



Industry  
Canada

Industrie  
Canada

---

## ***Industry Canada***

### ***Audit of CANARIE and Precarn Grants and Contributions Final Report***

*July 22, 2003*

Canada 

## TABLE OF CONTENTS

---

	<u>Page</u>
<u>1 EXECUTIVE SUMMARY</u> .....	1
<u>2 INTRODUCTION</u> .....	5
<u>3 OBJECTIVES &amp; SCOPE</u> .....	8
<u>4 APPROACH</u> .....	9
<u>5 AUDIT RESULTS</u> .....	10
<u>6 PRECARN: DETAILED FINDINGS</u> .....	11
<u>7 CANARIE: DETAILED FINDINGS</u> .....	18
<u>8 APPENDICES</u> .....	
<u>    A - CANARIE AND PRECARN PROJECTS SELECTED FOR REVIEW</u> .....	1
<u>    B - CANARIE AND PRECARN CLAIMS PROCESSES</u> .....	1
<u>    C - MANAGEMENT RESPONSE TO THE REPORT'S RECOMMENDATIONS</u> .....	1

# 1 EXECUTIVE SUMMARY

---

## 1.1 OBJECTIVES

The objective of the audit was to review the practices in place at CANARIE and Precarn primarily in the context of the existing audit framework for claims as described in the Consultants' Report (see Background section) recently received by Industry Canada. The audit included consideration of the extent to which the existing audit frameworks in place in both organizations were achieving the following expectations:

- Funding provided by CANARIE and Precarn is to eligible organizations.
- Expenditures are eligible in accordance with funding agreements.
- Project claims auditing is performed of recipient organizations and the status of audits performed is apparent.
- Forecasting practices are in place to produce highly accurate and reliable forecasts.
- Reporting by CANARIE and Precarn to Industry Canada is against annual plans and other established criteria.
- Overhead and administrative costs are appropriately handled, accounted for and allocated to various activities.
- Project administrative fees levied against recipients are appropriate.
- The handling and reporting of investment income earned under the grant to Precarn Associates Inc., and the extent of processes available to accommodate the expected royalty income stream for CANARIE Phase 3.
- Funding sources to recipients does not result in unacceptable levels of government funding versus private funding.

## 1.2 SCOPE AND APPROACH

The scope of the audit included:

- CANARIE projects being funded by Industry Canada through the Contribution Agreement described in the report. These projects are within CANARIE's Phase 3 Advanced Application Development Program and include projects funded by programs in the areas of Intelligent Systems, Health, Learning and E-Commerce.
- Precarn Projects being funded by Industry Canada through the Funding Agreement described in the report. These projects are within Precarn's Phase III Research Programs.
- CANARIE Intelligent Systems projects funded by Industry Canada through the Contribution Agreement and subsequently funded through the Project Delivery Agreement as enabled by the Memorandum of Understanding, also described in the report.

The audit approach was established in consultation with the Audit and Evaluation Branch of Industry Canada and included the following key elements.

- Interviews were held with Industry Canada to define their audit requirements, discuss the various funding programs, and review relevant background material.
- All relevant agreements and contracts providing the funding to projects which are included in the scope of this audit were identified and reviewed. To the extent appropriate, other documentation was also reviewed.
- Industry Canada officials selected projects for detailed review of the project claim process and project files in Precarn and CANARIE. These projects are identified in Appendix A.

- Initial meetings were held with management officials at Precarn and CANARIE to introduce the audit and review scope and objectives.
- Program Officers at CANARIE were interviewed to discuss the project claim processes and document their practices, procedures and controls around projects and claim submissions.
- All project and claims files for projects selected by Industry Canada for review were reviewed and tested. Follow up meetings were held with Program Officers to clarify issues or questions resulting from review and testing.
- Accounting Managers were interviewed to review the requirements for claims processing, payment, and other claim related issues.
- Meetings were held with Accounting Managers to discuss preliminary audit results, validate observations and conclusions and obtain preliminary feedback on issues discussed.

