


Raymond Chabot Grant Thornton Consulting Inc. 

# ***FINAL NATIONAL REPORT***

*Audits of TPC Recipient  
Companies*

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## *Disclaimer*

This Final National Report is prepared for the Audit and Evaluation Branch of Industry Canada in order to document the purpose, scope, approach and results of the audits. This Final National Report is based on the results of the individual recipient company audits presented from a National perspective. This Final National Report is not to be used for any purpose other than as described in this paragraph. It should not be reproduced in whole or in part without our express written permission, other than as required by Industry Canada.

We reserve the right, but will be under no obligation, to review and/or revise the contents of this Final National Report in light of additional information, which becomes known to us after the date of this Final National Report.

# Executive Summary

## Background

Technology Partnership Canada (TPC) is a program through which the Government of Canada provides strategic assistance to firms engaged in private-sector research and development (R&D) projects on a risk and reward-sharing basis. Working in collaboration with innovative companies across Canada, TPC funds private sector research, development and prototyping for pre-competitive projects. Once the applicant company is accepted for funding, a contribution agreement is prepared and signed.

In August 2004, Raymond Chabot Grant Thornton Consulting Inc. (RCGT Consulting Inc.) was contracted by the Audit and Evaluation Branch to conduct audits of 47 recipient companies. This engagement was initiated based on the results of four audits of recipient companies in British Columbia who, as a result of these audits, were found to be in non-compliance with two specific sections of the TPC Contribution Agreement(s).

## Purpose of the Engagement

The purpose of the engagement was to determine the extent of non-compliance with the TPC Contribution Agreement(s) with respect to a recipient company utilizing the services of individuals or companies (consultants) who:

- (1) solicited agreement(s) on behalf of the recipient company and who were paid a commission or a contingency fee dependent upon the execution of the TPC contribution agreement(s) [Section 9.5 or 12.5 (pre-2000)/ Section 6.5 (post-2000) ];
- (2) lobbied on its behalf to obtain the TPC contribution agreement(s) and who, if required to be registered as a lobbyist under the *Lobbyists Registration Act*, were not registered under that Act [Section 6.11 (post-2000) ].

## Scope

47 companies were selected for this audit, which represented 24% of the total number of recipient companies (197 recipient companies as of August 2004) that received TPC contributions. At the time of this report, we have completed 46 recipient company audits. The 47<sup>th</sup> recipient company has not provided us with timely access to its books and records; as such, the file has been referred to Industry Canada for action.

The sample was stratified into the following:

- Selected recipient companies identified by RCGT Consulting Inc. (19); and
- Selected recipient companies identified by Industry Canada where it was believed there was a higher potential for non-compliance (28)

The sample of recipient companies selected spanned the country. This sample was not random and as a consequence, the results cannot be extrapolated to the entire population of TPC recipient companies.

## Recipient Audit Approach

The approach to the recipient audits was risk-based. The initial phase was designed to assess a large number of recipient companies by applying audit procedures that would provide an indication of potential non-compliance. Where audit results did not provide an indication of non-compliance, the recipient companies were categorized as "appearing to be compliant" and as such, were not subject to extended audit procedures.

Where there were immediate indications of non-compliance, recipient companies were categorized as "non-compliant". Where there was an indication of potential non-compliance, extended audit procedures were carried

out. These extended procedures included in-depth interviews, documentation review and financial analysis to gather sufficient evidence to enable the auditors to make a reasonable categorization of the recipient companies. On the basis of the extended audit procedures undertaken, the recipient companies were categorized as either being:

- ▶ appearing to be compliant; or
- ▶ non-compliant.

For all recipient companies categorized as "non-compliant", the supporting evidence and the summary of results was submitted to Industry Canada.

### Results<sup>1</sup>

Our results are broken down as follows:

**Table 1 - Compliance Status**

	Number of Companies in the sample	Percentage of the Sample
Recipient company appears to be compliant	30	65%
Recipient company is non-compliant	16	35% <sup>2</sup>
<b>Total</b>	<b>46</b>	<b>100%</b>

As can be seen from Table 1, 65% of the recipient companies appear to be compliant and 35% of the recipient companies are non-compliant with at least one of the specific sections of the contribution agreement(s). The rate of non-compliance is high and in our professional judgement, we believe that it is reasonable to assume that it is likely that other recipient companies who were not covered by the audit are non-compliant.

