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REPORT TO THE
DEPARTMENT OF REGIONAL INDUSTRIAL EXPANSION
OF THE GOVERNMENT OF CANADA
ON THE GRANTS AND CONTRIBUTIONS EXPENDITURES STUDY
AUGUST 1987

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Price Waterhouse



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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

The Department of Regional Industrial Expansion (DRIE) was created in December 1983 under the Department of Regional Industrial Expansion Act for the purpose of:

- "enhancing the national economy and achieving economic development in all regions in Canada;
- improving opportunities for productive economic expansion in all regions of Canada and access to those opportunities;
- promoting economic development in those regions in Canada in which opportunities for productive employment are exceptionally inadequate."

DRIE accomplishes its mandate through funding the private sector by means of grants, contributions, loans, and loan guarantees. These programs are managed in regional offices as well as centrally.

DRIE's initial voted amount for Vote 10 - Grants and Contributions for the fiscal year 1986-87 was \$789 million. This amount was subsequently increased, through Supplementary Estimates, to \$799 million. DRIE has reported having spent \$879 million for the year or \$80 million in excess of the amount voted by Parliament.

There is no one single program or factor which caused the 1986-87 overexpenditure. Rather, many interrelated factors have contributed to the overexpenditure. More details of these factors are discussed in the report which follows this executive summary.

Financial control over Grants and Contributions was not given a high priority since the establishment of DRIE. Several deficiencies in systems and practices followed by DRIE did not allow for optimum management of the funds provided and contributed to the overexpenditure of Vote 10 - Grants and Contributions. The three areas which were major contributors are:

- Forecasting;
- Budgeting;
- Financial Reporting.

Forecasting

Forecasting is a key element in controlling expenditures. In this respect, DRIE's financial management requirements are unique in the Government. Forecasting involves estimating the level and timing of payments that DRIE will make to meet the claims of its client corporations. Forecasts are developed by using an information base of commitments entered into, together with information on the client corporations' plans and DRIE's own plans.

DRIE has not been accurate in forecasting its expenditures which has led to an important credibility gap both within the Department and with Treasury Board. DRIE's expenditures for Grants and Contributions have differed significantly from the voted amount and from forecasts over the last five years. The amounts (in millions of dollars) are as follows:

	<u>Initial Forecasts</u>	<u>Voted Amounts</u>	<u>Actual Expen- ditures</u>	<u>(Under) Over-Expenditures</u>	
				<u>\$</u>	<u>% of Voted Amounts</u>
1982-83*	\$ n/a	\$ 972	\$ 685	\$ (287)	(30%)
1983-84*	n/a	998	757	(241)	(24%)
1984-85	955	970	773	(197)	(20%)
1985-86	1,027	930	710	(220)	(24%)
1986-87	1,081	799	879	80	10%

* Combination of Departments of Regional Economic Expansion and Industry, Trade and Commerce.

The variances between the voted amount and the expenditure have been very substantial every year except in 1986-87 where the variance was a closer 10% and, this time, an overexpenditure. In 1986-87, the voted amount, when compared to 1985-86, was reduced by 14% to an amount more in line with the actual expenditure of prior years. The expenditure itself increased over that of 1985-86, by 23%, for many reasons including management pressure on regions to meet their budgets and maturity of programs.

The accuracy in forecasting depends on the reliability of the financial data contained in the corporate data base which is used for the preparation of the forecasts. It also depends on the systems and practices followed in the preparation of the forecasts.

■ The reliability of the financial data used in the preparation of the forecasts has been a problem for some years. In 1985, the Auditor General of Canada reported serious errors in the data used in the computerized systems.

■ The systems and practices did not provide assurance that forecasts were prepared with due care. The forecasting process to be followed by the responsibility centers was not integrated with the departmental data base. The information on forecasts transmitted to Headquarters was a summary and was not sufficient to permit Headquarters to carry out a reasonable analysis and review. The forecasting process was not documented and before June 1987 there were few general departmental guidelines or procedures for forecasting.

■ The follow-up process with client corporations varied between responsibility centers and there is no evidence that the regional officers concerned consistently took the necessary steps to ensure that the corporate data base reflected the most up-to-date information.

■ Discounting was used by DRIE as a means of compensating for the large variances with actual expenditures. The manner in which discounting was applied was a further cause of poor forecasting. Double discounting was practiced: Headquarters were reducing the amounts already discounted at the operational level. The discounts applied were based on historical underspending and not on an evaluation of what current spending levels might be.

Budgeting

Another factor contributing to the 1986-87 overexpenditure is the levels at which internal budgets were set. The total of the responsibility centres' budgets in 1986-87 was greater than the final amount voted as well as the funds available during the year.

DRIE determines its level of funds available by adjusting the amounts voted to reflect additional sums of money authorized by Treasury Board as well as those sums which are frozen by Treasury Board. The table which

follows indicates the amount (in millions of dollars) by which the internal budgets exceeded the voted amount and the funds available at various moments during the year 1986-87.

