

Audit Report of Environment Canada's Bilateral Cooperation Program for Implementation of the Montreal Protocol

FINAL
March 2007

Report Clearance Steps

Planning phase completed	August 2006
End of conducting phase	November 2006
Report sent for management response	January 2007
Management response received	February 2007
Report completed	February 2007
Report approved by Departmental Audit and Evaluation Committee	March 2007

Prepared by the Audit and Evaluation Branch

Note to reader

In order to simplify things for the reader, we will use "Program" in the following pages when referring to Environment Canada's Bilateral Cooperation Program and "Multilateral Fund" to refer to the "Multilateral Fund of the Montreal Protocol.

Definitions

Contributing Country

A country that participates in the Montreal Protocol and that must make mandatory annual contributions to the multilateral fund and/or that participates in bilateral agreements with other countries (partners).

Partner Country

A developing country that participates in the Montreal Protocol and receives contributions from the Multilateral Fund or from contributing countries (bilateral agreements) to implement projects that will enable it to fulfill its obligations to reduce ozone-depleting substances.

Acknowledgments

The Audit and Evaluation Project Team, under the authority of Stephen McClellan, would like to thank those individuals who contributed in various ways to this audit project, particularly:

- all those interviewed who spent time sharing with us their expertise, thoughts and comments, all of which were essential to this audit; and
- all those who helped to provide the documentation required

The project was led by Bruno Pilotte, along with Abdellah Ismaili, under the direction of Jean Leclerc, Director of Internal Audit.

Original Signed by: _____
Stephen McClellan
Chief Audit Executive

Table of contents

EXECUTIVE SUMMARY	1
1.0 INTRODUCTION.....	3
1.1 Context.....	3
1.2 Objectives	5
1.3 Scope.....	5
1.4 Methodology.....	5
2.0 FINDINGS AND RECOMMENDATIONS	6
2.1 Objective A: Requirements Under Terms and conditions and provisions of the contribution agreements are met.....	6
Recommendation #1	8
2.2 Objective B: Requirements under the Financial Administration Act and Treasury Board Policy on Transfer Payments	10
2.2.1 Financial Administration Act.....	10
2.2.2 Transfer Payment Policy.....	11
Recommendation #2	12
Recommendation #3	14
2.3 Other Findings.....	16
3.0 CONCLUSION	17
ANNEX 1 – AUDIT CRITERIA	18

EXECUTIVE SUMMARY

The Departmental Audit and Evaluation Committee approved the audit plan for Environment Canada's Bilateral Cooperation Program under the Multilateral Fund of the Montreal Protocol in its 2005-2006 plan. Due to other priorities, the project was deferred to the 2006-2007 Audit and Evaluation Plan. This audit engagement is a prerequisite for renewal of the terms and conditions that will expire on March 31, 2007.

The Program is managed by the Bilateral Affairs Division within the Multilateral and Bilateral Affairs Branch. It contributes to results-oriented projects entitled "Management of risks incurred by Canadians and the effects of dangerous substances and pollutants on the air, water, and soil" which is under the Environmental Protection Board responsibility.

The program is responsible for funding and implementing bilateral projects that help partner countries to gradually eliminate their emissions of ozone-depleting substances and thereby fulfill their obligations under the Montreal Protocol.

It benefits from a permanent source of funding of approximately CAN\$2M per year. Of this amount, an annual grant of around CAN\$600K is paid to the Multilateral Fund to cover differential costs for the secretariat. The remaining is paid in the form of contributions to fund bilateral projects with partner countries. The average amount of contributions paid in connection with the Program represents 1% of the total contributions paid by the Department¹.

An evaluation of the program was also conducted concurrently with this audit. The purpose of the evaluation was to examine the results achieved, the efficiency of the design and use of resources, and the continued relevance of the bilateral mechanisms.

The objectives of the audit were to ensure that the Program has been managed in order to meet the requirements under the terms and conditions of the class contributions, the provisions of the contribution agreements, the *Financial Administration Act* and Treasury Board and Environment Canada's policies.

The audit focused on 8 bilateral contribution agreements (out of a total of 15) that were related to bilateral projects that commenced after April 1, 2001. The audit did not cover annual grants to the Multilateral Fund of the Montreal Protocol.

The methodology used for this audit consisted of an analysis of the relevant documentation, a review of the 8 contribution agreements for which there was activity during the period targeted and meetings with the Program managers and employees.

The audit findings show that the requirements under the terms and conditions and contribution agreements have been satisfactorily met.

¹ This amount represents the average of all contribution payments from Fiscal-Years 2001-2002 to 2004-2005 as per the Public Accounts of Canada.

The Program managed the public funds with due diligence. All contribution payments were initiated and certified by a person authorized to do so in accordance with the departmental delegation instrument and the *Financial Administration Act*.

Progress reports submitted by recipients confirmed that expenditures have been made against authorized activities. However, they did not provide enough details on the nature of expenses to confirm that they were eligible under the contribution agreements.

Recommendation 1

In order to ensure that expenses are eligible for reimbursement, Program management should request that recipients indicate in their progress reports the nature of the expenses incurred and/or should include in the contribution files all the information required to provide a reasonable assurance on the eligibility of the expenses.