For the category "non-compliant", the total amount of the identified contingency payments was in excess of \$3.3 million. In our professional judgement, the dollar value of contingency payments could be larger as our focus was only on cash payments and not on non-financial inducements such as the granting of stock options. These contingency payments ranged between 1% to as high as 18% of the total funding that a recipient company was awarded and involved payments ranging from approximately \$100,000 to \$900,000.

Details on the above results are included in the following sections of this report.

<sup>1</sup> No extrapolation can be made of these results to the remaining TPC recipient companies.

<sup>2</sup> This rate of non-compliance is high. This is in part due to the fact that the sample included 28 recipient companies that Industry Canada believed had higher potential for non-compliance. These identified recipient companies represented 60% of the sample and the results for this group therefore increase the overall rate of non-compliance.

## Background

Technology Partnership Canada (TPC) is a program through which the Government of Canada provides strategic assistance to firms engaged in private-sector research and development (R&D) projects on a risk and reward-sharing basis. Working in collaboration with innovative companies across Canada, TPC funds private sector research, development and prototyping for pre-competitive projects. TPC invests in projects that develop new technologies, many of which, without TPC's financial assistance, would not proceed to the same degree of advancement. Since its inception in 1996 - 1997 to August 2004 (date Raymond Chabot Grant Thornton Consulting Inc. (RCGT Consulting Inc.) started the recipient audits), TPC had provided approximately \$2.5 billion in funding to eligible recipient companies (this does not include funding under the TPC Industrial Assistance Research Program (IRAP)).

The eligible recipient companies are Canadian companies that:

- Conduct research, development and innovation activities;
- Meet the eligibility criteria; and
- Are likely to achieve the stated objectives of the proposed project.

Industry Canada informed RCGT Consulting Inc. that the process for seeking TPC funding involves the completion and submission of an Investment Outline. Investment Outlines are reviewed by TPC and in some cases, officials from other government departments. If it is determined that a project described in an Investment Outline merits further consideration, and that funding for that project may be available, then the applicant is invited to submit an Investment Proposal in accordance with an established TPC process. The Investment Proposal is a very lengthy and comprehensive business plan that requires significant time and effort, often in excess of a year, to compile. Investment Proposals are then subject to financial and business case due diligence reviews performed by TPC and various technical experts. Various levels of formal approval are required for TPC projects, depending on the dollar value of the funding being requested.

When the government decides to provide funding to an eligible company, TPC enters into a contribution agreement with the applicant company. The terms and conditions are negotiated and detailed in the TPC contribution agreement, which establishes the legal framework (contract) between TPC and the recipient company.

As the process of obtaining funding under the TPC program can be complex, especially for applicant companies that have never applied for and/or received government funding, applicant companies may enlist the services of firms and/or consultants who are familiar with the TPC process. However, they cannot be paid a commission, contingency fee or other consideration dependent upon the execution of the TPC contribution agreement and cannot lobby on behalf of their client company to obtain the TPC contribution agreement unless they are registered under the *Lobbyists Registration Act*.

## *Purpose & Scope of the Recipient Audits*

### **Purpose**

The purpose of the engagement was to determine the extent of non-compliance with the TPC Contribution Agreement(s) with respect to a recipient company utilizing the services of individuals or companies (consultants) who:

- (1) solicited agreement(s) on behalf of the recipient company and who were paid a commission or a contingency fee dependent upon the execution of the TPC contribution agreement(s)<sup>3</sup>;
- (2) lobbied on its behalf to obtain the TPC contribution agreement(s) and who, if required to be registered as a lobbyist under the *Lobbyists Registration Act*, were not registered under that Act<sup>4</sup>.

All lobbyists who have dealings with the federal government are governed by the *Lobbyists Registration Act*, which defines activities that constitute lobbying and requires registration by persons engaged in these activities. The Act defines a lobbyist as an individual paid to act on behalf of a person, a company or a non-profit organization (a "consultant lobbyist") who communicates with public office holders or, an individual, a significant part of whose duties as an employee is to communicate with public office holders on behalf of his/her employer (an "in-house lobbyist") in an attempt to influence the development of legislative proposals, the introduction of bills or resolutions in Parliament, the making or amendment of regulations, the development or amendment of policies and programs, the awarding of grants, contributions or other financial benefits by or on behalf of the federal government, and, in the case of a consultant lobbyist, arranges a meeting between a public office holder and any other person. A public office holder is defined in the Act as any member of the Senate or the House of Commons or any person on the staff of such a member and any officer or employee of the federal government. It is the responsibility of consultants and lobbyists to register if they are engaged in activities described in the Act.

