranet site with electronic tools and forms and personal assistance from the Financial Advisors.

Awareness and Support – The completion of Appendix G to the Manager’s Guide (Contribution Agreement Template) would be mandatory for all agreements. The form “Class Grant and Contribution Approval” would be completed by all managers to describe the approval process and rationale for selecting the recipient. This form would require that managers provide the selection criteria against which potential recipients were evaluated and how a final decision was reached. The mandatory use of the G&C Agreement Management Checklist was also cited as being another tool by which the department would ensure that a manager’s choice of a recipient was rational and transparent.

Monitoring – In 2003, it also became mandatory for managers to use the G&C Agreement Management Checklist. This tool was developed to assist managers in developing a consistent approach and strategy for monitoring the progress of G&C projects and for assessing risks. This obligation would be continuously reinforced by financial advisors and would be part of the training program of the department. A G&C Management Monitoring Plan was to be introduced by all regions to provide assurance that checklists would be used consistently by Program Managers and that all information would be maintained on the G&C file.

Tracking and querying capabilities – Corporate Finance acknowledged that the existing G&Cs database required improvement and would undertake a process to review the functionality of the existing financial system’s modules (MERLIN).

Results of the Follow-up Exercise:

In general, Program Managers attested to a positive changing environment with respect to how G&Cs are managed. Program Managers interviewed indicated that greater accountability and stewardship was expected of them in the administration of G&Cs. They indicated spending more time on contribution agreements (i.e. establishing activities and results, negotiating performance management plans with recipients, etc.).

The Manager’s Guide on G&Cs was well received by departmental managers and staff involved in the G&C process. Managers interviewed liked the manual and the information it presents. Although some Program Managers questioned its accessibility, many indicated that they were satisfied with the comprehensiveness of the manual. They also indicated that the manual could provide more guidance and detail on the development of activities and performance management plans for contribution

agreements. Future revisions to the manual should also be highlighted so that these changes can be more easily identified by Program Managers.

Finally, the auditors also observed through this follow-up exercise that Regional Financial staff and Regional Managers have established good working relationships – all Regional Managers interviewed indicated that they appreciated the assistance that they are being provided by Regional Financial Officers.

Training – At the end of 2001, the Director of Finance for the Pacific and Yukon Region was appointed “champion” for transfer payments within the department and acted as a corporate source of information and guidance. In the two subsequent years, she organized a first round of training for Program Managers and other individuals who supported the G&Cs process. All managers that we spoke with appreciated and recognized the importance of the training that focussed on the Manager’s Guide on G&Cs. Following this initiative, training on the Manager’s Guide became more infrequent and was only carried out at the request of a specific region or on a special occasion (i.e. conference). Program Managers expressed the need for a more formalized training program that would cover various areas of the G&C management process, such as the need to better understand the financial information provided by the recipient, improve their ability to analyze this information vis-à-vis the corresponding narrative progress reports (to link activities to expenses incurred), and better understand the process leading to the approval of eligibility and entitlement under Section 34 of the FAA. There is also a need for the training program to provide Program Managers with assistance in risk assessment, monitoring of the G&C agreement, and the development and implementation of a recipient audit strategy.

Awareness and Support - The approval process for the selection of the recipient remains a complex issue within the department as several research initiatives require multi-year assistance. Although the contribution agreements are not necessarily multi-year, they are renewed every year until the project is completed. This was the case for several contribution agreements that the auditors reviewed as part of this follow-up exercise [i.e. Atlantic Coastal Action Program, University of Sherbrooke, BIOCAP (initially a 5 year endeavour approved by the Treasury Board), and Zones d’Intervention Prioritaire (where projects were renewed in 2004 for three years)]. Other initiatives are selected through a formal process using specific selection criteria and a selection committee. This was the case for Manitoba Heritage, Simon Fraser University and Okanogan University College and all contributions under the EcoAction and “Intéractions Communautaires”, which the auditors also examined.

The department has introduced an approval process for contribution agreements, based on their total value. The “Class Grant and Contribution Approval Form” requires that the Director of Finance or the Financial Management Advisor approve all agreements greater than \$100K. The audit also determined that some regions require all agreements, regardless of the amount, to be approved by the Regional Financial Planning Division. However, this process is not consistent from one region to another. These processes provide an important challenge function and ensure a more open and transparent selection process. Senior Managers should be exercising a more active challenge role in the approval process.