## **1.3 RESULTS**

### **1.3.1 Overall Conclusion**

The results of the audit with respect to the stated objectives and in consideration of the sample projects reviewed indicate the following:

- Projects reviewed were eligible for funding by Precarn and CANARIE. Processes exist to ensure that maximum allowable levels of government funding are not exceeded.
- Precarn and CANARIE are providing project status reports to Industry Canada on a regular basis.
- Precarn and CANARIE continue to experience forecasting challenges to meet Industry Canada requirements. Given the nature of the difficulties, the parties will need to discuss requirements and reach a mutually agreeable solution. CANARIE has started to implement some changes in an attempt to increase forecast accuracy at the project level.
- Precarn is making some changes to the description of fees charged to members to avoid any misunderstanding as to the nature of the charges.
- Precarn and CANARIE should ensure that holdbacks are taken on each project claim paid, to ensure that the organization is protected to some extent during the entire project duration.
- Precarn should enhance their claims review practices to ensure that projects are not charging for salaries, benefits or overheads in excess of actual cost. CANARIE has good practices in place to verify actual costs of project claims.
- Precarn should implement financial audits at the end of each project. CANARIE already follows this practice and is achieving good results in relation to the nominal audit costs incurred.
- Issues were identified to consider the appropriateness of retaining and investing holdback funds in CANARIE.

## **1.4 FINDINGS AND RECOMMENDATIONS BY ORGANIZATION**

The key findings and recommendations from this audit are presented in the following two sections relating individually to Precarn and CANARIE. For a complete listing of all audit findings, risks and recommendations refer to the detailed findings contained in this report.

### **1.4.1 Precarn**

Generally, the testing indicates that Project Managers have a good understanding of the projects they manage. They use their close relationships with Lead Contractors to assist them in reviewing claims received against their understanding of project performance and project plans. There are, however, areas where more rigorous assessment of claims could be performed if Lead Contractors were required to provide additional detailed support for the quarterly claim submissions.

Recommendations to improve claims review processes and documentation include the following:

- Salaries charged for each individual being charged to the project should be verified to contractor payroll records at the start of the project or the first instance of that employee charging to the project.
- Lead Contractors should be required to provide signed employee time sheets to substantiate all hours billed to the project in the period.
- Lead Contractors should be required to provide a complete analysis of their benefit costs and rate calculations at the start of the project, including all necessary supporting documentation.
- Lead Contractors should be required to provide a complete analysis of their overhead costs and rate calculations at the start of the project, including all necessary supporting documentation.
- All projects should receive a financial audit prior to project acceptance and release of holdback.
- Operating procedures should be modified to apply the holdback provisions of the contract to all claim submissions.
- Precarn should consider the appropriateness of borrowing against the grant funds to early pay claims resulting from projects under the Intelligent Systems program undertaken on behalf of CANARIE. As well, Precarn should consider reviewing the current reimbursement process in order to shorten the waiting period that Lead Contractors must go through for reimbursement of their incurred expenses.
- The Financial Manager should meet with Industry Canada and CANARIE officials to determine forecasting requirements suitable for all parties.
- Precarn should consider revising the threshold requirements for invoices in future contracts to a reasonable level. This would require contractors to provide invoice backup while not requiring excessive administrative effort on the part of Precarn.

### **1.4.2 CANARIE**

Generally, the testing indicates that Project Managers do a fairly thorough review of quarterly claim submissions. Issues relating to inconsistent verification and documentation of reviews have been confined to periods preceding changes implemented by CANARIE to the review process.

Recommendations to improve the claims review process and documentation include the following:

- Procedures should be modified to apply the holdback provisions of the contract to all claim submissions.

- Industry Canada and CANARIE should discuss whether other opportunities exist which could result in higher yielding investments on holdback funds while continuing to allow CANARIE to pay out these monies once all conditions to clear the holdback have been satisfied.
- The Financial Manager should meet with Industry Canada and Precarn officials to determine forecasting requirements suitable for all parties.
- Any future contracts should be negotiated to include terms and conditions to meet all CANARIE's operational reporting requirements and expectations.

## **2 INTRODUCTION**

---

The following section provides a brief description of the organizations and government funded programs which are the subject of this audit and the context for conducting the audit.