In general, the contribution agreements were consistent with the Policy on Transfer Payments and included the basic provisions expected. However, the rationale for advance payments was not documented. Moreover, the amount, frequency and year-end processing of advance payments were not always in line with the Policy.

Recommendation 2

When choosing to use advance payments, Program management should ensure that the rationale for that decision is documented. A general explanation may be satisfactory if it applies to all the projects. As well, management must ensure that the amounts and frequency of the advance payments fall within the limits set out in Appendix B of the Treasury Board's Policy on Transfer Payments.

Recommendation 3

Program management should put in place the required controls to ensure that recipients return unused funds at the end of every fiscal year unless an exception in this regard is granted by the Treasury Board Secretariat. Furthermore, payments provided for in contribution agreements and in their amendments, should be limited to expenses that recipients expect to incur in the course of a single fiscal year.

Management Response

The Branch agrees with the recommendation. The report provides a detailed Management response for each of the above recommendation.

1.0 INTRODUCTION

The Departmental Audit and Evaluation Committee approved the audit of the Environment Canada's Bilateral Cooperation Program under the Multilateral Fund of the Montreal Protocol in its 2005-2006 plan. Due to other priorities, the project was deferred to the 2006-2007 Audit and Evaluation Plan. This audit engagement shall be conducted in compliance with the Risk-based Audit Framework developed in 2002.

The audit is a prerequisite for renewal of the terms and conditions for a grant and a class of contributions that will allow Canada to continue to fulfill its international commitments with regard to the Multilateral Fund. The current terms and conditions have been in effect since April 1, 2002 and will expire on March 31, 2007.

An evaluation of the program has also been conducted concurrently with this audit. The purpose of the evaluation is to examine the results achieved, the efficiency of the design and use of resources, and the continued relevance of the bilateral mechanisms. By sampling common projects, the information obtained from the audit and the evaluation will provide a more comprehensive picture of the program.

1.1 Context

The Montreal Protocol on ozone-depleting substances was signed in 1987 by 24 countries and became effective on January 1, 1989. Over 190 countries have now ratified the Montreal Protocol.

The Multilateral Fund was created in 1991 to provide financial assistance to developing countries (partner countries) to gradually eliminate their emissions of ozone-depleting substances and thereby fulfill their obligations under the Montreal Protocol. It is funded by mandatory annual contributions from parties representing developed countries (contributors).

The Montreal Protocol regulations allow Parties that contribute to the Multilateral Fund of the Montreal Protocol to withhold up to 20% of their annual contribution for bilateral cooperation programs with partner countries. The costs of bilateral projects are one way for contributing countries to meet their commitments with regard to the Multilateral Fund.

The Government of Canada has decided to exercise the option to allocate part of its annual contribution to the Multilateral Fund for bilateral cooperation. The Canadian International Development Agency is responsible for paying 80% of Canada's contribution directly to the Multilateral Fund in the form of a grant and Environment Canada is considered to pay the remaining 20% through participation in bilateral agreements with partner countries or in the form of a grant to the MFMP. Any unused balance in the form of bilateral agreements at the end of each year shall be paid to the Multilateral Fund in the form of a grant as Canada's annual contribution.

The MF is replenished every three years. Canada's share of total contributions to the MF has remained constant at 3.1% (0.6% for EC only) for the 2000-2002 and 2003-2005 periods.

The Program benefits from a permanent source of funding of approximately CAN\$2M per year. Of this amount, an annual grant that has historically varied between CAN\$500K and CAN\$800K is paid to the Multilateral Fund to cover differential costs related to locating the secretariat in Montreal rather than at the offices of the United Nations Environment Program in Nairobi. The remaining \$1,2M to \$1,5M is paid in the form of contributions to fund bilateral projects with partner countries or a grant to the Multilateral Fund for the unused funds at the end of the year.

The amount of contributions paid in connection with the Program over the past four years represents only 1% of the total contributions paid by the Department².

The Department is responsible for managing the bilateral projects. Contributions to partner countries may be made in kind (specialized machinery, service contracts for training, etc.) or in cash. The Department may choose to request help from a third party or transfer full responsibility for implementing a project to a third party. The third parties used by the Program to date are the United Nations Environment Program (UNEP) and the United Nations Development Program (UNDP). Thus, the recipient of a contribution agreement could be the government of a developing country or a third party.

The Program objectives are:

- to provide assistance to partner countries to help them honour their obligations under the Montreal Protocol concerning the elimination of ozone-depleting substances (ODS);
- to help strengthen cooperative relationships between Canada and partner countries, particularly those wherein Canada may have a special political, economic or other interest;
- to share and promote Canadian expertise in the field of ozone layer protection; and
- to increase the visibility and reputation of Canada as an active partner on the international environmental scene.

In most agreements, the Program uses the services of the Canadian Commercial Corporation to transfer the funds to the recipients. The Corporation returns unused funds to the Program at the end of every fiscal year.

During the period covered by the audit, the Program was managed by the Technology and Industry Branch, under the Technology Advancement Directorate. The Program is now part of the Bilateral Affairs Division within the Multilateral and Bilateral Affairs Branch. The Program contributes to results-oriented project entitled "Management of risks incurred by Canadians and the effects of dangerous substances and pollutants on the air, water, and soil." The Environment Protection Board is responsible for this results-oriented project.

