Chapter 28

Canadian International Development Agency

Financial Controls Over Projects

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Main Points

28.1 CIDA's financial controls are effective in monitoring and controlling the flow of funds for projects, and in tracking the financial status of projects — that is, what has been spent and what remains to be spent. However, reports on the progress of projects often do not compare what has been accomplished with what was planned. This makes it difficult to determine the rate of progress or to analyze the financial implications of changes from expected progress. The result is a risk that project scope may have to be reduced or the budget increased to accomplish the intended objectives.

28.2 CIDA uses audits as a means of ensuring that its executing agents are respecting the financial conditions in its contracts with them. These audits have generally indicated that expenditures by executing agents are largely in accordance with contract conditions. In the contracts we audited, the amounts identified as possible adjustments because of non-compliance with contract conditions were relatively small — $32.2 million out of about $932 million. However, CIDA's audits have also identified some persistent problems of non-compliance with contract conditions. CIDA has released (that is, waived) some dollar adjustments identified as amounts to be repaid by the executing agents as a result of non-compliance. The rationale for doing so was documented in most cases but, in our view, the reasons given did not always justify the releases. From our sample, we estimated these amounts to be $12 million to $13 million over the four years of reports we examined.

28.3 We believe that the Performance Review Branch needs to be more active in auditing whether the system of financial controls is functioning as intended.

Background and other observations

28.4 CIDA is responsible for managing about $1.8 billion of Canada's international assistance. Just over $1 billion represents contributions to third parties, usually referred to as Canadian executing agents (CEAs), to deliver development assistance projects. Executing agents may be Canadian or developing country institutions, provincial governments and their organizations and agencies, or Canadian private sector firms.

28.5 CIDA has put in place a number of financial controls to support the management of its aid projects. At the centre of project management is the contract or the contribution agreement with the CEA. CIDA uses audits to ensure that CEAs are complying with its contracts and contribution agreements. In this audit, we wanted to see if CIDA's financial controls for projects were functioning as intended. We also wanted to examine the actions taken by CIDA to deal with the results of its compliance audits of these projects.

28.6 Although we noted problems of non-compliance with contracts, in nearly all the contracts we examined we also observed that once there was agreement between CIDA and a CEA that money should be repaid, CIDA recovered the amounts owing. Information generated by the audits commissioned by CIDA was being assembled and analyzed, but was not presented to senior program management for action.

The Agency has accepted our recommendations and agreed to take action to address the issues raised.

Introduction

28.7 Canada's International Assistance Envelope for 1999–2000 totals just over $2 billion. CIDA is responsible for managing about $1.8 billion within this envelope.

28.8 Nearly all ($1.7 billion or about 93 percent) of CIDA's budget for 1999–2000 is allocated to development assistance programs (see Exhibit 28.1). Operating and capital expenditures of $131 million (about 7 percent) make up the rest of its budget. CIDA's $1.7 billion in program expenditures are made in the form of grants, contributions and other transfer payments. These payments are made to Canadian and developing country institutions, provincial governments and their organizations and agencies and Canadian private sector firms, for specific development projects, programs and activities.

28.9 Just over $1 billion represents contributions to third parties, usually referred to as Canadian executing agents (CEAs), to deliver development assistance projects. Payments are made to the CEAs according to conditions stipulated in their contracts or contribution agreements. Information on the breakdown of amounts between the types of payments is not available. However, a rough rule-of-thumb is that contracts are used for payments to private sector firms, and contribution agreements for other governments and not-for-profit organizations. For purposes of this audit, we treated payments under both arrangements as the same.

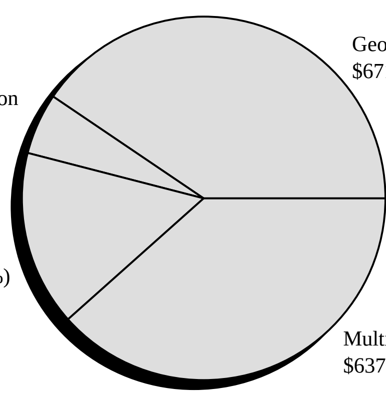
28.10 In December 1998, we reported on CIDA's implementation of its results-based management approach, with an emphasis on how it plans, manages for, measures and reports project results. In the current audit, we examined the financial controls CIDA has put in place to support the management of its aid projects. Our next audit will examine the management of contracting for goods and services, including the selection of Canadian executing agents to manage projects.

28.11 Two other audits related to financial management in CIDA are also under way. CIDA is one of the four departments included in Chapter 30 of this Report on sole-source contracting; that chapter reports on compliance with the contracting rules in a sample of professional service contracts. A second audit, to be reported in October 2000 as part of a government-wide audit, will include CIDA in an examination of how well departments are meeting our expectations for effective financial management as set out in the Financial Management Capability Model we published in April 1999.

Just over $1 billion of CIDA's annual budget is paid to third parties to deliver aid projects.