### **2.1 INDUSTRY CANADA**

Industry Canada is a Department within the Government of Canada, whose mission is to foster a growing competitive, knowledge-based Canadian economy. The Department works with Canadians throughout the economy and in all parts of the country to improve conditions for investment, improve Canada's innovation performance, increase Canada's share of global trade, help make Canada the most connected nation in the world and build a fair, efficient and competitive marketplace. This refers to the degree of sharing of business and technical data through electronic linkages within and across organizational boundaries, such as between partners, suppliers, customers and subcontractors. With improved connectedness, increased productivity should result and, ideally, to an environment that fosters innovation

Through Industry Canada, the Minister of Industry and the Government of Canada have provided funding for programs carried out by CANARIE and Precarn. CANARIE and Precarn, as well as their programs, are described below in more detail. Industry Canada performs a monitoring function of CANARIE and Precarn to review their ongoing activities and ensure that government funding is used for purposes provided in accordance with governing agreements and other government funding requirements. Industry Canada has staff specifically assigned to monitor activities of CANARIE and Precarn and these staff are involved in organizing audits and reviews.

#### **2.1.1 CANARIE Inc.**

CANARIE Inc. (CANARIE), is a not-for-profit Corporation headquartered in Ottawa and employing approximately 35 full-time staff dedicated to the research and implementation of advanced networks and applications. Through its funding programs, CANARIE supports a variety of initiatives to develop innovative applications and technologies to advanced broadband networks. To qualify for project funding, projects must be led by a Canadian organization and meet certain other eligibility criteria established for each of CANARIE's funding programs.

In order to achieve certain objectives around the development and use of advanced Internet networks, the Government of Canada agreed to support CANARIE's Phase 3 Advanced Application Development Program in 1999. Funding for this program is provided through the Contribution Agreement between the Minister of Industry and CANARIE. This agreement provides for maximum contribution funding of \$78 million over the five-year period ending March 31, 2004. As a condition of funding, the Contribution Agreement requires CANARIE to make minimum funding allocations to projects in the areas of Intelligent Systems (IS), e-health, e-learning and e-business. The Intelligent Systems component of CANARIE's program has been contracted to Precarn for delivery and is described below.

#### **2.1.2 Precarn Incorporated**

Precarn Incorporated (Precarn) is a consortium of corporations, research institutes and government partners working within the intelligent systems sector to develop intelligent system technologies and processes in Canada with the goal of expanding Canada's technological base to enhance Canada's internationally competitive position. Precarn funds and coordinates collaborative research conducted by

industry, university and government researchers. To qualify for funding, projects must meet criteria outlined in the standing request for proposals and meet eligibility criteria for the program.

To achieve certain objectives in the area of Intelligent Systems, the Government of Canada provides funding to Precarn in support of Precarn's Phase III Research Programs. These programs have the objective of moving intelligent systems solutions from the research community out into key sectors of the economy, thereby contributing to business growth and productivity improvements. This support was provided through the Funding Agreement signed in March 2000 between the Minister of Industry and Precarn. This agreement provided for a one-time payment to Precarn in the amount of \$20 million. The Phase III Research Program is to be conducted over the 2000-2006 time period.

### **2.1.3 CANARIE Intelligent Systems Program**

In 1999, the Minister of Industry, CANARIE, and Precarn entered into a Memorandum of Understanding (MOU) to provide a framework for a contractual relationship between CANARIE and Precarn. The purpose of this framework was to allow Precarn's expertise to be used in the implementation of the IS component of CANARIE's Phase 3 program. Following the MOU, CANARIE and Precarn entered into the Project Delivery Agreement to allow Precarn to function as the primary delivery agent for the Intelligent Systems Component of CANARIE's Phase 3 Program.

## **2.2 PROGRAM DELIVERY**

CANARIE and Precarn operate as stand alone organizations and each is responsible for managing and administering their respective funding programs. At a high level, the project funding processes at both organizations are fairly similar. After applying for project funding, projects are screened against eligibility criteria by selection panels. Successful applicants are invited to enter negotiations leading to a contract with either CANARIE or Precarn setting forth the terms and conditions under which they will receive program funding. The process for managing each program is further described in the following sections, and presented pictorially in Appendix B.