² This amount represents the average of all contribution payments from Fiscal-Years 2001-2002 to 2004-2005 as showed in the Public Accounts of Canada.

1.2 Objectives

The objectives of the audit were to ensure compliance with:

- A. terms and conditions of the class contributions as well as the provisions of the contribution agreements; and
- B. TBS and Environment Canada's policies and procedures (transfer payments, contracting) as well as the *Financial Administration Act*.

1.3 Scope

The scope of this audit was based on the risks associated with the program and the audit objectives. The audit focused on eight bilateral contribution agreements (out of a total of 15) that were related to bilateral projects that commenced after April 1, 2001 and that were also part of an evaluation of the program. Prior to that date, the Program operated under different terms and conditions. Therefore, it would not be possible to use the current terms and conditions to evaluate agreements that commenced prior to April 1, 2001. The audit did not cover annual grants to the Multilateral Fund.

Projects that have been selected for this audit are:

<u>Country</u>	<u>Project</u>	<u>Recipient</u>	<u>Budget (US\$)</u>
Benin	Refrigerant Management Plan	UNEP ³ & Country	306 117
Bolivia	Refrigerant Management Plan	Country	584 210
Caribbean	Regional Halon Bank Management Plan	UNEP	177 410
Chile	Refrigerant Management Plan	UNDP ⁴	293 800
Cuba	Chlorofluorocarbon Phase-out	Country	522 060
India	Halon Management and Banking Program	Country	270 270
Jamaica	Chlorofluorocarbon Phase-out Management Plan	Country	288 150
Kenya	Strategies for reducing the use of methyl bromide	Country	100 000

1.4 Methodology

The methodology used for this audit consists of:

- analysis of the relevant documentation to provide familiarity with the program, its processes and the controls in place;
- review of the 8 contribution agreements for which there was activity during the period targeted by this audit (including a review of goods and services contracts, if applicable) in order to ensure compliance with the terms and conditions of the class contributions and meticulous management of public funds.
- meetings with the managers and employees responsible, when required.

³ United Nations Environment Programme

⁴ United Nations Development Programme

2.0 FINDINGS AND RECOMMENDATIONS

2.1 *Objective A: Requirements under Terms and conditions and provisions of the contribution agreements are met*

The audit findings indicated that the requirements under the terms and conditions and contribution agreements have been satisfactorily met.

The following paragraphs provide more details on the analysis of criteria used to measure this objective.

Eligible Recipients

The terms and conditions stipulate that recipients that are eligible to receive contributions as part of the Program must be:

- developing countries that have signed the Montreal Protocol and are eligible for assistance under the terms and conditions of the Protocol; or
- third parties such as Canadian or international organizations that have proven their capacity to implement projects in such countries.

All the contribution agreements audited involved eligible recipients, either partner countries or third parties, such as the United Nations Development Programme and the United Nations Environment Programme.

Method of Delivering Assistance

Contributions (in-kind or cash) must be made by:

- companies, agencies or other organizations selected by the Government of Canada to provide the required goods and services. (The goal is to promote Canadian expertise internationally);
- Canadian or international organizations (third parties) with the capacity to implement projects; or
- the governments of partner countries responsible for activities such as organizing training workshops.

All contribution payments under the Program were made by eligible organizations such as the Canadian Commercial Corporation (cash payments) and the United Nations Development and Environment Programmes (in-kind payments), or directly to partner countries.

Supporting Material

In addition to the regular basic documents,⁵ the following documents had to be produced and used as a basis for establishing contribution agreements to reflect the specific features of the Program:

- a project proposal approved by the Executive Committee of the Multilateral Fund, including a work plan, deadlines and the budget;
- a letter from the Multilateral Fund Secretariat to the partner country indicating that Canada has received approval to implement the project; and
- a cash flow forecast.

The audit findings show that the Program manager obtained and kept all the documents required to keep complete records.

Respect for maximum amounts provided for in the terms and conditions as well as in contribution agreements

According to the terms and conditions, contribution agreements must not exceed a maximum amount of CAN\$1M per year, per recipient.

Furthermore, the total amount paid to recipients must not exceed the annual and overall limits provided in the contribution agreements.

In all cases, the amounts provided for in the contribution agreements were well below the maximum amount provided for in the terms and conditions. The average amount provided in the agreements associated with the eight projects audited was approximately US\$222K.

The annual amount provided for in a contribution agreement exceeded the maximum in only one case (project with Benin in 2001). However, the overage was not significant (US\$3,7K). The cause of this discrepancy was recorded. A new agreement should have been established to reflect the new costs.

Basis of Payment

As specified in the terms and conditions, contributions should normally be paid based on the attainment of objectives or as reimbursement for expenses incurred by the recipient. This statement is consistent with paragraph 7.6.1 of the Treasury Board's Policy on Transfer Payments.⁶

The audit findings show that most payments were issued as advances to cover expenses that the recipient would have to incur to achieve his objectives and not as

⁵ *A contribution file should normally contain the initial application, the documentation associated with application approval, the initial agreement and all amendments, relevant communications, recipient requests for reimbursement, supporting documents and monitoring and progress reports.*

⁶ *This paragraph specifies that transfer payments should not be paid to recipients in advance of need; payments should be timed to correspond as closely as practicable to recipients' cash flow requirements.*

reimbursement for expenses already incurred. This subject is covered in more detail in Section 2.2.2 of this report.