	<u>Voted Amount</u>	<u>Funds Available</u>	<u>Internal Budget</u>	<u>Excess of Internal Budgets Over</u>	
				<u>Voted Amount</u>	<u>Funds Available</u>
April 1, 1986	\$ 789	\$ 761	\$ 810	\$ 21	\$ 49
June 30, 1986	789	751	802	13	51
September 30, 1986	789	744	818	29	74
December 31, 1986	789	743	869	80	126
March 31, 1987	799	799	895	96	96

The regions, in total, spent \$879 million which is close to the amounts of their budgets. This practice of overbudgeting is very risky, especially in view of the difficulties inherent in forecasting and in controlling the actual expenditures.

Financial Reports

No regular financial reports were submitted to the Minister and to the Management Committee in 1986-87 until September 1986. There is no evidence of any regular discussion of financial matters by the Management Committee until that time.

Regular management reports for distribution to Management were initiated in September 1986. However, the information contained in these reports was incomplete and sometimes conflicting. The forecast information in the reports varied widely from month to month as shown in Exhibit 2 of the report. The presentation of the information did not transmit clear,

credible and timely warning signals as to the potential problem. The commentary in the reports emphasized only forecasts after the departmental discounts had been applied. The presentation of the information invited the reader to focus attention on the wrong bottom line. There was no pertinent summary of key indicators and essential information was missing.

DRIE'S ACTIONS

A study was undertaken by the Operations Audit Branch at the end of 1986 to develop recommendations for improving forecasting.

A directive was issued in June 1987 outlining an improved forecasting process, defining roles and responsibilities and establishing accountability.

A department-wide review was undertaken in June 1987 to confirm outstanding commitments and to determine if projects could be rescheduled. The result of that review was a reduction of \$49 million in forecasts for 1987-1988.

In July 1987, additional actions have been taken to update the financial information and contacts have been made with client corporations in an effort to improve the information base for forecasting.

These actions should in the long term result in more reliable financial information for forecasting.

RECOMMENDATIONS

The following is a summary of the recommendations, details of which are included in the report that follows.

DRIE should reduce the uncertainties created by its external environment. There should be regular contacts with client corporations. It should consider introducing conditions into its contracts which would allow it to forecast better.

DRIE should undertake a review of the financial information contained in the departmental data base and make the necessary adjustments to it in order to establish the reliability of the financial information.

DRIE should maintain systems and practices which allow for the updating of the departmental data base and for the preparation of realistic data. Detailed procedures for the forecasting process should be prepared as soon as possible by the responsibility centres, in accordance with the general directive issued in June 1987, and should be submitted for approval.

Regular independent confirmations of client corporations' intentions should be carried out by the Operations Audit Branch.

Efforts should be made to balance spending patterns throughout the year.

Forecasts should be realistic estimations of overall project realization based on all relevant factors.

The practice of establishing internal budgets in excess of voted amounts and funds available should be abandoned.

The format of financial reports to senior management and the Minister should be reviewed to focus attention on the needs of differing levels of management for financial information.

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INTRODUCTION

The Department of Regional Industrial Expansion (DRIE) was created in December 1983 under the Department of Regional Industrial Expansion Act for the purpose of:

- "enhancing the national economy and achieving economic development in all regions in Canada;
- improving opportunities for productive economic expansion in all regions in Canada and access to those opportunities; and
- promoting economic development in those regions in Canada in which opportunities for productive employment are exceptionally inadequate."⁽¹⁾

DRIE accomplishes its mandates through funding the private sector by means of grants, contributions, loans and loan guarantees. The programs through which financial assistance is provided are numerous and varied. Some are managed in regional offices while others are managed centrally and coordinated with regional offices. The three main programs are the Economic and Regional Development Agreements (ERDA), the Defence Industry Productivity Program (DIPP) and the Industrial and Regional Development Program (IRDP).

(1) Regional Industrial Expansion, 1987-1988 Estimates, Part III, Expenditure Plan.

DRIE's total initial voted amount for 1986-87, as reported in the Main Estimates, was \$1,122 million of which \$789 million was attributed to Vote 10 - Grants and Contributions. This amount was subsequently increased, through Supplementary Estimates, to \$799 million.

DRIE has reported having spent \$879 million for Grants and Contributions in 1986-87 or \$80 million in excess of the amount voted by Parliament for that period.

Price Waterhouse was asked to review the situation to determine and report to the Minister the causes of the overexpenditures in Vote 10 - Grants and Contributions and to make recommendations which would reduce the possibility of this situation recurring.