In 2000, the Treasury Board Policy on Transfer Payments was amended to require that contribution agreements contain a clause requiring a recipient company to indicate that any individual or company engaged by that recipient company to lobby on its behalf to obtain a contribution agreement was registered as a lobbyist under the *Lobbyists Registration Act*. Industry Canada amended the terms and conditions of the TPC contribution agreements from then on to include this requirement. As a result, TPC contribution agreements executed after 2000 contain this requirement.

RCGT Consulting Inc. was engaged to identify, gather and document the evidence relating to the above-noted purpose and to refer these facts to Industry Canada's Audit and Evaluation Branch. Based on the audit findings, RCGT Consulting Inc. classified recipient companies into two categories (appears to be compliant and non-compliant).

### **Scope**

47 recipient companies were selected for this engagement, which represented 24% of the total number of recipient companies (197 recipient companies as of August 2004) that received TPC contributions. At the time of this report, we have completed 46 recipient company audits. The 47<sup>th</sup> recipient company has not provided us with timely access to the books and records; as such, the file has been referred to Industry Canada for action.

<sup>3</sup> This obligation is found in section 6.5 of Schedule 1 (TPC General Conditions) of TPC Contribution Agreements. For TPC Contribution Agreements executed prior to 2000, this obligation is found either in section 9.5 or 12.5 of the Agreements

<sup>4</sup> This obligation is found in section 6.11 of Schedule 1 (TPC General Conditions) of TPC Contribution Agreements. This obligation is not found in TPC Contribution Agreements executed prior to 2000



Industry Canada indicated that, in March 2004, TPC requested all recipient companies to certify that they were in compliance with the terms and conditions of the TPC contribution agreement(s) by signing and returning a compliance certificate to Industry Canada. 101 of the recipient companies returned a signed compliance certificate to TPC. A list of those recipient companies that had returned and of those that had not returned the compliance certificates was prepared by Industry Canada and presented to RCGT Consulting Inc. From this list, RCGT Consulting Inc. selected a sample of 19 recipient companies. Industry Canada identified a further 28 recipient companies to be audited where it was believed there was a higher potential for non-compliance.

For each recipient company, a maximum of two projects were included in the audit as the majority of recipient companies did not have more than two projects approved under the TPC program. However, there were some recipient companies that had more than two projects and our audit sample included one such recipient company. All projects for this one recipient company were included in the audit.

The financial period included in the scope of the audit for each recipient company was six months prior to the recipient company's submission of the Investment Proposal and six months after the first payment of eligible costs from TPC. This time period was selected as it represented a reasonable timeframe for the flow of money between a recipient company and a consultant(s) for services rendered in obtaining the contribution agreement, should this have occurred.