Exhibit 28.1

CIDA's Program Budget for 1999–2000



TOTAL = $1,658.1 million

Source: CIDA

Focus of the audit

28.12 CIDA has put in place a number of financial controls for planning and managing its development projects. Our purpose was to examine whether these controls are functioning as intended. At the centre of these controls is the contract or the contribution agreement with the Canadian executing agent (CEA) selected by CIDA to deliver its projects. Audits requested by CIDA's project managers are an important financial control used by the Agency. Once requested, the audits are commissioned by CIDA's Contract and Contribution Audit Unit (CCAU). We examined the audit findings on compliance with financial conditions in contracts, and reviewed the action CIDA had taken to deal with them. We selected a sample of 45 projects from CIDA's Geographic and Canadian Partnership branches. Our specific objectives were to:

- examine CIDA's financial controls over non-goods procurement contracts and contribution agreements and assess whether they are functioning as intended;
- examine and assess the actions taken by CIDA to deal with the results of contract and contribution audits, and assess the extent to which CIDA is recovering money identified by those audits as owed to it; and
- examine the role of the Performance Review Branch in reviewing whether financial controls for contracts and contribution agreements are functioning effectively.

More information on how we approached the audit is presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Project Financial Controls

A number of elements make up CIDA's financial controls over projects

28.13 Most of CIDA's projects in recipient countries are delivered through contracts and contribution agreements with Canadian for-profit and not-for-profit organizations who act as Canadian executing agents (CEAs). CIDA is accountable for the selection of its contract partners and the actions taken to develop and manage its agreements with them. The executing agent is responsible and accountable for delivering the project according to the terms of its contract with CIDA. Within CIDA, project managers are accountable for obtaining development results as described in project approval documents, in conjunction with Canadian and recipient country partners. They are also responsible for monitoring and reporting on project performance, and for communicating expected and achieved results.

28.14 CIDA has put in place various financial controls to support its project managers and their teams in planning and monitoring the implementation of projects. These controls include:

- project approval documentation (PAD);
- project budgets and schedules;
- financial risk assessments;
- contracts or contribution agreements;
- project implementation plans;
- work breakdown structures (WBS);
- reviews of claims and advance payments;
- project progress reports and financial reports;

- project monitors;
- annual project performance reports;
- Aid Information System (AIDIS);
- contract and contribution audits; and
- project audits.

A more detailed description of these elements of financial control is contained in the Appendix to this chapter.

28.15 The contract itself is at the core of financial control over projects. It stipulates what CIDA expects from the executing agent in delivering the project, and the terms of payment. It also specifies what information CIDA requires for managing the project, and defines the financial controls it will use to monitor the project.

CIDA's contracts with its executing agents are at the core of financial control over projects.

Projects were approved at the appropriate level

28.16 The level of approval required for a project depends on its dollar value. Projects between $500,000 and $5 million require approval by a vice-president; the Minister's approval is needed for projects between $5 million and $15 million; and projects over $15 million must be approved by the Treasury Board. We found that all projects in our sample had been approved by the appropriate authorities. The budgets presented in the contracts were consistent with those specified in the project approval documentation.

Assessments of financial risks are not always sufficiently taken into account

28.17 CIDA established the Financial Risk Assessment Unit (FRAU) in December 1992. Initially, the unit was to provide support to the Canadian Partnership Branch in assessing non-governmental organizations and institutions. The role of the unit subsequently evolved to include assessing a CEA's financial viability and capacity to execute a project. In 1998–99, the unit carried out more than 200 risk assessments. The risk assessments are intended to ensure that the responsible CIDA officers are aware of:

- the level of financial risk associated with entering into a contribution agreement or contract with an organization;
- the means by which CIDA can limit or mitigate financial risk; and
- how CIDA will protect its investment in the program or project if the CEA runs into financial difficulties.

28.18 Most financial risk assessments are of not-for-profit organizations. In general, over 90 percent of these assessments consist of an analysis of the organization's financial statements. Where an organization is considered financially weak, project managers can decide to have the FRAU undertake a more in-depth assessment. These represent less than 10 percent of all assessments and include reviewing the CEA's financial management capability, accounting and financial reporting systems, and banking and financing arrangements, and determining whether the organization has taken appropriate corrective action to improve its financial position.

28.19 In the project files we examined, there were six organizations on which FRAU had conducted an assessment. It assessed the financial viability of four of the organizations as a high risk. FRAU made recommendations on ways to mitigate financial risks in these four cases, and in another that was assessed as a low risk. Recommendations of three of the five assessments were not implemented by the project managers. The reasons for this were not documented. We noted that in two of the three contribution agreements, subsequent audits by the Contract and Contribution Audit Unit (CCAU) revealed problems that could have been avoided if the FRAU recommendations had been implemented.

28.20 CIDA should require that when project managers choose not to accept the recommendations of financial risk assessments, they document their reasons.

Agency's response: *CIDA will require that project managers document the rationale for not implementing the recommendations made by FRAU.*

Actual and planned expenditures are closely monitored

28.21 Project managers use CIDA's Aid Information System (AIDIS) to monitor and control project spending. The system provides information on project budgets, including details on annual planned expenditures and on actual expenditures based on advances and payments against claims submitted by CEAs. CIDA project teams review requests for advances and expenditure claims to ensure that they are consistent with the contract and the CEA's budget for the project. This verification involves procedures such as ensuring that services are in accordance with the contract and that costs are legitimate, reasonable and related to the request for payment. In several cases we observed, CIDA's project teams had adjusted claims pending receipt of further information because they believed that the claims were not in accordance with the contract. Verification is generally limited to the documents provided by the executing agents. The project manager can also request an audit to ensure that the expenditure claims are properly supported and are consistent with the terms and conditions of the contract.