Furthermore, the terms and conditions for in-kind contributions indicate that contribution agreements must stipulate the nature and amount of the assistance. The six agreements providing in-kind contributions were consistent with this statement.

Allowable Expenditures

According to the terms and conditions, eligible expenses must be detailed in all contribution agreements. The types of expenses covered are mainly limited to wage costs, the purchase of capital assets, professional services and other operational expenses such as travel, administrative fees, supplies and fees related to the organization of workshops and information sessions.

All the contribution agreements audited included a clause detailing eligible expenses. The list of detailed expenses in this clause was consistent with the one contained in the terms and conditions.

Only a field audit could determine whether recipients complied with this clause. In certain cases, the progress reports provided by the recipients presented only a summary of expenses incurred for each activity and did not contain any details on the nature of the expenses. In other cases, the annexes to the reports provided more information. Although, even it was difficult to confirm the eligibility of expenses incurred by the recipients, the Program manager confirmed that the information on file was sufficient to provide that assurance.

Recommendation #1

In order to ensure that expenses are eligible for reimbursement, Program management should request that recipients indicate in their progress reports the nature of the expenses incurred and/or should include all the necessary information in the contribution files that is required to provide a reasonable assurance on the eligibility of the expenses.

Management Response

The Branch agrees with the recommendation.

However, the observation in the draft audit report that "progress reports submitted by recipients confirmed that expenditures had been made against authorized activities. However, they did not provide enough details on the nature of expenses to confirm that they were eligible under contribution agreements", could perhaps be misinterpreted. It is true that the expenditure reporting table in the format of the progress reports used by the Program requires recipients to report their expenditures based solely the list of activities included in contribution agreements. However, other sections of the progress reports, including textual summaries, and sometimes annexes and attachments to progress reports provide additional information regarding the nature of expenses incurred. In addition, the approval of payments to recipients is not based only on the information contained in the progress reports, but also on other information requested by the Program, depending on the circumstances of the particular project, such as

copies of invoices and/or contracts. When one considers this range of information, the eligibility of expenditures in the large majority of cases can indeed be confirmed. Furthermore, it should be noted that, for all projects, the Program manager or relevant project officer were satisfied that expenditures reported by recipients were eligible.

Nevertheless, in order for information on eligible expenditures within progress reports to be clearer and more systematic in the future, the Program will revise the format used for the progress reports, so that it becomes mandatory for recipients to report such information in a standardized fashion.

Duration of Agreements

The current terms and conditions are effective from April 1, 2002, to March 31, 2007. All contribution agreements must cover activities and payments within this period.

All the contribution agreements provided for activities and payments were within the period covered in the terms and conditions.

In the case of the agreement associated with the project with Cuba (Oficina Tecnica de ozono), it provided an end date of March 31, 2008, in which it falls beyond the scope of the current terms and conditions. However, a clause was added to specify that three payments totalling US\$41K and covering activities after March 31, 2007, are conditional upon Treasury Board renewal of the terms and conditions.

Schedule of Payments

All contribution agreements included a clause on methods of payment indicating, among other things, payment amounts and dates.

There were a significant number of modifications made to the agreements as a result of project delays. For example, the contribution agreement for the project with Bolivia was modified three times to reflect new project deadlines. The original agreement provided for an end date of December 31, 2004, which was changed through three amendments (December 31, 2005, March 31, 2006, and August 31, 2006). Program Management indicated that extensions are fairly common with projects dealing with other countries. The cause of such extensions is often not under their control (i.e. Workshop cancelled due to an insufficient number of participants, changes in the personnel of the foreign country).

With a view to reducing the number of amendments required for agreements and the resulting administrative work, the possibility of modifying contribution agreements to provide for payments in a given period rather than on a specific date should be examined. The period should not cover two fiscal years and should be reasonable, reflecting the activities to be accomplished by the recipients. The opinion of the Department's legal services in this regard could be sought.

Progress Reports

The audit findings indicated that, for all the projects audited, the payments provided in agreements were made in accordance with the conditions. Payments were made after the Program manager received progress reports from the recipients. These reports

show the activities completed using the previous payments and an estimate of the expenses to be covered by the next payment.

Although this practice contributes to further ensuring that recipients have completed all of the activities provided in the agreement, before new payments are made, the use of advance payments reduces such insurance since the control was exercised after the fact.

Activities under the Responsibility of the Program and the Recipients

The audit of the files indicated that activities to be undertaken by the Program and the recipients for projects completed at the time of the audit were accomplished as provided for in the agreements, despite frequent delays in projects.

There were a number of controls in place to ensure that anticipated results were achieved. Accordingly, in addition to the progress reports submitted by recipients, the Program manager mentioned that he regularly communicated with the recipient countries and third parties involved in the projects to monitor activities underway. As well, the Program manager asked recipients to produce all relevant documents showing that anticipated results were achieved. These may include training materials, pamphlets, etc.

When the information provided by the recipients was deemed insufficient or the Program manager felt such action was necessary, given the nature of the activities, Program employee and consultant were, in some instances, dispatched to the field to observe the following implementation of activities; to ensure that anticipated results had been or were in the process of being achieved; and to provide the support required for future activities. Missions were organized for the projects with Chile, Bolivia, Cuba, Jamaica and others.

