

Final Audit Report

Audit of Transfer Payments to the Canadian Health Services Research Foundation (CHSRF)

October 2008

Table of Contents

Executive Summary ii

Introduction..... 1

 Background 1

 Objectives 1

 Scope and Approach 2

Findings, Recommendations and Management Responses..... 2

 SPD Management Control Framework..... 2

 CHSRF Management Control Framework 4

 CHSRF Compliance with Terms and Conditions of the Funding Agreements 4

Appendix A 8

 Audit Criteria 8

Appendix B 9

 Summary of Funding Agreements: 9

Executive Summary

This report sets out the observations, conclusions and recommendations from the Audit and Accountability Bureau's audit of the Science Policy Directorate (SPD) (formerly known as the Office of the Chief Scientist (OCS) – Canadian Health Services Research Foundation (CHSRF). Health Canada has funding agreements with CHSRF which total \$140 million through four separate grants. CHSRF is an organization that funds research in health services and nursing in order to increase the quality, relevance and usefulness of research for health-system policy makers.

The objectives of this audit were to provide the Deputy Minister with assurance that an appropriate Management Control Framework is in place within the SPD and CHSRF to manage Transfer Payment funds, and that CHSRF is using funds in compliance with the terms and conditions of the funding agreements. The audit was conducted by the Audit and Accountability Bureau in accordance with the Government of Canada's *Policy on Internal Audit*.

The SPD had a management control framework in place to manage the ongoing activities with CHSRF. Audit results indicated that monitoring activities were carried out, however, SPD program managers require more clarity in terms of monitoring expectations.

CHSRF had an effective management control framework in place which includes: operational plans and objectives aimed at achieving its strategic objectives; financial management policies and authorities that are communicated, reviewed and revised as required; procurement activities compliant with policies and authorities; and the production and dissemination of sufficient, complete, timely and accurate information.

CHSRF was in compliance with the administrative requirements of the terms and conditions of the funding agreements. Expenditures related to the EXTRA and NURSE funds were in scope and program related. However, audit results indicate that CHSRF holds investments of Core and NURSE funds in excess of the limits, and in categories inconsistent with, the 2007 *Minister of Finance Investment Management Framework*.

CHSRF has two types of funds with differing circumstances: an endowment fund (the Core fund) for which the Government did not specify at the outset whether the Foundation should be time-limited or whether it should operate in perpetuity, and nor has it done so since and funds with a predetermined duration (the NURSE and EXTRA funds). Given that the NURSE and EXTRA funds have a predetermined duration and CHSRF is currently spending down its endowment, the principal objective of investment decisions should be the preservation of capital in order to meet future disbursement requirements. This would preclude CHSRF from holding investments in bonds or equities outside Canada unless sufficiently protected; holding investments in equities or bonds with an investment strategy longer than the expected life of the organization or that do not match the profile of the organization; and holding investments that could result in potential loss of capital.

CHSRF should be encouraged to revise its investment policy related to Core and NURSE funds to be aligned with the Prudent Person Principle as articulated by the *Minister of Finance Investment Management Framework for Up-Front Funding (2007)*. It is important to note that funding provided to CHSRF prior to the 2003 EXTRA funding agreement did not include any specific provisions or guidelines regarding the investment of those funds. Furthermore, it was not until 2007, that the Minister of Finance brought in the *Investment Management Framework for Up-front Funding (2007)*, which consists of ‘Part I: Investment Management Framework for Up-Front Funding to be Held in Perpetuity (Endowment Fund)’ and ‘Part II: Investment Management Framework for Up-Front Funding with Predetermined Durations’. This investment framework now sets out clear guidance and criteria for investment funds held by recipients of government funding.