28.22 Contracts usually require CEAs to provide financial reports on a quarterly and an annual basis. These reports compare actual expenditures with budgeted amounts by element of expenditure — such as staff salaries, consultants' fees, allowances, travel expenses, procurement and so on. CIDA's project officers review these reports to determine whether spending is consistent with what was budgeted for that period and whether significant variances are explained. This permits CIDA to manage the flow of funds within projects effectively, and to reallocate funds to other projects as needed.

It is difficult to link financial information with information on project progress

28.23 Not all projects call for the same type or frequency of reporting in order for CIDA to be able to manage effectively. What is important is that a reporting approach be identified at the planning stage, agreed upon with the CEA, reflected in the contract, and respected. Any subsequent major changes to the monitoring approach and reporting requirements need to be reflected in an agreement with the CEA. In simplest terms, reporting needs to be structured so that CIDA can know what has been achieved for the payments it has made. This requires the setting of realistic targets and milestones as well as concise reporting by output or activity.

28.24 CIDA's guidelines to project managers point out that the nature of a project, its size, the degree of risk inherent in the project, and the delivery mechanisms are all factors in determining the most appropriate means of measuring and monitoring project performance. Other important factors include CIDA's experience with the recipient country and with the CEA. CIDA's project managers receive information on progress from a number of sources; the most important are the regular reports from the CEA. Other sources of information include an external project monitor who provides advice on the implementation and management of the project; the CIDA field representative assigned to the project; and the recipient governments or organizations. Progress reports are to identify and explain any significant variances from planned spending and progress. Narrative information on progress and financial information are to be submitted and reviewed together whenever possible, so that progress toward expected results can be compared with the portion of the budget spent on each related activity. The analysis of information in the progress reports can indicate the need for decisions about any remedial action that the CEA, CIDA and/or the recipient country need to take.

28.25 Progress reports from executing agents vary in their content, frequency and format, depending on the project's size, complexity and potential risk. CIDA's guidelines call for reporting to include accomplishments (progress toward achieving outputs), time elapsed against the project's schedule, and costs compared with the budget for each output/activity. Typically, the contract requires that financial reports contain a summary of project expenses to date compared with the budget for the same period, and explanations of significant variances. Progress reports are to describe activities that have been completed in comparison with what was planned, with an explanation of significant variances. The CEA reports that we observed often did not compare actual accomplishments with what had been planned. External project monitors reviewing the implementation of projects have made similar observations, as Exhibit 28.2 shows. It also shows that when project managers make it clear what information they require, progress reports improve.

28.26 Because the regular quarterly progress reports we reviewed did not compare planned with actual operational progress, project managers could not readily determine the project's rate of progress or, if progress was not as expected, the financial implications. CIDA has put in place a process for reporting annually on all projects over $100,000. The Annual Project Progress Report compares actual expenditures to date with the total budget approved for a project, and gives estimates of accomplishments against expected results in percentage terms. This permits a basic comparison each year between the rate of expenditure and the rate of progress. It also provides CIDA with a picture of spending and progress for the portfolio of projects in a country. This report does help to flag problems but, because it is prepared only once a year, it is not timely enough to alert project managers to a rate of spending that is higher than expected relative to progress.

The progress reports that we reviewed often did not compare actual accomplishments with what had been planned.

28.27 There can be many events that affect project success. Some may be beyond CIDA's control, such as a failure by the recipient organization or country to

Exhibit 28.2

Examples of Project Monitors' Comments on Project Reports

In the case of a $10 million project for institution strengthening and capacity building, the project monitor reported, "A recent quarterly report contains 26 pages of detailed tables but does not tie in financial results to project results"; "reports and work planning focus on activities and not results"; "no relationship between costs and results has been identified...it is very difficult to tell whether the relationship between costs and results is reasonable."

After reviewing a $3 million project for capacity building in health reform, another monitor observed, "The main concern with this [progress] report is that it largely fails to provide a concise analysis and summary of whether the project is basically on track or not, which results have not been achieved on schedule and the reasons and what corrective actions could be made to redress the situation."

In the case of an $8 million project to upgrade the teaching capacity of a university-level institute, the monitor commented, "The reports were brief and to the point and provided a snapshot of the last quarter reported. In addition, a graphical summary of trainees by year was provided. This will make tracking and completion dates of the trainees much easier to follow for all concerned. These new reports should add considerably to using the reports as a management tool."

It is essential that project managers obtain sufficient information to know a project's financial status relative to its progress.

deliver on commitments. Even so, CIDA needs to analyze the financial implications of variances from planned progress, whatever the cause, in order to assess the impact of the problem. A considerable portion of contract costs for large, labour-intensive projects are "fixed costs" in the host country for items such as project management, fees and expenses of CEA staff and office expenses. These can exceed 50 percent of a project's budget. Once a project is launched on site, CIDA's contract requires it to continue paying the CEA's costs even if the expected progress has not been made. It is considered a cost increase if a project cannot achieve the expected results without a budget increase, or cannot be completed within the approved budget unless its scope is significantly decreased. Such cost increases must be approved by the appropriate management level. For this to happen, under its results-based management approach CIDA must have good information on actual costs and progress, and regularly compare this with what was planned.