2.2 Objective B: Requirements under the Financial Administration Act and Treasury Board Policy on Transfer Payments

2.2.1 Financial Administration Act

The audit findings show that all contribution payments were initiated and certified by a person authorized to do so in accordance with the departmental delegation instrument and the *Financial Administration Act*.

Section 32

All the contribution agreements and fund transfers to third parties were initiated and committed by a person authorized to do so and were in accordance with the departmental delegation instrument (Section 32 of the Act). These processes regarding the initiation of contribution agreements and the commitment of funds appear to have been well implemented and followed within the Program. These controls provide the manager with further insurance that the total expenses charged to Program budgets do not exceed amounts initially provided for.

Section 34

According to Section 34 of the *Act*, no payment shall be made unless someone with the appropriate delegated authority certifies that the payee is eligible for or entitled to the payment. This control ensures that contribution payments are made only when all the conditions contained in the agreement have been met and the policies of the Treasury Board and Environment Canada have been respected.

In all cases, the contribution payments had been certified by a person with the authority to do so and were in accordance with the departmental delegation instrument. In a few instances, the Section 34 certification accompanying the requests for payment had been signed by the Program administrative assistant and not the manager in charge (projects with Benin and Chile). Although the administrative assistant had the required authority, responsibility for certification under Section 34 should be delegated to the Program manager, given his ongoing involvement in the projects.

2.2.2 Transfer Payment Policy

In general, the contribution agreements were consistent with the Policy on Transfer Payments and included the basic provisions expected. However, Program management should pay particular attention to the following elements:

- rationale for advance payments;
- limits regarding the amount and frequency of advance payments;
- reimbursement of advance payments remaining unspent at year end; and
- advance payments for activities covering more than one fiscal year.

Rationale for Advance Payments

The Policy on Transfer Payments stipulates that advance payments should only be made when necessary. Recipients must prove that advance payments are essential to carry out the agreement. The decision to favour reimbursing expenses rather than making advance payments reduces the risk of the Program paying for activities that will not be carried out by the recipient or that do not meet anticipated results.

The audit findings show that most of the payments made under the bilateral agreements audited were advance payments.

Although all the agreements included a detailed forecast of cash flows, this does not explain the need for advance payments. The contribution records included no further justification for the issuance of advance payments. Program management indicates that generally it would not be feasible to implement projects with developing countries without using advance payments, since the Multilateral Fund often represents their unique source of funds.

A Risk Based Audit Framework has been developed for the Program and approved by Treasury Board. It indicates measures that are to be undertaken in order to reduce the risks related to the misuse of funds.

Limits Regarding the Amount and Frequency of Advance Payments

Considering the preceding, when the Program manager deems an advance payment is necessary, the payment amount must be limited to the recipient's immediate cash requirements and must respect the limits set out in Appendix B of the policy.⁷

The audit findings show that, for several of the agreements, the amount of advance payments made did not always respect the limits established in the policy. For example, in the project with Bolivia, the contribution agreement of August 2002, indicated that a payment of US\$84K (approximately CAN\$130K) was to be made on December 1, 2002, to finance the implementation of activities covering the period from December 2002 to April 2003 inclusive (five months). In this case, the policy states that the maximum amount of the advance payment should have been limited to expenses the recipient expected to incur in the following quarter (December 2002 to February 2003).

Also, the agreement with the United Nations Environment Programme for the project with the Caribbean provided for an advance payment of US\$64,7K (approximately CAN\$ 87,2K) on the date the agreement took effect, i.e. October 1, 2003. This represented the full annual amount provided for in the agreement. The advance amount should have been limited to 75% of the expenses the recipient expected to incur in that fiscal year.

Recommendation #2

When choosing to use advance payments, Program management should ensure that the rationale for that decision is documented. A general explanation may be satisfactory if it applies to all the projects. As well, management must ensure that the amounts and frequency of the advance payments fall within the limits set out in Appendix B of the Treasury Board's Policy on Transfer Payments.

Management Response

The Branch agrees with the recommendation.

The rationale for making advance payments under the Program was discussed in 2000 with the Program's Financial Management Advisor, who agreed, on the basis of the explanations provided by the Program, that advance payments were necessary to meet program objectives, consistent with Section 7.6 of the Policy on Transfer Payments. Furthermore, the risks associated with advanced payments, together with management measures to mitigate these risks, were identified and documented in the current Program's Results Based Audit Framework, prepared in 2002 with the advice of the Audit and Evaluation Branch.

The Program will prepare a justification for making advance payments to developing country governments and institutions, and keep this justification on file. This justification will include the following points:

- Most developing country governments generally have scarce resources for environmental protection and no internal budgets for ozone-related activities. In most cases, all of the funds these governments allocate for the phase-out of ozone-*

⁷ *The limits set out in the policy are based on the cash requirements of recipients, the term of the agreement and the annual amount provided for.*

depleting substances come from the Multilateral Fund, or bilateral donors, such as Canada, that opt to direct part of their obligatory contribution to the Fund towards bilateral projects. As a result, if the Department did not advance funds to these governments to undertake fundamental project activities such as organizing training workshops and contracting local expertise, projects could not be implemented. This has been confirmed by the project authorities in the developing countries concerned.