Monitoring – All Program Managers have indicated that they are exercising regular monitoring of their projects through the review of progress reports; personal contact with recipients to obtain updates on progress (e.g. phone calls to recipients, on-site visits); examining actual results achieved based on a performance management plan and, in some instances, participating in recipients' Board of Directors' meetings. However, some indicated that they lacked the knowledge to assess the financial information received and, at times, involved or relied upon Financial Services to review such information. This was the case for BIOCAP (Queen's University). Within Environment Canada, monitoring is a shared responsibility between the Administration Officer, the Project Officer and the Scientist. However, it was unclear how all three officers were interacting to share the knowledge captured through their monitoring activities. BIOCAP has also put in place its own monitoring system; however, it is unclear how EC's BIOCAP team is taking advantage of this system to complement its own monitoring activities.

The Manager's Guide introduced a requirement for Regional Financial Services to conduct periodic sample audits (monitoring) of Program Managers' files to ensure that all the relevant documents as required in the G&C Agreement Management Checklist were included in the project file. At the time of this audit, this practice was in place in only two regions: Prairie and Northern Region and Pacific and Yukon Region.

The follow-up exercise also found that the department had not undertaken, as part of a global monitoring strategy, recipient audits. When Program Managers or Finance Officers were questioned about recipient audits, several responded that they had not conducted a project risk assessment as required in the ARAF. They also indicated that they had little funding to undertake such recipient audits. Most Program Managers held the view that recipient audits should be undertaken only when irregularities or other significant difficulties in the program are suspected. Corporate Financial Services indicated that it will introduce the requirement for recipient audits as part of its G&C Management Framework.

Tracking and querying capabilities – Corporate Finance introduced a requirement for all grants and contributions to be shown as a commitment in the departmental financial system (MERLIN), effective April 1st, 2004. This was already a common practice in several regions. The Ontario Region encountered some difficulties in completing this exercise, but succeeded in the last quarter of 2004-05. With G&C commitments now being recorded, the tracking and querying capabilities for grants and contributions should improve.

That said, Program Managers do not have access to MERLIN and therefore their query capabilities are limited. When in need of financial information, they ask Regional Financial staff to query MERLIN.

Until recently, no group within the department had been given the responsibility to oversee the management of contribution agreements. Although the Champion for G&Cs had done a great deal to improve the management of contribution agreements, the department needed a specific unit or function to continue the initiative that it had launched previously. The Financial Planning & Resource Analysis Division, under the Financial Services Directorate, was tasked to put in place a framework for managing grants and contributions. Management informed us that they will present a Grants and

Contributions Management Framework to the Executive Management Committee. The auditors commend management's initiative to develop such a framework.

The absence of an overall function managing G&Cs has led to:

- A lack of consistency in the way contribution agreements are managed across a wide range of activities (i.e. challenge process surrounding the selection of the recipient; assessment of risk; sign-off by Financial Services; sign-off surrounding the drafting of the contribution agreement; development of a monitoring strategy; monitoring exercised by Regional Financial Services; and recipient audits);
- Inconsistencies in the use of the Contribution Agreement Template (e.g. ACAP, Queens, EcoAction, Interactions Communautaires); and
- The absence of regular training programs for Senior Managers, Program Managers, Financial Officers, and Administrative Assistants.

Recommendation #1:

The Chief Financial Officer should:

- a) Develop a training program aimed at various levels (Senior Management, Program Managers, Administrative Assistants, and Financial Officers) with a focus on new Program Managers. This training program should include several courses that would address various topics surrounding the management of G&Cs and should be offered to all regions on an ongoing basis;**

Management Response:

Finance agrees that training is a key component of the Grants and Contribution Management Framework. Finance is in the process of creating a Centre / Network of Expertise that will be responsible for developing, maintaining and updating appropriate training programs so that they are available and offered on an ongoing basis.