In some cases, a project had three or four managers over a five-year period.

28.28 It is not always practical for project managers to conduct regular on-site visits of all the projects for which they are responsible. This makes it essential that they be able to obtain sufficient information from the CEA to know the project's financial status relative to its progress. CIDA is thus very dependent on the quality and integrity of the information provided by CEAs. Exhibit 28.3 illustrates a project where the lack of information on spending and progress created problems in managing the project.

28.29 We noted that in its transition to a results-based management approach, CIDA made efforts to improve its project planning and reporting. We observed that it made considerable efforts to ensure that the CEAs would understand and implement the new requirements of results-based management. Documentation in the files we reviewed showed extensive internal and external communication on the planning and reporting formats for results-based management. In more recent contracts, we found more consistent references to, and listings of, expected outputs and the activities required to achieve them. However, the contracts did not tie the delivery of these outputs to CIDA's payments to the CEA, and did not always call for reporting of expenditures against these specific activities. Project reporting still needs to improve in reflecting actual accomplishments so that financial and operational progress reporting can be properly linked.

28.30 CIDA should ensure that project progress reports include information on planned and actual accomplishments. The financial implications of variances between planned and actual progress should be analyzed so that CIDA can assess whether the project budget should be increased to achieve the expected results or the project scope reduced to stay within the approved budget.

Agency's response: *CIDA, in May 1999, published a* Guide to Project Performance Reporting: For Canadian Partners and Executing Agencies, *which clearly articulates these reporting requirements. CIDA will ensure that the principles of this guide are followed by project managers.*

Frequent staff rotation affects project monitoring

28.31 CIDA project managers are accountable for the performance of the contractors on their projects. It is sometimes difficult for them to monitor performance and enforce the terms of a contract. One reason is that continuity in project management is interrupted by the reassignment of personnel within CIDA. In the projects we examined, replacements were often unfamiliar with the objectives and requirements of particular contracts. During the life of some projects, responsibility for them changed hands several times. In some cases, a project had three or four project managers over a five-year period.

28.32 CIDA guidelines recognize that poor handover of project responsibilities will certainly affect the operation of the project team and may negatively affect the planning or implementation of the project itself. We found that some project managers had provided useful transition letters for their successors. Others seemed to provide very little or no documentation, which suggests that the new project managers may have had to start from scratch in order to understand the project. Our review also found that program/project files were not structured in a way that easily provided for a continuous assessment of progress, related expenditures incurred, problems, and actions taken to ensure the project's continuity and efficiency.

Exhibit 28.3

The Lack of Information Comparing Spending With Progress Led to Project Management Problems

In 1997, a $3.3 million project was proposed to CIDA to help establish lasting settlements for refugee families, mainly through housing construction. The project was to last for 14 months, ending in November 1998. Similar projects had been undertaken in that country since 1995 by many members of the international donor community.

A $3 million contribution agreement between CIDA and the CEA was signed in September 1997. The agreement also specified the CEA's reporting requirements, including quarterly progress reports by activity and quarterly financial reports, as well as explanations of variances between planned and actual progress. The agreement also specified six specific outputs for the project.

In October 1997, the CEA presented its management plan for delivering the proposed project. The plan provided a detailed work breakdown structure linked to expected outputs, and a timetable for all activities to be carried out.

The three quarterly reports prepared by the CEA described a number of detailed tasks performed and some results obtained, but did not link them to planned activities or expected results. The reports also provided a summary of the actual expenditures to date compared with the total budget for the project. However, there was no comparison of actual expenditures with the budget for that period, nor were actual activities compared with those planned.

The work breakdown structure and the timetable, the two management tools prepared at the planning stage of the project, were not used in reporting on activities and results of the project.

The quarterly report for the period ended 30 September 1998 was the third and last quarterly report submitted by the CEA prior to filing the end-of-project report in June 1999. As of 30 September 1998, the CEA reported that it had spent 52 percent of the total budget.

Until the third quarterly report, the CEA had always reported that the project was progressing within budget, and that it would end as expected in November 1998. However, in its third report on 29 October 1998, the CEA requested a budget increase of $235,000 and informed CIDA that the project would end one month later than expected, in December 1998.

In January 1999, CIDA learned that the CEA had actually spent the requested additional budget without having received CIDA's authorization. At CIDA's request, on 18 January 1999 the CEA provided details on additional activities and costs to support its request for a budget increase. Given the circumstances, CIDA informed the CEA on 27 January 1999 that it agreed to increase the budget to cover the shortfall. However, on the next day, CIDA informed the CEA that it had been informed by CEA staff that the proposed budget increase was not sufficient because the CEA had already incurred expenditures well beyond that amount. CIDA indicated to the CEA that again it was open to a request for an additional budget increase.

In March 1999, CIDA and the CEA signed an amendment to the contribution agreement, increasing the budget by $605,000. This represents a 20 percent increase from the original budget amount. In the revised agreement, three outputs budgeted originally for $560,000 were cancelled after $32,000 had been spent on them. Three new outputs were added, but the amounts to be spent on them were not identified.