FINDINGS AND RECOMMENDATIONS

Financial control over Grants and Contributions was not given a high priority since the Department of Industry, Trade and Commerce and the Department of Regional Economic Expansion merged to become the Department of Regional Industrial Expansion (DRIE). The considerable amount of effort required to carry through the merger, the high turnover in senior management, the availability of funds being greater than needed resulted in lower priority being given to the development of systems and practices which would provide optimum funds management. Optimum management of funds requires that DRIE:

- accurately identifies its needs for funds resulting from commitments it has made with client corporations;
- estimates with a reasonable degree of accuracy the level and timing of the payments it will have to make to respect the commitments;

- accumulates and processes information related to the expected expenditures to be incurred throughout the year;
- analyzes the expenditures incurred in relation to expected expenditures;
- explains any deviations of expenditures incurred from those expected and takes corrective action, if necessary;
- reviews and revises its estimates as a result of the analyses carried out;
- reports on its results to the Minister, Senior Management, Central Agencies and others, as required, in a manner to allow for sound decision-making.

An evaluation of the factors which must be present if DRIE is to exercise sound management of funds revealed deficiencies which contributed to the overexpenditure of Vote 10 - Grants and Contributions appropriation in 1986-87. Three factors were major contributors. They are:

- Forecasting
- Budgeting
- Financial reporting

Other factors which have been evaluated but which have had a lesser or indirect influence are:

- Voted amounts
- Programs
- Special Projects
- Management turnover

FORECASTING

The unreliability of forecasting has been a major contributing factor to the 1986-87 overexpenditure.

Forecasting is a key element in controlling the current year's expenditures. It involves estimating the level and timing of payments that DRIE will make to meet its commitments to client corporations.

Forecasts are developed by using an information base of commitments which DRIE has entered into, together with information on the client corporations' plans. Operational forecasts are prepared by responsibility centres. They represent the cumulative expenditures, the existing commitments for which the responsibility centres expect expenditures to be made as well as new commitments which are anticipated in the year. The forecasts are updated each month for the current year as well as for the two subsequent years. They are submitted to Headquarters which reviews and evaluates the operational forecasts and prepares a consolidated departmental forecast.

Discounts were applied by the responsibility centres before sending their forecasts to Headquarters. Headquarters applied additional discounts in preparing consolidated departmental forecasts. Discounting involves reducing forecasts to take into consideration uncontrollable events causing delays in the completion of projects.

DRIE has not been accurate in forecasting its expenditures resulting in an important credibility gap within the Department and with Treasury Board. As is indicated in the following table, DRIE has shown a poor record of forecasting over the last three years. DRIE's expenditures for Grants and Contributions have differed significantly from voted amounts and from forecasts.

	<u>Initial Forecasts</u>	<u>Voted Amounts</u>	<u>Actual Expen- ditures</u>	<u>Forecasts Over(under) Voted Amounts</u>	<u>Forecasts Over(under) Expen- ditures</u>
1982-83*	n/a	972	685	-	-
1983-84*	n/a	998	757	-	-
1984-85	955	970	773	(2%)	24%
1985-86	1,027	930	710	10%	45%
1986-87	1,081	799	879	35%	23%

* Combination of Departments of Regional Economic Expansion and Industry, Trade and Commerce.

The variances between the voted amount and the expenditure have been very substantial every year except in 1986-87 where the variance was a closer 10% and, this time, an overexpenditure. In 1986-87, the voted amount when compared to 1985-86 was reduced by 14% to an amount more in line with the actual expenditure of prior years. The expenditure itself increased over that of 1985-86, by 23%, for many reasons including management pressure on regions to meet their budgets and program maturity.

In 1986-87, forecasts submitted by responsibility centres were significantly higher than the actual expenditures during most of the year as is indicated in Exhibit 2.

Problems with Forecasting

DRIE's accuracy in forecasting depends on the reliability of the financial information upon which it is based. The reliability of the information contained in the data base is dependent on the timeliness and accuracy of information obtained from DRIE's client corporations, as well as the timeliness and accuracy of entering and updating the data base. Accurate forecasting also depends on the processes and systems in place to accumulate, analyse and report this information.

■ The reliability of the financial information upon which forecasts are based has been a problem for some years. In his 1985 comprehensive audit of DRIE, when examining the IRDP and DIPP programs, the Auditor General of Canada found serious errors in the departmental data used in DRIE's two computerized systems, Program Resource Information System for Management (PRISM) and Resource Accounting Management System (RAMS), which data was also used for preparing forecasts. Exhibit 1 presents extracts from the Auditor General of Canada's 1985 annual report relating to the unreliability of the data.

In 1986-87, forecasts submitted by responsibility centres were significantly higher than the expenditures during most of the year, as is shown in Exhibit 2, while the consolidated departmental forecasts were lower than the actual final expenditures.

■ Processes and systems used to prepare forecasts have not provided assurance that the forecasts were realistic. The two information systems in use at DRIE in 1986-87 were not intended for forecasting purposes. PRISM is a program management system while RAMS is a financial management system.