- The practice of the Department to advance funds to developing country governments, while holding back a portion of the contribution until a final accounting is provided by the recipient (in line with the Policy on Transfer Payments) is also used by other government-led and multilateral agencies that undertake similar projects under the Multilateral Fund. It is unlikely that developing countries would agree to a financial approach wherein payments are all provided as reimbursements, when they could receive similar projects from other agencies that allow the use of advance payments.
- While the use of advance payments admittedly carries some risks, these risks are minimized by the facts that: (1) subsequent advances are paid only upon: confirmation that activities in the preceding period have been implemented; submission of expenditure reports and, when deemed necessary, related invoices; (2) recipient governments must account for results not only to the Department but to an international body, the Executive Committee of the Multilateral Fund, and (3) the Program attempts to work with governments that have a good track record of spending funds appropriately.
- The evaluation of the Program has confirmed that recipients implemented their obligations under agreements, and the audit did not identify any instance of misspending by recipients due to the use of advance payments. These positive results are confirmed by other independent periodic evaluations conducted under the Multilateral Fund that examine a range of projects, including ones funded by the Department.
- Making advance payments for projects under contribution agreements with strict terms and conditions, reporting obligations and several advance payments based on cash flow requirements allows the Department a tighter control over the funds than if it didn't conduct such projects and had to provide its entire contribution to the Multilateral Fund as a grant payment.

The deviations to the limits of Appendix B of the Policy on Transfer Payments in contribution agreements made prior to 2005 were identified through departmental controls in fiscal year 2006-2007. The payment schedules under new agreements are fully consistent with the limits in Appendix B and, when possible, older agreements have been amended to bring them in line with these limits. Therefore, it is considered that this issue has already been rectified.

Advance Payments at Year-End

According to the Policy, contribution recipients *must* return unused funds at the end of the fiscal year.

The audit findings show that funds remaining unused by recipients were not returned to the Program at the end of every fiscal year. For example, the postponed

implementation of the projects with Bolivia and Cuba resulted in recipients being unable to meet their deadlines for the implementation of activities in the given fiscal year. Unused funds should have been returned to the Program at the end of the fiscal year. Nothing in the records indicates that these funds were, in fact, reimbursed. The Program Manager confirmed that these reimbursements didn't happen; however, the recipients used the funds to finalize the activities planned in the contribution agreements for this project.

Advance payments considered in contribution agreements should cover activities to be implemented during one fiscal year only. The Policy includes situations where activities for which an advance payment has been issued, can be postponed to the following fiscal year but no later than the end of April.

Audit results indicated that the contribution agreements (or their amendments) included issuance of advance payments for activities implemented during two fiscal years. For example, in the project with Bolivia, the advance payments were planned for activities to be implemented during the following periods: December 2002 to April 2003 and October 2003 to April 2004. Advance payments indicated in the agreements should have been limited to activities, or part of activities, to be implemented no later than March 31st of each fiscal year only.

An exception to this cash management policy may be obtained from the Treasury Board Secretariat if the Program manager can show that the additional administrative fees resulting from the higher frequency of payments will be greater than the additional interest charges incurred by the government to pay more rapidly or that Program objectives are compromised.

Recommendation #3

Program management should put in place the required controls to ensure that recipients return unused funds at the end of every fiscal year unless an exception in this regard is granted by the Treasury Board Secretariat. Furthermore, payments provided for in contribution agreements and in their amendments, should be limited to expenses that recipients expect to incur in the course of a single fiscal year.

Management Response

The Branch agrees with the recommendation.

In its new submission to Treasury Board to renew the terms and conditions for the contribution program, the Department has requested an exception to Section 7.6 of the Policy on Transfer Payments, to allow recipients to carry forward unused portions of advanced payments from one fiscal year to another fiscal year, if the following circumstances apply: (1) the unused portion of the advance is associated with activities that were scheduled to be implemented prior to the end of the fiscal year, but had to be re-scheduled in the new year due to unintentional delays in project implementation; (2) the recipient has provided a revised cash flow statement indicating that the unused portion will be disbursed on eligible project expenditures within the first quarter of the new year.

The rationale for this request is outlined in the Treasury Board Submission and consists principally of the following:

- Should recipients return funds remaining unused by the end of the fiscal year due to the rescheduling of activities to the next fiscal year, the Department would need to find additional funds to pay for project expenditures in the new fiscal year, since it is obliged under the Montreal Protocol to either pay the costs of approved projects, or pay the corresponding funds to the Multilateral Fund. Should such funds not be available, Canada would eventually find itself in arrears with respect to its mandatory contribution to the Fund.*
- Allowing recipients to re-profile unused funds in the new fiscal year carries no additional risks, since the Department is liable to pay these funds in one year or another, but it does avoid significant administrative difficulties that could seriously delay the implementation of project activities.*
- It is sometimes not feasible for governments of other countries, with their own financial and administrative rules, to return funds that they may have committed for activities which are legitimately delayed for a few months.*

Should the Treasury Board Secretariat not approve the exception, the Department will put in place measures to ensure that recipients return unused funds at the end of every fiscal year. However, should this result in serious complications, due to the reasons outlined above, the Department will need to weigh the pros and cons of continuing the contributions program, as opposed to providing its entire obligation to the Multilateral Fund as a grant.