Introduction

Background

The Canadian Health Services Research Foundation (CHSRF) is an independent, non-profit organization. It was originally named the Foundation of the Canadian College of Health Services Executives, but its corporate objects were varied and legally changed to CHSRF in 1996. It is an organization that promotes and funds management and research in health services and nursing in order to increase the quality, relevance and usefulness of research for health-system policy makers and managers. It also supports and enhances the use of research evidence focussed on health management and policy challenges by addressing the need for training and communication with health services professionals. This is primarily accomplished through funded contributions such as grants and capacity development (training and personnel awards). CHSRF received \$140 Million in the form of four separate grants from Health Canada since 1997 (see Appendix A for more details) and has an annual operating budget of approximately \$16 Million. The two main programs that CHSRF funds with Health Canada grants are the Executive Training for Research Application (EXTRA) Program and the Nurses Using Research and Service Evaluation (NURSE) fund.

The Office of the Chief Scientist (OCS) has been the branch responsible for Health Canada's relationship with CHSRF since 2003. It was created in 2001 to strengthen the Department's ability to perform and use science through science promotion, advice and management. In February 2008, OCS was amalgamated with the Strategic Policy Branch and in September 2008, became part of the Science Policy Directorate (SPD), resulting in a change in reporting relationships: the SPD Director General reports to the Assistant Deputy Minister Strategic Policy Branch (SPB) rather than the Deputy Minister.

The audit was undertaken by the Audit and Accountability Bureau in accordance with the Health Canada Risk-Based Audit Plan 2006-2007 to 2008-2009 which was approved by the Departmental Audit and Evaluation Committee on October 4, 2006. The audit was conducted in accordance with the Government of Canada's *Policy on Internal Audit*.

Objectives

The objectives of this audit were to provide the Deputy Minister with assurance that:

1. An appropriate Management Control Framework is in place within the SPD and CHSRF to manage transfer payment funds; and
2. CHSRF is using funds in compliance with the terms and conditions of the funding agreements.

Scope and Approach

The scope of the audit focused on the management of existing funding agreements between the Science Policy Directorate (SPD) and the Canadian Health Services Research Foundation (CHSRF).

It included an assessment of the SPD and CHSRF's management control frameworks; an assessment of financial controls in relation to the NURSE and EXTRA programs; and an assessment of CHSRF's investments portfolio. See Appendix B for audit criteria.

The following evidence gathering techniques were employed:

- interviews were conducted with SPD and CHSRF management and staff;
- supporting documentation was collected from both entities; and
- directed samples of CHSRF general ledger transactions relating to the NURSE and EXTRA funds and of investment portfolio holdings were examined for transactions occurring between January 1 2005 and October 31 2007.

Findings, Recommendations and Management Responses

SPD Management Control Framework

Based on Treasury Board Secretariat's (TBS) Management Accountability Framework, an appropriate management control framework would include several key control elements such as:

- operational plans and objectives aimed at achieving its strategic objectives;
- a formal and rigorous approach to policy and program design, including monitoring activities in a regular and timely manner;
- review and approval of financial and non-financial reporting for sufficiency, completeness, timeliness and accuracy;
- established processes to identify, solicit, evaluate and manage third party service delivery arrangements; and
- the identification of appropriate performance measures linked to planned results.

The SPD had a management control framework in place to manage the ongoing activities with CHSRF. Public scrutiny and oversight expectations of government programs have increased in recent years. Audit results indicated that monitoring activities were carried out, however, SPD program managers require more clarity in terms of monitoring expectations. Specifically, the expected outcomes of the NURSE and EXTRA programs are relatively abstract and intangible and assessing their effectiveness is proving to be a challenge for SPD program managers. The SPD relies on reports and other documentation driven by requirements of the funding agreements as well as CHSRF sponsored international review panel reports produced every five years to measure the effectiveness of its programs. SPD program managers assess this information to the best of their ability for reasonableness and acknowledged that they have not been able to adopt a more

proactive approach to program assessments due to undefined oversight expectations and lack of capacity. Current funding agreements have provisions that allow the SPD to carry out independent program evaluations; however, the SPD has not exercised this right as a means of monitoring.

A significant portion of CHSRF's assets are in the form of investment holdings. Substantial subject matter expertise is required to adequately analyse the foundation's investment policies for indicators of compliance with terms and conditions of funding agreements. Currently, SPD does not have that expertise.