### ***Scope Limitations***

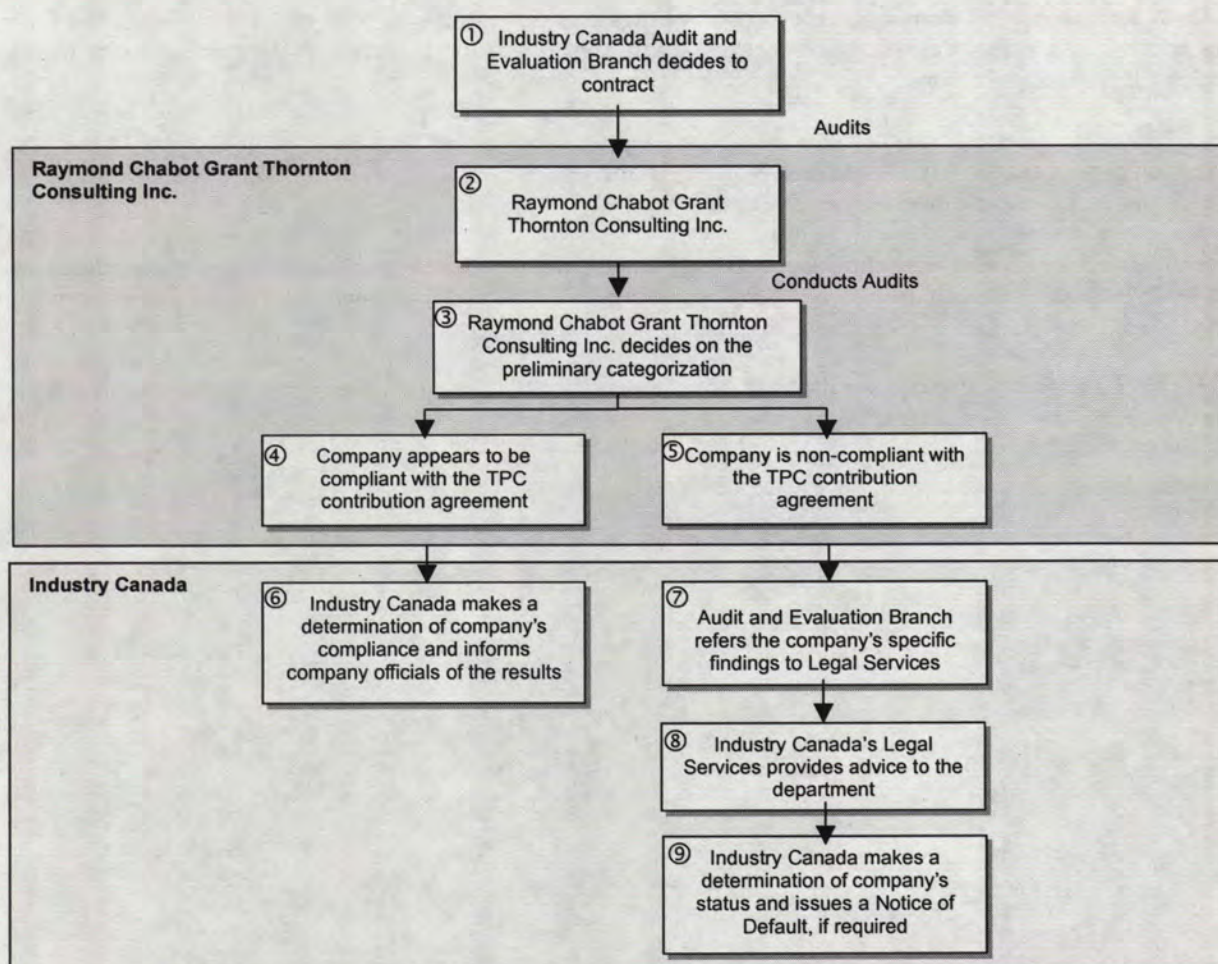
During the conduct of the recipient audits, we had the following scope limitations:

- Our audit procedures did not focus on the identification of non-financial inducements or considerations, such as future employment opportunities and stock options that were contingent on the award of the TPC contribution agreements, even though payment of non-financial inducements or considerations would also constitute a non-compliance under the terms of the agreement. If during the conduct of our audit procedures, non-financial inducements were identified, they were included and considered in our analysis and then referred to Industry Canada.
- Our audit included only the books and records of the recipient companies, as Industry Canada's audit rights under the TPC contribution agreement are restricted to these books and records. The books and records of any external parties (i.e. consultants or consulting firms) that were used by the recipient companies were not subject to the audit procedures as Industry Canada, under the contribution agreement, does not have audit right's to these books and records. We also did not audit the books and records of any companies related to the recipient companies.



## Industry Canada's Decision Process for the Conduct of the Recipient Audits

The following schematic depicts the roles and decision-making process developed by Industry Canada that is applied to each recipient audit.



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Industry Canada's Audit and Evaluation Branch contracted RCGT Consulting Inc. to conduct audits on selected recipient companies (box 1).

RCGT Consulting Inc. conducted an internal conflict of interest check on the selected recipient companies in order to determine if it could perform the audits (box 2). When the conflict of interest check was successfully completed, RCGT Consulting Inc. performed audit procedures in order to identify and gather appropriate evidence (box 3) to determine the categorization.

Based on the evidence gathered, RCGT Consulting Inc. classified the recipient companies' status and placed them into one of two possible categories (boxes 4 and 5):

- ▶ Appears to be compliant; or
- ▶ Non-compliant.