The forecasting process followed by the responsibility centres was not integrated with the departmental data base used in the other two systems. The process entailed obtaining the financial information contained in the corporate data base, updating it to reflect current financial information on commitments and on anticipated timing and levels of claims, preparing and reporting forecasts to Headquarters using a separate system (OPUS). The forecast information submitted to Headquarters was a summary of financial information by program and did not include details of the projects. It gave no indication of the discounts applied by the

responsibility centres. This did not permit Headquarters to rigorously analyze the information and evaluate the reasonableness of the forecasts.

Before June 1987, there were few general departmental guidelines or procedures for forecasting. Each centre was responsible for developing its own procedures relating to forecasting and follow-up in the client corporations regarding timing and levels of claims. The responsibility centres were not required to send their procedures to Headquarters.

The forecasting process was not documented and there is no evidence that it was followed in a uniform manner by all responsibility centres. The follow up process with the client corporations varied from centre to centre and there is also no evidence that the officers consistently took the necessary steps to ensure that the corporate data base reflected the most up-to-date information.

■ One major problem that DRIE faces in ensuring the reliability of its data is its lack of control over the timing of claims from its client corporations. DRIE manages multi-year programs and makes multi-year commitments. It is heavily dependent on its client corporations' planning of events and decisions to submit claims. There is no evidence that DRIE has formally taken steps to strengthen that control. Not all of DRIE's current contracts with client corporations include conditions which would permit the Department to control the timing of payments better and when they do, they are not always enforced. There is no evidence that program officers in responsibility centers apply, in a consistent manner, a rigorous follow-up with their client corporations to obtain more updated information on the status of the projects.

■ DRIE's expenditure patterns could be used as a means for verifying the reliability of the forecasts at various periods in the year. However, the current spending patterns do not permit the effective use of this information.

The table below shows the cumulative expenditures at the end of December and March for the fiscal year 1986-87 and the two previous years (in millions of dollars).

<u>Cumulative Expenditures</u>	<u>1984-85</u>		<u>1985-86</u>		<u>1986-87</u>	
December 31	\$382	49%	\$332	47%	\$370	42%
March 31	610	79%	490	69%	655	75%
Final	773	100%	710	100%	879	100%

The following table shows the expenditures of 1986-87 and the two previous years which were processed after their respective year-ends.

	<u>1984-85</u>		<u>1985-86</u>		<u>1986-87</u>	
Post year-end expenditures	\$163	21%	\$220	31%	\$224	25%

For the three years above, more than 50% of the expenditures have been processed in the last quarter of the fiscal year, of which more than 20% have been processed in the period subsequent to the year-end.

There is no evidence of either analyses as to why this bunching up occurs annually or of actions taken to balance the spending patterns throughout the year. There is no system to ensure that all claims received are

processed on a timely basis and in the appropriate fiscal year. Such a system would help in evaluating the outstanding claims and hence improve forecasting.

The last quarter rush creates additional uncertainties over the control of expenditures and does not permit DRIE to use expenditures as one of the means for evaluating its forecasts.

* Discounting was used by DRIE as a means of compensating for the large variances with actual expenditure. The manner in which discounting was applied compounded the problem. Double discounting was practiced, i.e., Headquarters applied discounts on forecasts which had already been discounted by the responsibility centres. There is no evidence of consistency in regards to the discounts taken by the responsibility centres nor was Headquarters informed as to the amounts of such discounts. Discount factors were based on historical underspending, the causes of which had not been adequately analyzed.

Corrective Actions

The difficulty in reasonably predicting expenditures has been recognized by the Department and actions have been taken recently to improve the forecasting process.

A review of Grants and Contributions Forecasting was undertaken by the Operations Audit Branch at the end of 1986 and reported in early 1987. The major resulting recommendation for improving forecasting was the issuance of a departmental directive on forecasting. At its April 6th meeting, the Operations Policy and Review Committee (OPRC) decided to postpone the implementation of this recommendation.

New computer software (Commitment Forecasting Module) was introduced in April 1987 aimed at giving more reliable and complete forecasting information. This module requires that responsibility centres use the corporate data base information to prepare their forecasts and permits Headquarters to access the same information for further analyses and validation.

A directive was issued in June 1987 outlining an improved forecasting process and defining roles and responsibilities. This requires each responsibility centre to develop its own internal forecasting process and submit it for approval.

A Department-wide review of the status of commitments was undertaken by an internal team in June to confirm outstanding commitments and to determine if projects could be rescheduled. The team visited all responsibility centres and requested the project officers to review and revise the financial information for all projects over \$50,000. The results of this review were a reduction of \$49 million in forecasts for 1987-88.

More recently, additional actions have been taken by DRIE to update its financial information and contacts have been made with client corporations to improve information on the timing and the amounts of the anticipated expenditures. Such actions include a detailed examination of all existing agreements so as to further clarify projected spending for the current and subsequent two years, and record the information in management information systems.

RECOMMENDATIONS

DRIE is dependent on its client corporations' actions and information as to the level and timing of claims to establish accurate forecasts of its

Grants and Contributions Expenditures. It has not until now taken all effective means that it could to reduce that dependency.