It should be noted that, were an exception to be granted, the management of the Program would still continue to do its utmost to minimize cases when recipients have funds remaining at the end of the fiscal year through: (1) applying, to all future agreements and amendments to existing agreements, the method of payment approach proposed by Finance in 2006, wherein only the value of the first payment and fiscal year totals are actually indicated in contribution agreement, so that follow-up payments can be decided on as the project is implemented, based on revised cash flow statements; (2) working more closely with the recipients in the development of their cash flow forecast related to the advanced payment for the last quarter of a fiscal year, to ensure that realistic and conservative judgment is exercised when estimating the funds required.

None of the payments provided for in the Program's contribution agreements covered recipients' expenses beyond the month of April of another fiscal year. Section 7.6.5. of the Policy on Transfer Payments indicates that "in exceptional circumstances where a department deems it necessary to meet program objectives and is permitted under the agreement an advance may be made prior to the end of a year but must not exceed expenditures expected to be incurred by the recipient during April". It should further be noted that some of the agreements allowing the payment of expenditures up to the month of April were reviewed by the Department's Legal Services and were found to be compliant with applicable rules and policies.

For future agreements, should the Program need to avail itself of the exception provided for in Section 7.6.5 in the Policy on Transfer Payments, it will keep an appropriate

justification on file. As per usual practice, the Program would consult its Financial Management Advisor and, if necessary, Legal Council, on this matter.

2.3 Other Findings

Financial reports used for decision making

The information contained in the departmental financial system does not permit the real costs of a given project to be determined or Program expenses to be effectively monitored. For example, no distinction was made between operating funds allocated to the Montreal Protocol Multilateral Fund for the implementation of bilateral projects and the departmental funds for Program management. The information used for decision making was generated using an in-house reporting system created by the Program manager. The information contained in these reports was difficult to reconcile with that contained in the financial system.

Consideration should be given to using the project code hierarchy of the financial system to improve the way the financial information is presented. This would contribute to isolating project-specific costs from those specific to the Program and improve the quality of the financial information used for decision making.

Memorandum of Understanding between Environment Canada and the Canadian Commercial Corporation

The aim of the memorandum of understanding is to specify procedures to be followed and the responsibilities of each party. Generally speaking, the clauses contained in the memorandum of understanding for all the years covered by this audit were applied as expected.

Clause 2.1 indicates that the Program must send a request to the Corporation to specify what is expected of the latter with respect to each of the projects for which its services are required. This clause has been fulfilled for all fiscal years where services of the Corporation were required.

Clause 2.2 specifies that the Corporation must confirm its acceptance of the conditions proposed by the Program. No documentation on record shows the Corporation's acceptance for the 2002–2003 and subsequent fiscal years.

3.0 CONCLUSION

The requirements under the terms and conditions and contribution agreements have been satisfactorily met.

The Program diligently managed the public funds. All contribution payments were initiated and certified by a person authorized to do so in accordance with the departmental delegation instrument and the *Financial Administration Act* (sections 32 and 34).

With a view to further ensuring that the expenses incurred by recipients are eligible for reimbursement (as stipulated in the terms and conditions), the progress reports submitted by recipients should provide more detailed information regarding the nature of the expenses.

In general, the contribution agreements were consistent with the Policy on Transfer Payments and included the basic provisions expected. However, management should pay particular attention to the following:

- The rationale for making advance payments should be recorded and kept on file;
- The amount and frequency of advance payments should respect the limits of the Treasury Board's Policy on Transfer Payments;
- Recipients should reimburse to the Program any portion of advance payments remaining unused at the end of the fiscal year; and
- Advance payments should be granted for activities covering a single fiscal year only.

In our professional judgement, sufficient and appropriate audit procedures have been conducted and sufficient evidence gathered to support the conclusions contained in this report. The conclusions were based on a comparison of the situations against the audit criteria as they existed at the time of the audit. Our findings apply only to Environment Canada's Bilateral Cooperation Program under the Multilateral Fund of the Montreal Protocol, i.e. the entity audited.

ANNEX 1 – AUDIT CRITERIA

AUDIT CRITERION	SUPPLEMENTARY INFORMATION
OBJECTIVE A – Is there compliance with the terms and conditions of the class contribution and with the provisions of the contribution agreements?	
Is the recipient eligible for this contribution? (<i>Source: Terms and Conditions</i>)	<ul style="list-style-type: none"> • Partner country that signed the Montreal Protocol • Third party (United Nations Environment Program)
Was the contribution (in cash or in kind) delivered by an organization as described in the terms and conditions? (<i>Source: Terms and Conditions</i>)	<ul style="list-style-type: none"> • Company, agency or other Canadian organization for the delivery of goods or services for in-kind contributions. • Canadian or international (third party) organizations that have the capacity to implement the project (e.g.: United Nations Environment Program) • The government of the recipient country (local workshops or funding from local experts)
Are all relevant documents in the file? (<i>Source: Terms and Conditions</i>)	<ul style="list-style-type: none"> • Letter from the Multilateral Fund Secretariat to the developing country to confirm approval of the project • Project proposal approved by the Executive Committee • Funds flow forecast • Statement by recipient on the sources of project funds and the involvement of former public servants
Is the maximum amount of the agreement less than or equal to \$1M for a period of one year? (<i>Source: Terms and Conditions</i>) AND Does the maximum amount of the agreement comply (in kind or in cash) (<i>Source: Agreement</i>)	
Are payment requests made on the basis of completion of work or as reimbursement of already incurred expenses? (<i>Source: Terms and Conditions</i>)	<ul style="list-style-type: none"> • Progress reports submitted by the recipients • Other documents available to the Program to determine if the work was completed before approval of payments