The Audit and Evaluation Branch discussed our findings and categorization, with us, and reviewed the facts (boxes 6 and 7). As of the date of this report the Audit and Evaluation Branch is in concurrence with RCGT Consulting Inc.'s categorizations.

For recipient companies that were classified as appearing to be compliant with the specific sections of the TPC contribution agreement (box 4), we are given to understand by Industry Canada that a notice will be sent to the recipient company to advise them of their status (box 6).

For recipient companies that were classified as being non-compliant with one or more of the specific sections, the Audit and Evaluation Branch transferred the supporting evidence and documentation to Legal Services for review (boxes 7 and 8).

Legal Services advises the department if a recipient company has breached its agreement and, if so, what actions by the department may be warranted (box 9).

# *Raymond Chabot Grant Thornton Consulting Inc.'s Recipient Audit Approach*

## **Planning**

The approach to the recipient audits was risk-based. The initial phase was designed to assess a large number of recipient companies by applying audit procedures that would provide an indication of potential non-compliance. Where audit results did not provide an indication of non-compliance, the recipient companies were categorized as "appearing to be compliant" and as such, were not subject to extended audit procedures.

Where there were immediate indications of non-compliance, recipient companies were categorized as "non-compliant". Where there was an indication of potential non-compliance, extended audit procedures were carried out. These extended procedures included in-depth interviews, documentation review and financial analysis to gather sufficient evidence to enable the auditors to make a reasonable categorization of the recipient companies. On the basis of the extended audit procedures undertaken, the recipient companies were categorized as either being:

- ▶ appearing to be compliant; or
- ▶ non-compliant.

For all recipient companies categorized as "non-compliant", the supporting evidence and the summary of results were submitted to Industry Canada.

RCGT Consulting Inc. developed an audit program, instructions for the audit teams and a letter requesting information from the recipient company representatives. RCGT Consulting Inc. also conducted training sessions with the audit teams across Canada to ensure that the audit procedures would be consistently applied and that all recipient companies would be treated fairly and equally. TPC project files were reviewed in order to provide the audit teams with some background information on the recipient company.

## **Fieldwork**

During the fieldwork phase, RCGT Consulting Inc. gathered the key evidence that was made available to the audit teams in order to classify the recipient companies into the two categories mentioned earlier.

Throughout the fieldwork phase, RCGT Consulting Inc. was in constant communication with the Audit and Evaluation Branch to ensure they were continually aware of the issues that were being encountered and their resolutions.

## **Quality Control**

After the audit teams completed the fieldwork, audit files were prepared based on a standard template of information to be collected and maintained. This template was developed in order to ensure that consistent information was collected from all audited recipients and to facilitate the quality review process.

RCGT Consulting Inc. also performed a more detailed review of selected TPC project files in order to gather additional information relating to clarifications on the nature of specific individuals' communications with TPC employees.

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The quality review process was performed in Ottawa, including partner equivalent review, in order to ensure that auditing standards were met, to compare results on a National basis, to modify audit procedures as required, to re-examine files as new information was identified and to allow for one point of contact to interact with the Audit and Evaluation Branch on a periodic basis. If additional clarifications or information were required, the audit teams across the country were requested to obtain and provide the information to the Ottawa office.

### **Extended Procedures**

If during the conduct of some of the audits, sufficient evidence could not be collected where there was the potential for non-compliance, the recipient companies were then subject to extended audit procedures. In many cases, Industry Canada requested RCGT Consulting Inc. to gather additional information. These procedures included in-depth interviews with recipient company officials and consultants, where available; additional documentation review and extended financial analysis, where required. The extended procedures also included gathering evidence to determine whether recipient company officials had received any payments that were contingent on the successful award of the TPC contribution agreement(s). We focused on cash payments. Non-cash payments such as the granting of stock options were not the focus of the recipient audits. We also focused on trying to identify the activities of recipient company officials and whether they should have been registered as lobbyists. Under the *Lobbyist Registration Act*, an interpretation bulletin issued by the Registrar of Lobbyist indicated that employees of corporations or organizations are required to register if 20% or more of their time is spent on lobbying activities. Where company officials were engaged in activities covered by the Act and where they were not registered, the company was categorized as non-compliant.