Recommendation 1: DRIE should reduce the uncertainties created by its external environment. Measures should be formalized to include:

- Regular contacts with client corporations.
- Quarterly statements to clients showing the amounts and timing of payments in DRIE's records. The statements should request the corporations to reply either confirming that their plans have not changed or giving details of changes.
- Introducing conditions in the agreements giving time limits for the submission of claims.
- Introducing conditions in the agreements specifying years in which payments are foreseen, and requiring companies to obtain DRIE's consent for amending the timing of claims.

The actions taken by the Department over the recent months to improve the quality of the information should result in a more reliable information base on which to forecast expenditures. The past years' forecasting has resulted in a lack of credibility in the Department's information base and forecasts. It becomes essential to re-establish this credibility and determine before year end the extent to which these actions have resulted in an information base reflecting the corporations' intentions and in realistic projected spending.

Recommendation 2: A review of the financial information contained in the departmental data base should be undertaken to establish the reliability of the information and to update the data base. To be cost-effective, the review should be concentrated in those programs and projects representing the greater dollar value of the authorized assistance. Programs and projects of lesser magnitude should be reviewed on a

selective or random basis, using statistical sampling techniques. The review should include:

- Review of the assistance agreement for those projects selected.
- Verification of the amount of the contribution agreement in the departmental data base with the agreement.
- Verification of the projected cash flow in the departmental data base with the agreements.
- Review of projects recorded only in the responsibility centres so as to determine the extent of projects not recorded in the Department's data base.
- Confirmation with the client corporations of their intentions as to the timing and level of claims. The methods of confirmation will vary according to the type of programs and to the type and status of the projects. These methods will include sending questionnaires to corporations on their intentions, follow-up telephone calls or visits where necessary.
- Analysis of results.
- Conclusion as to how accurate the information base is.

Keeping the information base up-to-date is an important element in the forecasting process. It is not enough for operational managers to update their own records. Senior management relies on information in the departmental system for decision-making. There has been no regular and systematic confirmation of client corporations' intentions carried out by an independent group in the Department. Processes and systems must be put in place to ensure that the Department's data base is reliable and forecasts are realistic.

Recommendation 3: Detailed forecasting procedures should be prepared as soon as possible by the responsibility centers, in accordance with the general directive issued in June 1987, and should be submitted for approval. There should be regular monitoring by the Operations Audit Branch to ensure that the approved procedures are being adhered to.

Recommendation 4: Regular independent confirmations of client corporations' intentions should be carried out by the Operations Audit Branch.

Recommendation 5: Efforts should be made to balance spending patterns throughout the year. Such efforts should involve:

- Analysis by the Department of the causes for the last quarter rush and the establishment of steps to change the pattern.
- Controls over the receipts of claims should be instituted. They should include the logging of claims as they are received and the monitoring of the status of claims until payment.
- DRIE should perform an analysis of historical spending patterns as well as current year patterns on a regular and a timely basis and give them more prominence in the monthly management report.

There are outside factors which may cause companies not to realize their intended start-up dates. A judgment has to be made based on factors including past performance, types of project, and economic factors to establish the general provisions which will reduce the overall total of anticipated payments to a realistic level. Discounts are best established by operational management. Responsibility centres' discount rates should be reviewed by Headquarters and discrepancies should be investigated. Discounts should not be based mainly on historical factors. There are considerable time lags between the establishment of the programs, the realization of the projects and the eventual payments

so that many other factors such as the economic conditions could alter the historical patterns.

Recommendation 6: Forecasts, which include discounts, should be realistic estimations of overall project realization based on program maturity, regional economic conditions and other relevant factors. The use of models should be considered when forecasting.

BUDGETING

A second contributing factor to the overexpenditure was the level at which the internal budget was set in 1986-87.

DRIE establishes an internal budget and allocates it to its responsibility centres. In 1986-87, DRIE established internal budget levels in excess of the voted amounts. Exhibit 3 shows the budget levels allocated throughout the year. These were greater than the voted amounts and have varied throughout the year to reflect approved new initiatives.

This practice of overbudgeting is risky. The responsibility centres are accountable for their allocated budgets and are expected to meet them. The responsibility centres, in total, spent close to their internal budget in 1986-87, thus creating an overexpenditure by reference to the voted amount.

The manner in which budgets are determined and monitored is not conducive to an effective expenditure control. As shown in Exhibit 4, there is no evident link between the internal budgets and DRIE's commitments and forecasts submitted by the responsibility centres. The commitments should be the basis for determining funds needed and the budgets.

The budgets are not allocated on a periodic basis so that a comparison of cumulative expenditures cannot be done meaningfully.

In 1986-87, DRIE did a monthly comparison of the annual budget to annualized forecasts as opposed to expenditures.

Recommendation 7: DRIE should stop the practice of overbudgeting. The annual budget should be subdivided by quarter and should be monitored against expenditures during the year.