As per the funding agreements, the Deputy Minister holds a seat on the foundation's Board of Trustees as an ex-officio member; a vehicle on which the SPD relies for additional monitoring of CHSRF activities. This responsibility is currently delegated to an Associate Assistant Deputy Minister. It provides the chance to strategically monitor their activities; to be privy to information that is not otherwise publicly available; and to have the opportunity to influence CHSRF directions.

In July 2008, the dual role of Health Canada officials exercising their duties as public servants, and simultaneously participating on the Boards of Not-for-Profit Corporations, and risk mitigation strategies were discussed by the department's senior management board. As a result, Health Canada Legal Services have been tasked to develop a framework to guide employees in considering new invitations to participate on boards and to re-assess ongoing participation; to explore potential training opportunities to help guide employees; and to develop and maintain an inventory of Health Canada employees' participation on boards. The safeguards to be developed will help to mitigate the risks associated with the participation of Health Canada officials on Boards of Not-for-Profit Corporations.

Recommendation No. 1

It is recommended that the Assistant Deputy Minister Strategic Policy Branch should improve the departmental monitoring of funding agreements with the Canadian Health Services Research Foundation.

Management Response

The Assistant Deputy Minister, Strategic Policy Branch (SPB) (formerly the Health Policy Branch) will provide the Science Policy Directorate (SPD) with clear requirements for departmental monitoring of CHSRF program impacts and ensure that the SPD has, in conjunction with other areas of the Department, the related capacity needed to perform such functions. The Chief Financial Officer's Branch (CFOB) will review and provide advice on CHSRF financial documents to the SPD. The SPD will provide relevant documentation to CFOB.

The following are the deliverables and expected completion dates:

- Clear, senior management-approved requirements for departmental monitoring of CHSRF programs and their impacts and linkages to departmental and governmental priorities. Appropriate resources provided to perform this monitoring function.. – December 2008
- SPD briefings for the Deputy Minister's (or his designate) participation at CHSRF Board meetings will now include expert analysis of financial matters - Completed. Advice to be provided as required.

CHSRF Management Control Framework

An appropriate management control framework would include several key control elements such as:

- operational plans and objectives aimed at achieving its strategic objectives;
- financial management policies and authorities that are communicated, reviewed and revised as required;
- procurement activities compliant with policies and authorities; and
- the production and dissemination of sufficient, complete, timely and accurate information.

The audit team found that CHSRF has an effective management control framework in place to manage its day-to-day activities.

The audit revealed that CHSRF operating objectives, plans and priorities were established, linked to strategic objectives and periodically re-assessed and reviewed by senior management and the Board of Trustees. Sound financial management policies and authorities, which for the most part are based on Treasury Board Secretariat guidelines, were communicated and adhered to. Testing confirmed that procurement vehicles were used as intended, expenditure authorities were respected and proper segregation of duties was maintained.

Ongoing communication and reporting between the SPD and CHSRF was confirmed through file review and interviews with senior management of both entities. Furthermore, CHSRF generated and dispensed relevant and required material to stakeholders, Health Canada and otherwise.

Consequently, no recommendations are necessary.

CHSRF Compliance with Terms and Conditions of the Funding Agreements

The audit included an assessment of CHSRF's compliance with the terms and conditions of the NURSE and EXTRA Funding Agreements, as well as audit procedures to determine whether funds were being used for their intended purpose. CHSRF was found to be in compliance with the administrative requirements of the terms and conditions. The audit team assessed the investment portfolio consisting of the Core and NURSE funds against the Minister of Finance *Investment*

Management Framework for Up-Front Funding (2007) and the EXTRA fund against the Investment Policy Guidelines as outlined in Schedule 'A' of the Funding Agreement. The resulting assessment demonstrated that only the EXTRA fund was in compliance with the conditions.

The audit revealed that approved expenditures were related to either the NURSE or the EXTRA fund. The audit team tested a directed sample of 125 transactions within the two funds for three fiscal years (2005 to 2007). The types of transactions selected included travel claims, salaries, grants, awards, purchase of service contracts, purchase orders, honorariums, overhead and indirect costs. All expenditures charged were found to be in scope and program related.