- b) Strengthen the approval process (including consultation with legal services) and internal monitoring whereby Regional Financial Services would be provided with sufficient resources to monitor the quality of the grants and contributions files as specified in the Manager's Guide on G&Cs; and**

Management Response:

Finance agrees that the approval process and internal monitoring should be strengthened. The Framework being proposed, defines the life cycle management of an agreement into seven stages which include assessment, recommendation and approval, and monitoring.

c) Introduce a Recipient Audit Program with the necessary funding.

Management Response:

Within the context of the Framework, Finance is proposing to implement, through a Centre of Expertise, a program of recipient audits beginning in 2006-07. Finance agrees that a centrally led and funded program of recipient audits is the most appropriate approach for the department.

2.2 Common Approach to Section 33 and 34 Sign off for G&Cs

The two previous audit and evaluation reports recommended a common approach to Section 34 sign-off for G&Cs that would enhance consistency and demonstrate managers' accountability with respect to compliance with the conditions of the agreements and the recipient's entitlement to funding.

The Financial Planning & Resource Analysis Division and Regional Financial Services were to develop a procedure to ensure a more consistent approach to certification under Section 34 for G&C payments. This procedure would require uniformity in coding and would ensure that the required reports are submitted and reviewed prior to payment initiation.

Results of the Follow-up Exercise:

The follow-up exercise concluded that there continues to be a fragmented approach by Program Managers to confirm that recipients are entitled to payment under Section 34 of the FAA, as well as by Financial Officers authorizing payment under Section 33 of the FAA.

Section 34

File reviews and interviews revealed the following:

- The absence of a checklist to attest to the verification points carried out by Program Managers exercising Section 34 (approval of entitlement based on meeting the terms and conditions included in the Contribution Agreement);
- Program Managers within the Pacific and Yukon Region are still using a stamp stating that the payment is entitled under Section 27 of the FAA. The Act was modified more than 10 years ago and Section 27 was replaced by Section 34;
- Under most of the class contribution programs managed by EC, recipients are not obligated to submit supporting invoices with the claim, but must retain these invoices in case there is a recipient audit. As recipient audits are not usually carried out, EC does not know whether recipients are maintaining good financial systems to account for the disbursement of funds received and whether these organizations have effective internal controls.

- On-site visits rarely involve a review of the financial information (i.e. matching invoices to claims);
- Expenses are not systematically reviewed for eligibility. For instance:
 - In the case of the University of Sherbrooke contribution, EC is contributing funds, but is not receiving a global report to demonstrate how expenses are recovered from other donors thereby ensuring that the same expenses are not recovered from several funding organizations;
 - In the case of the City of Kelowna, EC is contributing funds towards a project managed under the “Cash for Clunkers Clean Air Rewards Program”. The Program could be subject to potential abuse as EC is contributing to the incentive component of the program (purchasing vouchers for new bicycles, footwear; inline skates, skateboards, electric assist vehicles, etc.), but no supporting documentation confirming the list of beneficiaries has been requested from the City and matched to participants under the Program. Only general statistics are obtained to attest to the number of participants in the Program.
- Entitlements for advance payments are not always based on supporting cash flow statements. This was the case for the following projects examined: BIOCAP with Queen’s University; Southeast Environment and East Charlotte Waterways;
- Interest earned on funds advanced by EC is not being properly accounted for by the recipient nor is it reflected as part of the approved amount of the contribution (all recipients having received advances);
- In two instances, under the Vehicle Scrapage Program – Cash for Clunkers Clean Air Rewards Program – final payments were made even though the final reports that were required had not been received.
- There is a contradiction between clause 5d and 6b of the Contribution Agreement Template regarding the obligation of the recipient to provide a final report in order to receive final payment. This makes it more difficult for Program Managers to require recipients to demonstrate that the intended objectives/results of the agreement were met prior to issuing final payment.
- Unless specifically identified in the contribution agreement, the effective date is the date of the signature of the contribution agreement. It was noticed in two contribution files examined (University of Sherbrooke and BIOCAP with Queen’s University) that payments reimbursed retroactive activities and disbursements made prior to the effective date.

Auditors learned that the Prairie and Northern Region developed a training course on FAA Section 34 for claim verification. The region put additional information on their local Website to ensure this approval was completed in an appropriate and consistent manner.