The CEA presented its final report in June 1999. The full revised budget of $3.6 million had been spent.

28.33 We are concerned that the high rotation of project managers, inadequate transition documents and poorly kept files increase the difficulty of maintaining control over the management of projects. An appropriate transition process would help to reduce this difficulty.

28.34 CIDA should ensure that project managers who are reassigned understand the importance of preparing and providing to their replacements key project implementation documents, including a realistic assessment of a project's status in terms of its progress against its expenditures, and any significant issues affecting project delivery.

Agency's response: *CIDA will revise its ROADMAP guidelines to better guide the transition process between project managers so that continuity and stability of the project's implementation can be maintained.*

A new information system is expected to improve financial management

28.35 Recently CIDA introduced a new Aid Information System (AIDIS) that envisions building a foundation for more effective management of the Agency's development programs. It is intended to be compliant with the new government-wide Financial Information Strategy (FIS), which is designed to link financial and management information.

28.36 CIDA expects that AIDIS will provide it with a greater capability to manage its projects and resources. The new system is being designed to incorporate project, contracting and financial management information. One of its intended key features is improved corporate reporting by branch, program and division and by project, supplier and status. CIDA officials expressed confidence that the system would meet the operational requirements of results-based management.

28.37 AIDIS is being introduced in three phases. Phase I went live on 1 June 1999. Phase II is expected to be completed by 1 April 2000 and to provide CIDA with the necessary functions to manage all projects from start to finish. With Phase III, the Agency expects to meet FIS requirements. The timeframe for this phase is driven by the government's target, which is to have FIS operational on 1 April 2001.

Dealing With the Results of Audits

Audits reveal some persistent problems of non-compliance with contract conditions

28.38 CIDA has put in place a program of annual audits to examine whether expenditures by CEAs comply with contract conditions. CIDA's program branches select projects for audit. The headquarters Contract and Contribution Audit Unit (CCAU) then arranges to have the audits conducted by independent audit firms. The CCAU also randomly selects some contracts for audit. In our discussions with project managers, they consistently mentioned to us that they use these audits for assurance that financial conditions in contracts are being respected.

28.39 About 100 to 115 financial audits are requested each year by project managers, and CCAU also randomly selects about 10 contracts to be audited. These audits are commissioned by CCAU at an annual cost of about $2 million. However, in the period covered by our audit (between 1995 and 1998), we noted that only about half of CCAU's selected contracts were audited. Annually, the audits covered about $238 million in expenditures by CEAs, going back to the start of the contract or the date of a previous audit. When an audit reveals instances of possible non-compliance with contract conditions, the auditor identifies the item as a possible overpayment requiring an adjustment by CIDA. On average, auditors propose adjustments totalling about $8.1 million annually.

28.40 Overall, the audit reports we examined indicated that, to a large degree, expenditures were in accordance with contract conditions. The amounts identified as possible adjustments because of non-compliance with contract conditions were relatively small — $32.2 million out of about $932 million audited over four years. However, the reports frequently proposed dollar adjustments based on non-compliance with some conditions over the life of the contract. The most frequent reasons for proposed adjustments were:

- expenditures made without CIDA's prior approval;
- lack of supporting documentation; and
- unreported interest earnings on advances.

Of the 45 audit reports we examined, 37 raised one or more of these observations.

28.41 Many adjustments were proposed because the required prior approvals from CIDA for claimed expenses were not available at the time of the CCAU audit. In most of these cases, approval from CIDA was obtained only after the expenses had been incurred.

28.42 Contracts require that all expenditure claims submitted to CIDA be appropriately supported. However, contracts are silent on the specific kind of support required from CEAs to substantiate the expenditures they claim. A standard clause specifies that CIDA will pay for the time allocated to the project's activities by employees and consultants or for the "time actually worked". Audit reports indicated that in many cases the salaries and fees charged by the executing agents could not be verified, because there was no documentation of time actually worked on the project.

28.43 In some contracts and contribution agreements, specific clauses allow for CIDA to make cash advances to CEAs to cover immediate costs of delivering their projects. Such advances must be supported by a forecast of estimated costs. Contracts and contribution agreements require that these advances be deposited in a separate interest-bearing bank account wherever possible, and that all interest earned be credited to the project. In the case of a contract, interest, if material, is to be recovered by CIDA or used to reduce its future payments under the contract. For contribution agreements, the interest is not recovered by CIDA and is to be used for the purposes of the contribution.

28.44 Auditors reported that in some cases, interest revenue had been calculated and recorded in accordance with the contract. In many cases, however, interest clauses were not respected. The most common observations were the following:

- advances were not deposited into a separate interest-bearing bank account and no interest revenue was accounted for;
- the CEA did not have a separate bank account for the project and it was practically impossible to determine the amount of interest earned;
- the interest earned was related to the CEA's own deposit in the project account and thus no interest had to be reimbursed to CIDA.

28.45 The contracts audited for the CCAU were not always clear on what expenditures were to be included in fringe benefits and overhead and thus charged to CIDA. Where contracts were silent or ambiguous, auditors did not raise this issue because there was no contract clause with which to verify compliance.