FINANCIAL REPORTING

Financial reporting to senior management has varied over the last few years reflecting the different requirements of Senior Management for regular financial information.

Up until September 1986, there were no regular financial reports submitted to the Management Committee and there is no evidence of any regular discussion of financial matters by the Management Committee until that time. In September 1986, monthly financial management reports were prepared and submitted to the Operations Policy and Review Committee (OPRC). These reports contained program information as well as financial information on voted amounts, budgets, responsibility centres' and Headquarters' forecasts and expenditures. They also contained a written commentary on the financial situation. These reports were distributed to members of the OPRC, to the financial officers in each responsibility centre, to the Minister's office and to representatives of the Treasury Board Secretariat and the Office of the Comptroller General.

The commentary and the financial data contained in these reports was incomplete and sometimes conflicting. The financial data in the reports combined amounts related to Vote 10 and Vote 20. It did not clearly distinguish between voted amounts and the funds available. The financial data included forecasts before and after discounts established by Headquarters. Although Headquarters' discount fluctuated widely (from \$268 million in September 1986 to \$44 million in March 1987, as may be determined from Exhibit 2), no explanation was provided in the report. There was no pertinent summary of key indicators and essential information was missing, such as:

- A comparison of forecast expenditures to voted amount.
- Total commitments before discounts (at Headquarters as well as responsibility centre levels) so as to highlight the total contingent liability.
- Discounts at responsibility centre levels.
- Deficit between the undiscounted forecasts and the voted amounts and related explanations.
- Amount of funds available for new projects or special initiatives.

The presentation of the information did not transmit clear, credible and timely warning signals as to the potential problem. A sample of the comments follows:

September 1986 -

"For Grants and Contributions in 1986-87, the budget should be sufficient to handle proper requirements including major items..."

"The rate of Grants and Contributions spending in 1986-87 is slow by historical standards. Although it is too early to draw definitive conclusions at this time, this may suggest that expenditure forecasts in this document for 1986-87 are on the high side."

October 1986 -

"For Grants and Contributions a year-end surplus is now forecast, taking into account spending under regular program projects and special initiatives..."

November 1986 -

"For Grants and Contributions in 1986-87, a year-end deficit of \$19 million is now forecast, taking into account spending under regular program projects and special initiatives... A forecast deficit of this magnitude is not considered significant vis-à-vis the total resources available, given the usual margin of forecasting error."

December 1986 -

"For Grants and Contributions a year end deficit of \$7 million is now forecast, assuming the GM/Ste. Thérèse and parts of the Versatile project all go forward. This is now considered a hard forecast and suggests a serious possibility of DRIE over-utilizing its Grants and Contributions budget for the year. Cautious management of the claims process and payables at year end will be required to avoid over-utilization."

January 1987 -

"For Grants and Contributions, in fiscal 1986-87, a year-end deficit of \$20 million is now forecast... This is now considered a hard forecast and suggests a serious possibility of DRIE over-utilizing its Grants and Contributions budget for the year if the GM/Ste. Thérèse project is implemented. As fiscal year-end approaches cautious management of the claims process and 'payables at year-end (PAYE)' account will be required to fully utilize reference levels and avoid over-utilization. A 'steady as she goes' approach to claims processing is appropriate at the present time."

February 1987 -

"A year end surplus of \$4 million is now forecast."

March 1987 -

"A year end overexpenditure of \$46 million is now forecast for 1986-87."

The commentary in the report emphasized forecasts after the departmental discounts had been applied. The presentation of the information invited the reader to focus attention on the wrong bottom line.

OTHER FACTORS

Other factors have had lesser influence on the 1986-87 overexpenditure.

Voted Amount

The funds available to DRIE for Grants and Contributions are voted by Parliament. Although still in excess of prior years' actual expenditures, these voted amount have decreased from \$972 million in 1982-83 (combination of the Departments of Regional Economic Expansion and Industry, Trade and Commerce) to \$799 million in 1986-87. They have been established at \$850 million in 1987-88. While this voted amount decreased, the actual expenditures increased in the same period from \$685 million in 1982-83 to \$879 million in 1986-87. (See table provided on page 5.)

Programs

Exhibit 5 represents the actual expenditures by major programs incurred in the fiscal year 1986-87 and the variance from the corresponding voted amount. No single program was the cause of the overexpenditure as it occurred in many programs.

The manner of allocating the voted amount does not permit the determination of whether the overexpenditure can be attributed to any particular responsibility centre.

DRIE accumulates detailed financial information on the expenditures by program and by responsibility centre. There is no analysis of historical spending patterns by program and no meaningful analysis of actual spending against budget or voted amount.

Exhibit 6 represents the cumulative spending patterns for 1986-87 and for the two previous years. The cumulative expenditures at the end of December 1986 and January 1987 as well as their percentages of voted amount and internal budgets were higher than those of the preceding year.