Total Initial NURSE & EXTRA Funding	<u>\$50 Million</u>
Total NURSE & EXTRA Expenditures (Jan 2005-Oct 2007)	\$14.9 Million
Total Expenditures Tested	\$5.1 Million
Total Eligible Expenditures	<u>\$5.1 Million</u>

The foundation has two distinct investment policies: one for funds associated with the EXTRA funding agreement, which accounts for approximately 20% or \$21M dollars, and another investment policy for the remaining 80% of the foundation's invested funds (Core and NURSE funds). The audit tested the portfolio of funds invested under the EXTRA investment policy, which sets out specific criteria for eligible securities and the minimum rating criteria for which these funds are to be invested. The EXTRA investment portfolio was in compliance with the requirements of Schedule 'A' of the funding agreement.

It is important to note that funding provided to CHSRF prior to the 2003 EXTRA funding agreement did not include any specific provisions or guidelines regarding the investment of those funds. Consequently, the March 2003 EXTRA funding agreement included a clause which required CHSRF to, amongst other things; *"commit its intention to work with the Minister with a view to bring the foundation's investment policies with respect to previous grants received from the Minister, totaling \$125M, towards alignment with the investment provisions and guidelines set out in this funding agreement"*. Both parties negotiated this issue over a period of approximately eighteen months. Correspondence demonstrated CHSRF's willingness to comply with this clause; however, an agreement could not be reached which would respect an acceptable timeline for meeting these requirements. CHSRF was requesting a longer timeframe to convert its investment holdings than was being proposed by Government officials to avoid incurring substantial financial losses during the transition process.

In October 2004, Health Canada sent a letter to CHSRF, with a copy to TBS, informing them of its decision to concede on this point of contention. Health Canada recognized that both parties had made efforts to address the issue and understood that CHSRF was following independent, professional investment advice. Consequently, they accepted that the foundation's investment guidelines for previous grants differ from those established for the EXTRA funds. The only stipulation imposed on CHSRF was that they agree to *"exercise investment policies, standards and*

procedures that a person of ordinary prudence would exercise in dealing with the property of others". Health Canada did not provide further guidance or criteria on the intent of how CHSRF is to apply this proviso to its investment strategy.

Furthermore, it was not until 2007, that the Minister of Finance brought in the *Investment Management Framework for Up-front Funding* (2007), which consists of 'Part I: Investment Management Framework for Up-Front Funding to be Held in Perpetuity (Endowment Fund)' and 'Part II: Investment Management Framework for Up-Front Funding with Predetermined Durations'. This investment framework now sets out clear guidance and criteria for investment funds held by recipients of government funding.

In the absence of specific criteria to assess CHSRF's investment policy for Core and NURSE funds prior to 2007, detailed testing could not be performed for this segment of the foundation's portfolio. Rather, a review of the foundations' application of the Prudent Person Principle was carried out. The new 2007 Minister of Finance framework was used as a benchmark tool to establish two main criteria of the Prudent Person Principle: standards and procedures, and investment policies.

The standards and procedures criteria refers to the investment management framework supporting investment activities, such as: investments held in trust; investment purchases made by Fund Managers; having an investment policy approved by the Board of Trustees; Fund Managers who are independent from members of the Board of Trustees; and having independent investment advisors. Audit results indicate that CHSRF had a sound investment framework in place.

One of the main elements of the investment policies criteria is the importance of making investment decisions in accordance with criteria that are appropriate to the circumstances of the foundation. CHSRF has two types of funds with differing circumstances: an endowment fund (the Core fund) for which the Government did not specify at the outset whether the Foundation should be time-limited or whether it should operate in perpetuity, and nor has it done so since and funds with a predetermined duration (the NURSE and EXTRA funds). Given that the NURSE and EXTRA funds have a predetermined duration and CHSRF is currently spending down its endowment, the principal objective of investment decisions should be the preservation of capital in order to meet future disbursement requirements. This would preclude CHSRF from holding investments in bonds or equities outside Canada unless sufficiently protected; holding investments in equities or bonds with an investment strategy longer than the expected life of the organization or that do not match the profile of the organization; and holding investments that could result in potential loss of capital. The audit results indicate that CHSRF holds investments of Core and NURSE funds in excess of the limits, and in categories inconsistent with the *2007 Minister of Finance Investment Management Framework*. Considering the above noted audit results, CHSRF should be encouraged to align its investment policies for Core and NURSE funds accordingly.