Section 33

Auditors also noticed that approval of payment under Section 33 of the FAA was undertaken without Regional Financial Services carrying-out a re-verification of the claim verification system that was followed by the Program Manager (thereby ensuring that Section 34 of the FAA is adequately exercised). TBS Policy on Account Verification requires that a quality assurance process be used to assess the adequacy of the claim verification system and that the QA process be tailored to reflect the risk level of the transactions under review.

NCR and all regions, except PYR and Québec, request that the required financial reports accompany the requests for payment. These reports are subsequently assessed prior to issuing payments. The two remaining regions are not requesting any supporting documents prior to exercising payment authority.

Regions have been fairly autonomous in setting up the approach for processing payments for claims and several Financial Services groups in the regions have reduced their oversight activities over time due to time and resource constraints.

The Financial Planning & Resource Analysis Division and Regional Financial Services have not yet standardized the process across regions for approving payments under Section 33 and for assessing the adequacy of the claim verification system as required by TBS Policy. As a result, the quality of the information received from recipients to support the processing of payments is unknown. There is a risk to the department that it could be paying for ineligible expenses or making payments for which expenditures were not, in fact, incurred.

Recommendation #2:

The Chief Financial Officer should:

- a) Implement a process whereby the department would be assured of the recipients' system to account for the disbursement of funds and the effectiveness of their internal controls. There are various ways of achieving this goal. These include:**
- **On-site visits to review financial systems and information;**
 - **Requiring recipients to forward supporting documentation and proof of payment (as a percentage of the total value of the claim);**
 - **Requesting recipients to conduct and report on the results of any external audits undertaken and their degree of compliance with the Contribution Agreement with EC; and**
 - **Implementing a Recipient Audit Program.**

Management Response:

Finance agrees that there are various ways to achieve this goal and notes that the ways must be adaptable to the capacity of the recipient and the nature of the initiative. Finance has included a number of measures in the proposed Framework that will strengthen the department's capacity to gain assurance for the recipients' systems and the effectiveness of their internal controls.

To that end, tools will be developed and will be accompanied by guidelines (and the training referenced above) that will outline best practices for different types and capacities of recipient organizations and assist the manager in tailoring requirements to the specific recipient capacity. Guidelines and documented processes will be provided including more detailed information on monitoring approaches and their use in assessing recipient capacity and compliance with the agreement.

The capacity of Financial Management Advisors to assist managers in performing these responsibilities and in assessing the adequacy of systems and controls also will be enhanced through the Framework.

- b) Implement a Contribution Verification Checklist to be completed by the Program Manager to document the verification steps that the manager has carried out prior to approving the claim(s) under Section 34 of the FAA;**

Management Response:

The Framework will include a process to be followed by the Program Manager to attest to progress against set objectives and compliance with requirements of the agreement prior to providing Section 34 certification. Signature of Section 34 will also be supported by a verification of expenditures incurred to date, in support of further funding disbursement.

- c) Develop a training package focusing on Program Managers' responsibilities for ensuring the appropriateness of entitlements of recipients to receive payment under Section 34 of the FAA. The training package could be based on the training developed by the Prairie and Northern Region and should be offered to all Program Managers across the department.**

Management Response:

As noted above, the Framework will include an extensive national training component to be introduced in 2006-07 in support of the new approach and processes; this element will be included in the training.

- d) Implement the Regional Financial monitoring program referred to in Section 20 of the Manager's Guide to G&Cs, which would provide assurance on the quality of the documentation maintained on file.**

Management Response:

Finance believes that once the Framework is fully implemented and a dedicated case management system is in place, the quality and sufficiency of documentation on file will be maintained at a consistently high level.

- e) Implement an Audit Checklist, which would be completed by the Financial Officer to document the verification steps that the officer has carried out prior to authorizing payment under Section 33 of the FAA.**

Management Response:

In conjunction with the measures identified in the response to Recommendation 1b and 2b, Finance will implement a verification process to be followed and documented by the Financial Officer to support payment authorization under Section 33 of the FAA.

2.3 Process for Aligning G&C Results with Board Objectives

The audit and evaluation reports identified a need to make more visible the linkage between grants and contributions and the realization of program and business line goals and objectives (now Board results and project outcomes). The previous auditors had recommended that the Financial Planning & Resource Analysis Division, in its capacity to provide guidance for the department's planning and reporting, assist Boards to implement a process to clearly align G&Cs results with Board objectives.