28.46 The lack of clarity in contract clauses related to fringe benefits and overhead can result in double payments by CIDA to CEAs. In most contracts, the calculation of fringe benefits and overhead to be paid by CIDA is based on salaries. Contract clauses specify the percentages to be used in this calculation. Some contracts indicate that fringe benefits include the payment of salaries when CEA project personnel are not at work because of vacation, statutory holiday or sick leave. This means that the per diem rate billable to CIDA includes a mark-up for these fringe benefits. However, in some instances, audit reports identified a double payment by CIDA because CEAs had claimed and been paid for time not worked by employees although these benefits were already included in the CEAs' per diem rates.

28.47 CEAs are responsible for purchasing and using assets (vehicles, furniture, etc.) for the duration of the project. They are also responsible for disposing of these assets at the end of the project. However, contracts do not always specify how, after their purchase, the use of these assets should be controlled and reported during the project and disposed of at the end. Some examples of lack of reporting include the following:

- project vehicles were used by personnel working on the project, but their use was not reported. No benefit was added to the salary of the employees who used the vehicles for personal reasons, although this is required; and

- assets purchased for the project were sold at the end of the project and the proceeds from their sale were not reported.

Lessons learned from audits were not presented to senior program managers for action.

28.48 From 1992–93 to 1997–98, the CCAU prepared three biannual reports summarizing its activities and results. These reports identified the types of adjustments raised in audits and suggested lessons to be learned from recommendations in the reports. Many of the same issues were raised in all three reports. We noted that these reports and the recommendations in them were not presented to senior program managers for action.

28.49 In July 1999, CIDA approved a policy on overhead rates to be paid under contribution agreements and non-competitive service contracts. This is one of the issues that the CCAU had consistently reported as a problem area since 1992–93. However, no action has been taken to deal with the remaining problems identified in its reports.

28.50 CIDA should ensure that the Contract and Contribution Audit Unit presents its biannual reports to senior program management for action, and that the adequacy of the actions taken to respond to its recommendations is periodically reviewed.

Agency's response: *The biannual reports of the Contract and Contribution Audit Unit will be presented to senior management for review and approval.*

The release of dollar adjustments is not always adequately justified

28.51 Although audit reports indicated that expenditures by CEAs were largely in compliance with contract conditions, they also identified a number of areas of possible non-compliance where proposed adjustments needed to be examined.

28.52 Project managers are accountable, in collaboration with the CCAU, for following up the audit reports on their projects. The manager must assess the accuracy and appropriateness of all the audit adjustments and negotiate the recovery of funds from the CEA. In some cases, the gathering of supporting documentation and the negotiation process can be quite lengthy and time-consuming for both CIDA staff and the CEAs, due to the large numbers of adjustments that are proposed. The average length of time between the date of the audit report and the date established for recovery of adjustments was about eight months, with the longest about 29 months. At the end of this process, about 65 percent of proposed adjustments are released and consequently not reimbursed by CEAs.

28.53 Adjustments can be released for a number of valid reasons:

- missing supporting documentation is subsequently provided by the contractor;
- the project manager recognizes that the CEA's interpretation of a contract clause and not the auditor's is the correct one; and
- confirmation of prior approval is subsequently obtained.

28.54 The supporting rationale for releasing audit adjustments was documented in most of the audit reports we reviewed. Often, adjustments were released because CIDA found the contract wording ambiguous and did not want to enter into a dispute with the CEA. However, we believe that the reasons given for the release of adjustments were not always justified — for example, in projects involving a lack of records for time actually worked by employees and consultants, and personal use of project vehicles.

28.55 We also felt that the release of many adjustments related to travel expenses, such as airfare, hotel accommodation and others, was not adequately justified. In many cases, CIDA accepted claims for airfares that were higher than allowed in the Treasury Board travel directive. In one instance, an adjustment of $19,262 was noted for double payment of salaries. CIDA released the adjustment but there was no supporting explanation on file.

28.56 We also noted some instances where project managers had entered into discussions with CEAs to release dollar adjustments rather than applying the provisions of the contracts. Exhibit 28.4 illustrates this type of situation.

28.57 Overall, based on the audit reports in our sample, we estimated the amounts released without sufficient justification to be $12 million to $13 million over the four years of reports we examined. We recognize that these amounts are relatively small when compared with the total amounts of the expenditures audited. However, in the interest of fairness and because most

Exhibit 28.4

Audit Adjustments Released Without Adequate Justification

In a $686,000 project, the audit report identified an adjustment of $471,000 because of lack of support for the fees charged by the CEA. The CEA had no system to verify the actual time worked on the project.

The CEA argued that it earned its revenues from the results it produced, not the time it billed for a project. However, the contract tied CIDA's payment not to results but to fees for staff carrying out the project. CIDA nonetheless accepted the CEA's explanation for time charged by its staff. There was no documentation on file supporting this time allocation, although CIDA was aware that CEA staff were also working at the same time on other projects in Canada and abroad, one of which was funded by CIDA.

In another case, CIDA's share of a $585,000 project was 51.2 percent of acceptable expenses, to a maximum contribution of $300,000. The recipient indicated that it had spent $656,000. An audit of the contribution agreement before CIDA's final payment identified an adjustment of $498,000 because of a lack of support for amounts claimed as salaries by the company's shareholders. The company did not have a system for recording time worked. The audit noted that the amounts claimed for salaries had not actually been paid, but were based on the notional value of fees that the shareholders allocated to themselves for the time they worked on this project, one of three projects in which they were involved at the same time.