Major Projects

The amounts spent on major projects in 1986-87 had a minor impact on the year's overexpenditure. DRIE spent \$78.9 million on Special Projects. Of this amount, \$23.9 million was financed from the funds available for DRIE's regular programs; the remaining amounts were obtained by an additional vote (\$10 million) of Parliament and by releasing previously frozen funds. The documentation examined indicated that DRIE believed the special projects could be financed out of regular funds.

Although the amounts granted special projects did not have a significant impact on the 1986-87 overexpenditure, the uncertainty surrounding the amounts and the timing of the payments created additional difficulties in forecasting expenditures.

Management Turnover

Since its creation in December 1983, DRIE has had a significant turnover in senior management. Five ministers and six deputy ministers were appointed during that period. Other levels of management also underwent significant changes. The management turnover did not have a direct impact on the 1986-87 overexpenditure. It has, however, contributed to the existence of inconsistent financial information systems and reporting as the requirement for information changed with different senior managers.

CONCLUSION

We have conducted a study to determine the causes for the Department of Regional Industrial Expansion exceeding the amounts voted by Parliament for Grants and Contributions in 1986-87. Our study included interviews with key officials in the Department, as well as reviews of relevant documentation such as internal studies, reports, correspondence and minutes. We also reviewed the reports of the Auditor General of Canada. In addition, we consulted with the Operations Audit Branch of the Department and had some participation in its internal study of the Grants and Contributions overutilization which was carried out concurrently.

Our study was limited to identifying the major factors which have contributed to the overutilization, and to making recommendations with regards to actions that the Department should take to reduce the possibilities of having this situation recur. We did not carry out an audit of the information in the Department's data base or financial systems; therefore, we do not express any opinion on the reliability of the information therein. We did not examine the systems which collect the financial information and accordingly, we do not express an opinion as to the integrity of these systems.

We have discussed our findings with senior departmental officials. They have not disagreed with the findings and have provided additional information and perspectives.

There was no one single factor which led to the overutilization of \$80 million in Vote 10 - Grants and Contributions in 1986-87. The major factors causing the overexpenditure were inaccurate forecasts on expenditures, internal budgets being set at a higher level than the amounts voted by Parliament and a lack of clear warning signals in financial reports. Such problems result from the low priority given to financial control over Grants and Contributions since the creation of DRIE. The common denominator in these problems is the absence of reliable information which would allow management to take appropriate actions. We acknowledge that the Department can never totally control the environment in which it operates. The companies who receive the Grants and Contributions control the timing of claims. The Department could tighten the conditions in its agreements with companies. DRIE should make it a priority to improve and maintain the quality and reliability of its financial information in order to effectively control the expenditures of the amount voted by Parliament.

Our study could not have been completed within such a short time span without the complete collaboration of the officials of DRIE. We appreciate the cooperation of the Department's management.

Price Waterhouse

PRICE WATERHOUSE

August 1987

EXTRACTS FROM THE AUDITOR GENERAL OF CANADA REPORT
FOR THE FISCAL YEAR ENDED MARCH 31, 1985

12.16 ...Also, in over half the projects we examined, there were serious errors in the data in the department-wide IRDP information system. Although relatively few IRDP projects were processed by headquarters staff, we observed many of the same problems at headquarters as we found in the regions.

12.58 IRDP is supported by two computerized management information systems with a corporate data base that contains detailed information on IRDP projects. These systems were implemented in the relatively short time of less than a year, and development work on them is continuing.

12.59 We compared the data recorded in the Program Resource Information System for Management with the information in each project file we examined. We also verified whether forecast cash flow patterns in the Resource Allocation Management System were accurate. There were errors in the data recorded in nearly all the approved projects. About half of these were serious errors, for example the amount of assistance or jobs created. The extent of these was such that the overall usefulness of the system to management was impaired.

12.60 Some of the problems were due to difficulties with the definitions of what should be entered into certain data fields. Others were due to errors in original data input or poor procedures for verifying and updating the many data requirements of the system. In most regions, a copy of the information system printout for a project was not on the project file. This meant that errors could not be spotted and corrected by case offices. However, the basic problem appeared to be that responsibility for the quality of information in the systems was not clearly identified, and individual project officers did not have to use this information in analysing projects. At the end of our audit, action was under way in the regions to correct the most serious problems we noted, and definitions were being clarified.

Project Monitoring

12.92 Approved projects must be monitored to ensure that DIPP funds are being disbursed and used in accordance with contract conditions. There were significant gaps in the monitoring of approved projects. In 40 per cent of the cases we reviewed, there were no project status reports or other monitoring reports on file.

12.100 Key performance information on DIPP projects was not being entered into the Program Resource Information System for Management, the Department's main program information system. As a result, information was not available on basic program performance, such as expected export sales and job creation. With respect to the main financial system, the Resource Allocation Management System, we noted several errors in the statements of cumulative assistance granted and total funds available for future years.