The Financial Planning & Resource Analysis Division had indicated that the department's Report on Plans and Priorities provided sufficient disclosure of planned results. However, they also indicated that disclosure of the actual results achieved relative to planned commitments could be enhanced in the Departmental Performance Report. It had determined that this increased level of disclosure would be feasible after the development and implementation of the Accountability, Risk and Audit Framework that was being finalized in the spring of 2003 when they responded to the second audit report's recommendations.

Results of the Follow-up Exercise:

The follow-up exercise concluded that while an Accountability, Risk and Audit Framework (ARAF) was completed for Class G&Cs, the reporting obligations on specific class contributions remained imprecise. It was also observed that Program Managers were generally not aware of the ARAF and its reporting obligations. More particularly, auditors have observed the following:

- Certain Program Managers interviewed indicated that there were no formal results-reporting obligations to Senior Departmental Management. This was the case for the following contribution projects examined:
 - City of Kelowna - Cash for Clunkers Clean Air Rewards Program;
 - Canadian Environmental Network;
 - BIOCAP at Queen's University (the Program Manager explained that Senior Managers are sitting on the Board of BIOCAP and this could be the reason for no formal reporting obligation);
 - Fur Institute; and
 - Zones d'Intervention Prioritaire.
- Not all programs had systems or an approach in place that could be used to capture results of specific contribution agreements (i.e. ACAP; BIOCAP; ZIP); and

- Other programs such as Eco-Action and Interactions Communautaires had their own database for capturing information reported by recipients;

Program Managers indicated that it was often difficult to capture ongoing results of programs that intended to have long term impacts. This may explain why there was not always a systematic means of capturing the results of all programs. However, some Program Managers indicated that they were not reporting on the results of G&Cs in their portfolio as they had not been requested to do so.

Recommendation #3:

The Chief Financial Officer should:

- a) **Ensure that the key components of the Accountability, Risk and Audit Framework (ARAF) are integrated into the Manager's Guide on G&Cs; and**

Management Response:

Finance agrees with the intent of the recommendations, however, we believe that the need to be able to demonstrate clear linkages from individual projects to Departmental results is not limited to the class contributions and that there is an opportunity to update our approaches given the evolution of the Department since the preparation of the ARAF.

- b) **Ensure that training is provided to Program Managers regarding key aspects of the Class ARAF (i.e. risk assessment; monitoring, reporting, recipient audits).**

Management Response:

One of the key elements of the Framework will be the assessment stage where program managers will be required to assess proposals against a risk matrix. The results of the assessment will allow program managers to establish the level of monitoring to be performed and will serve to identify the requirement to perform a conformity audit (recipient audit).

Finally, the department should ensure that Program Managers have appropriate performance reporting requirements. This would strengthen the accountability of managers.

Management Response:

The reporting requirement implies that there is a system in place to capture the information. Finance is exploring the adoption of a reporting system to support grants and contributions management at all stages. Finance believes that the combination of these measures together with the implementation of a system capturing the necessary information on results of the performance of individual agreements will strengthen the accountability on the part of managers.

2.4 Other Specific Issues

Orders-in-Council – When dealing with provincial governments and its agencies, auditors noted that Orders-in-Councils were not being systematically requested, as required. In the review of 25 contribution agreements, two agreements did not obtain a prior Order-in-Council (City of Kelowna and Okanogan College).

This can be attributed to a lack of awareness and training; the lack of a consistent approval process (Regional Finance approval) for projects valued at less than \$100K; and to some extent, the lack of precision in the Manager's Guide.

It is important that Program Managers be told exactly under which circumstances they need to obtain an Order-in-Council and that they also are given a contact name (in Finance or Legal Services) in order to validate the need for the Order-in-Council.

Collaborative Agreements – Financial Officers expressed some concerns over the use of collaborative arrangements where the Program Manager enters into an arrangement to collaborate on certain projects and EC disburses money to the other party for such projects. Two regions (Québec and Prairie Northern) commented that these arrangements were becoming more and more popular with Program Managers, but that there were no clear procedures to follow in implementing these arrangements. They indicated a need for clarification of the rules pertaining to this instrument.