After discussions with the company, CIDA accepted this explanation and made the final $43,000 payment. The allocation for time worked on the project was never adequately documented.

expenditures by CEAs are in accordance with contract conditions, we believe CIDA needs to be more insistent about challenging CEAs whose expenditures have been identified as non-compliant.

CIDA needs to be more insistent about challenging non-compliant expenditures.

28.58 CIDA should clarify its standard contract clauses to reduce ambiguity. Where the wording in a contract is clear, CIDA should maintain adjustments unless recovery of the funds is clearly not cost-effective.

Agency's response: *CIDA will clarify standard contract clauses and will develop guidelines to help project managers determine whether audit adjustments should be recovered or released.*

Adjustments that are maintained are recovered

28.59 In our sample of 45 audit reports we found that CIDA did recover the audit adjustments that had not been released. We found that these amounts were fully recovered in all but two cases where money was owed. Either the executing agencies paid the full amount owed by cheque or CIDA deducted the amounts from progress payments owed to the executing agents under the same contract or contribution agreement. Interest owing in accordance with Treasury Board regulations was not always charged or collected.

28.60 In two cases, we found that the funds were not recovered or were only partly recovered. In one case involving $452,505, CIDA believed that the CEA's financial situation made it impossible to recover the funds. It still hopes to recover at least some of the amount outstanding at a later date, should the CEA's situation improve. We were told that this case is being monitored by the Agency. The other case was related to annual program funding of a not-for-profit organization. The amount was insignificant. CIDA decided that the organization should keep the funds on the understanding that it would spend them on its aid program in the future.

The Role of Performance Review

A need for more active audit of financial controls

28.61 In 1994, CIDA's Performance Review Branch was assigned the lead role in developing and implementing results-based management across the Agency. The work plans of the Performance Review Branch reflect this. As a result of the emphasis on results-based management, there was no emphasis on internal audits of management systems such as those related to financial controls. Branch plans did not include any audits of financial controls for contracts and contribution agreements although, to avoid potential overlap or duplication, the Performance Review Branch took the compliance audits managed by CCAU into account when it prepared its annual work plan. However, the Performance Review Branch does not audit or assess the coverage and selection of the contract and contribution audits or the adequacy of resulting follow-up actions taken by program managers.

The Performance Review Branch needs to be more active in auditing whether financial controls are functioning effectively.

28.62 In our view, there is a need for the Performance Review Branch to play a greater role in assessing whether audits of contracts and contribution agreements are providing the level of financial control expected by CIDA. As part of its audit program, the Branch needs to examine whether findings and recommendations from CCAU audits are fed back to CIDA's management so it can apply the observations to the rest of the Agency's operations.

28.63 Another important financial control involves the financial and progress information provided to CIDA by the CEAs who deliver aid projects. It is essential that this information be meaningful and accurate. Here, too, we believe that the Performance Review Branch needs to be more active in auditing whether CIDA is receiving the kind of information needed to support good project management.

28.64 The Performance Review Branch needs to periodically assess the audits of contracts and contributions to determine whether they are providing the required level of financial control.

Agency's response: *The Performance Review Branch will include, on a cyclical basis, the audit of the Cost and Contribution Audit Activity as part of its Internal Audit Plan.*

28.65 The Performance Review Branch should include in its future work plans an audit of the quality and accuracy of financial and progress information reported by Canadian executing agents.

Agency's response: *In the periodic conduct of internal audits of financial management, the Performance Review Branch will include in the scope of these audits the quality and accuracy of financial and progress reports.*

Conclusion

28.66 We concluded that CIDA's financial controls were effective in monitoring and controlling the flow of funds for projects. The Agency had good information on its expenditures, and on what remained to be spent on projects. However, it was difficult to link expenditure information with information on operational progress. Progress reports tended not to describe actual accomplishments in relation to what had been planned. This made it difficult to carry out a timely analysis of the financial implications if progress was not as expected. The result was a risk that project scope would have to be reduced or the budget increased in order to accomplish intended objectives.

28.67 The contract is the key document for financial control over projects. CIDA uses audits for assurance that the financial conditions in its contracts are being respected. Overall, audits show a high level of compliance, although there are some persistent problems that need to be addressed. In the cases we reviewed, we believe that CIDA's project managers needed to be more insistent about challenging CEAs whose expenditures were identified as non-compliant with the terms of their contracts. However, once CIDA had determined that an amount was owed, its procedures for recovery were good, with minor exceptions. Lessons learned from the information generated by audit reports were not being fed back to program managers to make the changes needed to correct recurring problems.

28.68 At the corporate level, CIDA needs to periodically assess whether financial controls are providing the expected support to project managers.

About the Audit

Objectives

Our objectives in this audit were to:

- examine CIDA's financial controls related to non-goods procurement contracts and contribution agreements and to assess whether they are functioning as intended;
- examine and assess the actions taken by CIDA to deal with the results of contract and contribution audits, and assess the extent to which CIDA is recovering money identified by those audits as owed to it; and
- examine the role of the Performance Review Branch in reviewing whether financial controls for contracts and contribution agreements are functioning effectively.