### **Summary of Findings and Categorization**

A "Summary of Findings" was prepared for each recipient company. The "Summary of Findings" for the recipient companies identified the key evidence that was gathered during the audit process and how their categorization was determined.

## Recipient Audit Results

The recipient audit results are described below. No extrapolation can be made of these results to the remaining TPC recipient companies. The results are based on the completion of audits of 46 recipient companies. If a recipient company was non-compliant for one agreement, the recipient company was identified as being non-compliant. This does not imply that the recipient company was necessarily non-compliant for all its TPC contribution agreements.

### Recipient Audit Results by Compliance Status

**Table 1**

	Number of Companies in the sample	Percentage
Recipient company appears to be compliant	30	65%
Recipient company is non-compliant	16	35% <sup>5</sup>
<b>Total</b>	<b>46</b>	<b>100%</b>

As can be seen from Table 1, 65% of the recipient companies appear to be compliant and 35% of the recipient companies are non-compliant with at least one of the two specific sections of the contribution agreement. For recipient companies that are non-compliant, the total amount of the identified contingency payments was in excess of \$3.3 million.

In our professional judgement, the dollar value of contingency payments could be larger as our focus was only on cash payments and not on non-financial inducements such as the granting of stock options. These contingency payments ranged between 1% to as high as 18% of the total funding that a recipient company was awarded from TPC and resulted in payments which range from approximately \$100,000 to \$900,000.

### Recipient Audit Results by Method of Sample Selection

**Table 2**

	Number of Recipient Companies in the Sample	Recipient company appears to be compliant	Recipient company is non-compliant
Recipient companies selected by RCGT Consulting Inc.	18	14 (78%)	4 (22%)
Recipient companies selected by Industry Canada	28	16 (57%)	12 (43%)
<b>Total</b>	<b>46</b>	<b>30 (65%)</b>	<b>16 (35%)</b>

In Table 2 the results are presented for the Industry Canada selected recipient companies and recipient companies that were selected by RCGT Consulting Inc.

These results would indicate that Industry Canada's concern of non-compliance was valid as there is a 43% non-compliance rate, which is higher than the 22% non-compliance rate for the recipient companies selected by RCGT Consulting Inc. In our professional judgement, we believe given the non-compliance rate in the sample, it is reasonable to assume that there are likely more recipient companies that are non-compliant among those that were not subject to an audit. However, no extrapolation should be made in this regard from the sample given the method of selection of the recipient companies to be audited.

<sup>5</sup> This rate of non-compliance is high. This is in part due to the fact that the sample included 28 recipient companies that Industry Canada believed had higher potential for non-compliance. These identified recipient companies represented 60% of the sample and the results for this group therefore increase the overall rate of non-compliance.

## Recipient Audit Results by Status of Responses to the Request for Compliance Certificates

Table 3

	Number of Recipient Companies in the Sample	Recipient company appears to be compliant	Recipient company is non-compliant
Recipient companies that returned the compliance certificates	29	19 (66%)	10 (34%) <sup>6</sup>
Recipient companies that did not return the compliance certificates	17	11 (65%)	6 (35%) <sup>6</sup>
<b>Total</b>	<b>46</b>	<b>30 (65%)</b>	<b>16 (35%)</b>

In the audit sample, 29 recipient companies responded that they were in compliance with the terms and conditions of the agreement and 17 recipient companies did not respond.

The non-compliance rate between these two groups shows very little variance (34% to 35%). The non-compliance rate of 34% for those selected recipient companies that did return the compliance certificate would indicate that the certification responses cannot be relied upon.

We noted that in 2004, some recipient companies certified that they were in compliance with their obligations under their contribution agreements. As we did not provide our audit findings to the recipient companies, we did not discuss the apparent discrepancy between our findings of being non-compliant and the compliance certificates provided by these recipient companies. As a result, we are not in a position to comment on whether these recipient companies, by providing compliance certificates to TPC, made an inadvertent or deliberate misrepresentation.

Also, during the course of conducting these recipient audits, we noted actions of third parties, which may be in contravention with legislation. These matters were referred to Industry Canada for review.

<sup>6</sup> This rate of non-compliance is high. This is in part due to the fact that the sample included 28 recipient companies that Industry Canada believed had higher potential for non-compliance. These identified recipient companies represented 60% of the sample and the results for this group therefore increase the overall rate of non-compliance.



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