Strategic Policy Branch and CHSRF began discussions to amend the Terms and Conditions of existing Funding Agreements in early 2008 to enhance accountability and reporting requirements and to reflect the *2007 Minister of Finance Investment Management Framework*.

Recommendation No. 2

It is recommended that the Assistant Deputy Minister Strategic Policy Branch and the Science Policy Directorate (SPD) encourage the Canadian Health Services Research Foundation and the Board of Trustees to amend the Core and NURSE investment policy to reflect the criteria appropriate to the circumstances of the foundation while respecting the Prudent Person Principle as articulated by the Minister of Finance Investment Management Framework for Up-Front Funding (2007)

Management Response

The SPD will initiate discussions with the CHSRF to bring its investment policy in line with the 2007 *Minister of Finance Investment Management Framework* (Framework). These discussions will take place in the context of other discussions currently underway with the CHSRF to amend the Foundation's funding agreements to reflect Treasury Board Secretariat's new accountability and reporting requirements for recipients of federal funding.

In light of CHSRF's concerns about the impact of adoption of (the conservative investment approach of) the Framework, prior to engaging in discussions on this particular matter, the SPD is consulting with TBS and the Department of Finance on the implementation of the Framework. Further, given CHSRF's contention that the Framework will result in decreased investment revenues for CHSRF and, therefore, on the Foundation's long-term sustainability, the SPB, including SPD, intends to consult within the Health Portfolio and with the CHSRF on the future of health services research in Canada and the appropriate roles and responsibilities of key players in this area.

The following is the deliverable and expected completion date:

- Revised Health Canada- CHSRF funding agreements on or before Winter 2008-09

Appendix A

Audit Criteria

Science Policy Directorate (SPD)

Objective: An appropriate Management Control Framework is in place with the SPD to manage transfer payment funds

Criteria:

- Governance - The SPD has in place operational plans and objectives aimed at achieving its strategic objectives. Information requested and received from the CHSRF is sufficient, complete, timely and accurate.
- Policies & Programs - The SPD has a formal and rigorous approach to policy and program design, including monitoring activities in a regular and timely manner.
- Financial Management - Financial and non-financial reporting is reviewed and approved. SPD management has established processes to identify, solicit, evaluate and manage third party service delivery arrangements.
- Results & Performance - Management has identified appropriate performance measures linked to planned results.

Canadian Health Services Research Foundation (CHSRF)

Objective: An appropriate Management Control Framework is in place with the CHSRF to manage transfer payment funds

Criteria:

- Governance - CHSRF has in place operational plans and objectives aimed at achieving its strategic objectives
- Financial Management - Financial management policies and authorities are established, communicated, reviewed regularly and revised as required
- Procurement - Procurement activities related to contracting, travel expenses, Acquisition card and/or purchase order use are in compliance with CHSRF policies and authorities.
- Reporting Requirements - Health Canada/ Office of the Chief Scientist request and receive sufficient, complete, timely and accurate information.

Objective: CHSRF is using funds in compliance with the terms and conditions of the funding agreements

Criteria:

- Terms & Conditions – NURSE & EXTRA
- CHSRF has complied with the Terms and Conditions relating to the Investments
- Minister of Finance *Investment Management Framework for Up-front Funding* (2007)

Appendix B

Summary of Funding Agreements:

Funding Agreement	Length of Agreement	Value of Agreement	Agreement Effective Date	Audit Coverage
Initial Endowment	undetermined	\$55 Million (from HC)	April 1997	January 1, 2005 – October 31 2007
NURSE Fund	10 years	\$25 Million	March 1999	January 1, 2005 – October 31 2007
CIHR Endowment	undetermined	\$35 Million	June 1999	January 1, 2005 – October 31 2007
EXTRA Program	13 years	\$25 Million	March 2003	January 1, 2005 – October 31 2007