**Audit Report of Environment Canada's Bilateral
Program for Implementation of the Montreal Protocol**

In the case of a contribution in kind, does the agreement between Environment Canada and the developing country stipulate the kind and amount? (<i>Source: Terms and Conditions</i>)	
Is the list of eligible expenses included in the contribution agreement? (<i>Source: Terms and Conditions</i>) AND Are the expenditures listed in the recipient's financial reports eligible? (<i>Source: Agreement</i>)	<ul style="list-style-type: none"> • Equipment • Consultants • Wages and benefits • Administrative costs, supplies • Travel • Cost of organizing training sessions or workshops
Is the total funding from governments less than or equal to 100% of the eligible expenditures? (<i>Source: Terms and Conditions</i>)	<ul style="list-style-type: none"> • Mandatory disclosure by the recipient • Surplus must be reimbursed on a pro rata basis
Is the duration of the agreement within the limits specified in the terms and conditions? (<i>Source: Terms and Conditions</i>) AND Are the dates of the contribution payments within the period targeted by the agreement? (<i>Source: Agreement</i>)	Terms and Conditions: From April 1, 2002 to March 31, 2007
Do the payments to the recipient comply with the payment schedule as specified in the agreement? (<i>Source: Agreement</i>) AND Are the payments to the recipients made after submission of progress reports as specified in the agreement (<i>Source: Agreement</i>)?	<ul style="list-style-type: none"> • Date and amount • Invoice from recipient • Submission dates of progress reports
Have the Department and the recipient completed the activities under their respective responsibility as specified in the contribution agreement? (<i>Source: Agreement</i>)	In the case of an ongoing project, has there been follow-up on the current activities? (follow-up of implementation plan)
Was there compliance with all of the conditions of the agreement before payments were issued? (<i>Source: Agreement</i>)	<ul style="list-style-type: none"> • Maximum amount of contribution • Maximum amount in money • Maximum annual amount • Financial and other reports • Method of payment

OBJECTIVE B – Are the public funds managed meticulously?

B1 – Is there compliance with the *Financial Administration Act*?

Does the approval of the contribution agreement comply with Section 1.12 of Appendix A of the Departmental Delegation Chart?	Section 32 of the <i>Financial Administration Act</i> - Initiation of expenditure
Were the funds committed in accordance with Section 2.1 of Appendix A of the Departmental Delegation Chart?	Section 32 of the <i>Financial Administration Act</i> – Commitment of funds
In the case of an agreement that sets out payments in kind in the form of goods or services contracts, is there compliance with the limits specified in Section 3.0 of Appendix A of the Departmental Delegation Chart?	Contracting authority
Are the payment requests in accordance with Section 5.1 of Appendix A of the Departmental Delegation Chart?	Section 34 of the <i>Financial Administration Act</i> – Spending authority – contract price and performance, eligibility or right

Does the contribution agreement comply with the TBS Policy on Transfer Payments?

Are the basic provisions as specified in the Policy on Transfer Payments taken into consideration in the agreement?	<ul style="list-style-type: none"> • Appointment of recipient • Purpose of contribution • Expected outcomes • Effective date • Signing date • Duration of agreement • Non compliance with conditions • Eligible expenses • Conditions for reimbursement • Maximum amount due • Dept. withdrawal clause • Collection action • Statement of amount due to Govt. • Acquired property clause • Overpayment clause • Amendment to program funding by Parliament
Are the advances, if any, in compliance with Appendix B of the Policy on Transfer Payments?	

B2 – Are contracts for services or the purchase of goods from suppliers within the framework of a contribution agreement that sets out one or more payments in kind in compliance with the TBS Contracting Policy?⁸⁹	
Is the following information included in the file?	
<ul style="list-style-type: none"> • a detailed comprehensive statement of work • a clear and concise basis of payment • clearly defined deliverables • clearly identified delivery dates • a signed proposal 	
Are intellectual property and security clearance taken into consideration in the contract?	
Does the contract require approval from the Procurement Review Board? If yes, is there proof in the file that approval has been obtained?	
Has an explanation been included in the case of a request for proposal from a sole supplier?	
If the contract concerns the purchase of "goods" valued at over \$25K or the purchase of services valued at over \$100K, did the manager used a competitive process (MERX - Public Works and Government Services Canada)?	<ul style="list-style-type: none"> • Amounts including GST • Competitive process
B3 – When the contribution includes the involvement of the Canadian Commercial Corporation, does it comply with the memorandum of understanding between Environment Canada and the Corporation?	
Is there compliance with the procedures and responsibilities of the memorandum of understanding? (Source: Memorandum of understanding, sections 2.1 to 2.8)	

⁸ In cases where EC is party to the contract.

⁹ Of the eight files audited, only one contained a contract in which the Department was directly involved. All the other contracts were under the responsibility of the Canadian Commercial Corporation. Accordingly, the information collected in the course of the audit was not enough to draw any conclusions regarding these criteria.