Formal Request for payment - The Prairie and Northern Region commented during the audit that a practice has evolved with respect to certain programs (i.e. Eco-Action), whereby payments are issued to the recipient without obtaining a claim or another form of request for payment. This issue has recently been brought to the attention of the Financial Planning & Resource Analysis Division for consideration as part of developing a G&C Management Framework.

In-Kind Contributions – Certain regions raised some concerns about in-kind contributions, especially where a recipient is required as a condition of the agreement to confer a financial contribution. These regions indicated that they had difficulties in assessing the true values of such in-kind contributions and would like some guidance in establishing their value.

Recommendation #4:

The Chief Financial Officer should develop specific guidance on these issues and provide guidance to Program Managers as part of developing the G&C Management Framework. Also, an assessment should be made as to whether collaborative arrangements fall under Treasury Board Policy on Transfer Payments. If not, then guidance must be provided on their use.

Management Response:

- *Finance is aware of the concerns with respect to Orders-in-Council and would ideally like to have this requirement addressed through legislative change to the Department of the Environment Act. Finance does not expect, however, that this will occur within the timeframe envisioned for the implementation of the Framework.*

Greater rigour will be achieved through the committee review process, to be introduced in 2006-07, ensuring that no agreement requiring an OIC approval will be processed until the requirements are met.

- *Finance is equally concerned with the potential misuse of collaborative arrangements. To that end, the Framework proposes that the use of such arrangements be curtailed and be subject to the review by the proposed collaborative arrangements committee, beginning in the last quarter of 2005-06. The Framework will include guidance and training on the appropriate use of collaborative arrangements and will be available during 2006-07.*
- *Finance will examine the issue of Formal Request for Payment and provide appropriate direction by the beginning of 2006-07. Intent of the Framework is to cover all of EC programs under a single process that meets TB Policy requirements.*
- *The appropriate acceptance and application of in-kind contributions is a complex issue that has challenged most contribution funding departments. Through Finance and the proposed national committee on collaborative arrangements processes for funding arrangements, particular attention will be paid to identifying agreements with an "in-kind" component and evaluate their appropriateness. Depending on the results of the evaluation of a number of proposals over a period of six months, it will be determined whether specific direction can be incorporated in the Framework or whether an internal audit is required to further document the extent of practices.*

3.0 CONCLUSION

Auditors concluded that solid progress has been achieved with respect to the management of the department's grants and contributions. The department, through the efforts of the G&C Champion, Program Managers, Regional Financial Officers and the Financial Planning & Resource Analysis Division in HQ, has worked to improve different aspects of the G&C Management Framework. For instance, Program Managers indicated that there is a positive changing environment with respect to how G&Cs are managed. They acknowledge that greater accountability and stewardship is expected of them in the administration of G&Cs. They indicated they were spending more time on contribution agreements, establishing the activities to take place and negotiating performance management plans with recipients. However, auditors concluded that, currently, there is room for further improvements to the management framework. In particular, Program Managers have indicated a need for more precision and direction with respect to the management of G&Cs

The Financial Planning & Resource Analysis Division is currently developing a G&C Management Framework to improve the management of G&Cs and to correct certain weaknesses identified in the current process. There are a few areas that need greater attention. For instance, training and awareness of managers on all facets of the G&C management process is essential. The Division must also clarify certain aspects of the monitoring component of the framework. This clarification includes the active monitoring process that is to be exercised by Program Managers on an ongoing basis during the life of a project. The monitoring exercised by Financial Officers must also be strengthened to provide assurance that an appropriate verification system of expense claims exists before approval of payments under Section 33 of the FAA. Lastly, the Division must develop a means to obtain greater assurance as to the recipient's financial system for accounting for the disbursement of funds and the effectiveness of their system of internal controls. Very little evidence currently exists that would provide such assurance to the department.

Finally, a number of isolated issues need to be addressed as part of the development of the G&C Management Framework. These include the use of Order-in-Councils, the increased use of collaborative arrangements, and the proper valuation of in-kind contributions.

In our professional judgement, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusions contained in this report. The conclusions were based on a comparison of the situation as they existed at the time the follow-up audit was undertaken with the management responses provided to the audit and evaluation recommendations of the two previous engagements.