VOTE 10 - GRANTS AND CONTRIBUTIONS

COMPARISON OF FORECASTS TO EXPENDITURES
DURING 1986-1987
(in millions of dollars)

	HQ <u>Forecast(1)</u>	RC <u>Forecast</u>	Final Actual <u>Expen- diture</u>	Forecast Variance as a % of Final Actual Expenditure <u>- Over (Under) -</u>	
				HQ	RC
1986					
September	\$813	1,081	879	(8%)	23%
October	809	1,063	879	(8%)	21%
November	781	1,005	879	(11%)	14%
December	772	949	879	(12%)	8%
1987					
January	784	899	879	(11%)	2%
February	795	893	879	(10%)	2%
March	845	889	879	(4%)	1%

(1) Source: Financial Management Reports (Table VI).

The forecast figures have been adjusted to remove the Vote 20 amount (\$10 million).

RC: Responsibility Centres.

VOTE 10 - GRANTS AND CONTRIBUTIONS
COMPARISON OF BUDGETS TO VOTED AMOUNT
(in millions of dollars)

	<u>Voted amount</u>	<u>Internal Budgets(1)</u>	<u>Overbudget</u>
1986			
April	\$789	\$810	\$21
May	789	809	20
June	789	802	13
July	789	803	14
August	789	803	14
September	789	818	29
October	789	819	30
November	789	819	30
December	789	869	80
1987			
January	789	885	96
February	789	885	86
March	799	895	96

(1) Source: Status of Departmental Resources, Vol. 2 and 3, April 1986 to August 1986.

Financial Management Report (Table IX)
September 1986 to March 1987.

VOTE 10 - GRANTS AND CONTRIBUTIONS

COMPARISON BETWEEN BUDGETS
AND COMMITMENTS AND FORECASTS
1986-1987
(in millions of dollars)

	<u>Commitments</u>		<u>Responsibility</u> <u>Centre</u>	<u>Budgets</u>
	<u>Existing</u>	<u>Planned</u>	<u>Forecasts</u>	
1986				
September	\$851	\$230	\$1,081	\$819
October	822	241	1,063	819
November	842	163	1,005	819
December	848	101	949	869
1987				
January	863	36	899	885
February	867	26	893	885
March	884	7	891	895

Source: Financial Management Reports, Tables VI and IX.

VOIE 10 - GRANTS AND CONTRIBUTIONS
EXPENDITURES BY PROGRAM
1986-1987

	<u>Actual</u> <u>Expenditure(1)</u>	<u>Voted</u> <u>Amounts(2)</u>	<u>Variance</u>	<u>Variance</u> <u>as % of</u> <u>Voted</u> <u>Amounts</u>	<u>Program</u> <u>Variance</u> <u>as a %</u> <u>of Total</u> <u>Variance</u>
IRDP	\$275	\$242	\$33	13%	41%
DIPP	189	175	14	8%	17%
Sub-agreements	146	130	16	12%	20%
CIRB	73	55	18	33%	22%
NEDP	43	30	13	43%	16%
SIAP	14	13	1	8%	2%
ILAP	4	4	-	-	-
WTID	7	6	1	17%	2%
SARDA	19	21	(2)	(10%)	(2%)
Other programs	30	43(3)	(13)	(30%)	(16%)
Special projects	<u>79</u>	<u>80(3)</u>	<u>(1)</u>	<u>(2%)</u>	<u>(2%)</u>
	<u>\$879</u>	<u>\$799</u>	<u>\$80</u>		<u>100%</u>

(1) Source: Operations Audit Report extracted from RAMS.

(2) Source: Status of Departmental Resources, April 1987,
Section 1, page 3.

(3) Allocation based on Treasury Board approvals for special projects.

**VOTE 10 - GRANTS AND CONTRIBUTIONS
CUMULATIVE EXPENDITURES**

	<u>Actual Expenditures</u>			<u>% of Actual to Voted amount</u>			<u>% of Actual to Internal Budgets</u>		
	<u>1984/ 1985</u>	<u>1985/ 1986</u>	<u>1986/ 1987</u>	<u>1984/ 1985</u>	<u>1985/ 1986</u>	<u>1986/ 1987</u>	<u>1984/ 1985</u>	<u>1985/ 1986</u>	<u>1986/ 1987</u>
At end of:									
October	\$ 256	\$236	\$214	26%	25%	27%	25%	27%	24%
December	382	332	370	39%	36%	46%	38%	38%	42%
January	n/a	366	498	-	39%	62%	-	42%	56%
February	n/a	431	564	-	46%	71%	-	50%	64%
March	610	490	655	63%	53%	82%	61%	57%	74%
Final	773	710	879	80%	76%	110%	77%	82%	99%
Voted amount	\$ 970	\$993	\$799						
Internal Budgets	\$1,006	\$864	\$895						

Sources: Financial Management Reports
Resource Accounting Management System Reports



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