Scope and Approach

The audit focussed on the financial controls CIDA has put in place for managing its development projects. At the centre of these controls is the contract and contribution agreement with the Canadian executing agent selected by CIDA to deliver its aid projects. The projects we selected were non-procurement projects that had already been approved by CIDA.

Audits commissioned by CIDA's Contract and Contribution Audit Unit (CCAU) are an important financial control used by CIDA. The CCAU is a headquarters unit that arranges for audits by independent audit firms. The auditors examine expenditures of projects for compliance with financial conditions in contracts and contribution agreements. The projects to be audited are selected by the program branches based on CCAU criteria such as size, risk, contractor experience, etc. The Unit itself also randomly selects a certain number of contracts for audit. About 100 to 125 audits are conducted annually.

To carry out our audit, we selected at random 45 contracts and contribution agreements that had been the object of CCAU audits between 1995 and 1998. We did not redo the audits that had been carried out. Rather, we used them as a basis for examining the actions taken by CIDA to deal with the results of these audits and for examining whether CIDA was recovering any money identified by audits as owed to it. We also used 30 projects from this sample to examine the functioning of financial controls over projects. To ensure that the projects we examined reflected CIDA's current approach to project management, we also judgmentally included 15 more recent projects that had been audited in 1998–99. We selected these on the basis of their size and in order to include projects from the Geographic and the Canadian Partnership branches. Because the reports from these audits were still being discussed, we did not include them in our analysis of how CIDA deals with the results of audits.

We conducted our work at CIDA's headquarters. We reviewed project documentation and audit reports and held discussions with CIDA officials.

Criteria

Our audit criteria were largely derived from CIDA's internal guidelines and from the sound controls one would expect to find in place.

Basic financial controls

Project planning, analysis and approval documentation should contain the financial information and assessments called for in CIDA's program and project management framework.

Financial information in contracts and contribution agreements should be consistent with that in project approval documents.

Changes to project costs should be approved by the appropriate decision-making authority. These should also be reflected in amendments to contracts and contribution agreements.

Progress and financial reports should be submitted as called for in contracts and contribution agreements. Financial reporting should be linked to activities described in contracts and contribution agreements.

Information from performance monitoring reports and reviews should be used as required for management decision making and taking corrective action on projects.

Financial information should be linked to information on project progress. The financial implications of variances from planned progress should be analyzed.

Decisions to release audit adjustments should be appropriately supported and taken at the proper decision-making level.

CIDA should analyze issues identified in audit reports and take corrective action as needed.

Recovery of money

"Maintained" audit adjustments should be set up as receivables and recovered by CIDA.

A decision to write off amounts to be recovered should be documented, explained, and taken by the appropriate decision-making authority.

Records of amounts recovered should be kept.

Role of performance review

CIDA should assure itself that the elements that make up its financial control framework for contracts and contribution agreements are functioning effectively.

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Appendix

CIDA's Financial Controls Over Projects

Project approval documentation (PAD). The PAD documents include the project proposal, tentative budget, and logical framework analysis.

Project budgets and schedules. These include estimates of the cost of each of the proposed project outputs. Initially, the budget is included in the project approval document (PAD). Later, it plays a critical role in the financial control of the project.

Financial risk assessment. The financial viability of the selected Canadian executing agent (CEA) is assessed by the Financial Risk Assessment Unit (FRAU) for all contribution agreements with not-for-profit organizations that receive $200,000 or more per year and for all contracts with for-profit organizations where the fee component is estimated to exceed $1 million.

Contracts or contribution agreements. These govern how a CEA implements a project. They include project objectives and scope, budget, payment schedules, terms of payment and reporting requirements.

Project implementation plan. This is usually prepared within a few months of the signing of the contract or contribution agreement with the CEA. The report documents the degree to which the original assumptions, objectives, activities, schedules and budgets are still valid, and/or recommends changes where required. The report usually provides an updated and more detailed plan on how the CEA intends to implement the project. In addition to operational and technical issues, the report also focusses on the financial management, administration, control and reporting aspects of the project.

Work breakdown structure (WBS). This work plan breaks a project down into the activities required to produce each desired output, and describes their interrelationship.

Project progress and financial reports. These are used to assess progress toward planned results, and to compare expenditures with the approved project budget.

Project monitor. A Canadian or local project monitor may be engaged to independently review and report to CIDA on project performance. The monitor reviews narrative reports on progress and financial information, and usually undertakes site visits to observe actual progress. The monitor may also advise on technical issues involved in implementing the project.

Annual Project Progress Report. This report is the basic tool for tracking projects over $100,000. The report includes information on project expenditures, expected and actual results (outputs, outcomes and impacts), lessons learned and progress ratings.

Aid Information System (AIDIS). This system provides the information on overall budgets and expected and actual annual expenditures that is needed to monitor and control projects.

Contract and contribution audits. These are audits for compliance with contract conditions that are requested by project managers and commissioned by the Contract and Contribution Audit Unit (CCAU).

Project audits. These are project management audits by the Internal Audit Division of the Performance Review Branch. These audits cover management practices, operations, systems and controls, and the achievement of intended results.