### **2.2.1 Precarn Program**

Typically, the projects are performed by a number of partners who coordinate their activities and relationships with Precarn through one partner representing their group. In the case of Precarn, the contracting partner is the 'Lead Participant' who enters into the Lead Participant Agreement with Precarn. Following project start up, the Lead Participant is responsible for providing project status reports and claim submissions to Precarn and Precarn processes the claims for payment. Based upon the findings of the review, adjustments are made to the claim to reflect any adjustments to have the claim comply with Project Agreements. In the case of Precarn, once the review procedures have been satisfactorily performed, cheques are prepared to the Lead Participant for payment of the claim. Holdbacks are not taken on each claim, but are taken when projects near completion to ensure that a 10% holdback is retained at the end of the project. The holdback is released and paid to the Lead Participant once the technical audit of project deliverables has been established and a closing workshop is held. Precarn only has financial audits performed on the CANARIE projects.

### **2.2.2 CANARIE Program**

Typically, the projects are performed by a number of partners who coordinate their activities and relationships with CANARIE through one partner representing their group. In the case of CANARIE, the contracting partner is called the 'Lead Contractor' who enters into a Project Agreement with CANARIE.



Following project start up, the Lead Contractor is responsible for providing quarterly project status reports and claim submissions to CANARIE on behalf of the project, and CANARIE processes the claims for payment. Based upon the findings of CANARIE's review, adjustments are made to the claim to reflect any adjustments required for the claim to comply with the Project Agreement. In the case of CANARIE, once the review procedures have been satisfactorily performed, the project claim is grouped with other approved projects and a combined claim is submitted to Industry Canada for review, approval and funding in the amount of the claim. Once funding is received from Industry Canada, CANARIE issues cheques to the Lead Contractor for the amount of the approved project claim less a standard 10% holdback. The holdback is released and paid to the Lead Contractor once the technical and financial audits of the project deliverables and costs have been completed. CANARIE uses a firm of professional accountants to perform final project financial audits.

### **2.3 CONTEXT**

Industry Canada recently engaged Samson & Associates to review the control framework in place at Industry Canada, CANARIE and Precarn. The consultants issued a report dated February 21, 2003 (Consultant's Report) outlining various recommendations around the control framework. Since the Consultant's report was issued immediately prior to this audit, the recommendations had not yet been received by either Precarn or CANARIE. Consequently, it is too early to assess whether the Consultant's recommendations have been implemented or the impact on the review processes in place.

In addition, the Consultant's Report outlined the claims verification process for CANARIE and Precarn as well as an audit framework guide for audits of future programs. Industry Canada requested this current audit to perform a more detailed review of claims processed within existing verification processes, the audit framework recommended in the Consultant's Report, prevailing contracts, and prudent monitoring and control practices. As part of the current audit, Industry Canada selected a number of CANARIE and Precarn projects for review.

## **3 OBJECTIVES & SCOPE**

---

### **3.1 OBJECTIVE**

The objective of the audit was to review the practices in place at CANARIE and Precarn primarily in the context of the existing claims verification processes and the audit framework for claims as described in the Consultants' Report (see Background section) recently received by Industry Canada. The audit reviewed the claims processes and controls and included consideration of the extent to which the existing audit frameworks in place in both organizations were achieving the following expectations:

- Funding provided by CANARIE and Precarn is to eligible organizations.
- Expenditures are eligible in accordance with funding agreements.
- Project claims auditing is performed of recipient organizations and the status of audits performed is apparent.
- Forecasting practices are in place to produce highly accurate and reliable forecasts.
- Reporting by CANARIE and Precarn to Industry Canada is against annual plans and other established criteria.
- Overhead and administrative costs are appropriately handled, accounted for and allocated to various activities.
- Project administrative fees levied against recipients are appropriate.
- The handling and reporting of investment income earned under the grant to Precarn Associates Inc., and the extent of processes available to accommodate the expected royalty income stream for CANARIE Phase 3.
- Funding sources to recipients does not result in unacceptable levels of government funding versus private funding.

### **3.2 SCOPE**

The scope of the audit included:

- CANARIE projects being funded by Industry Canada through the Contribution Agreement described in the previous section. These projects are within CANARIE's Phase 3 Advanced Application Development Program and include projects funded by programs in the areas of Intelligent Systems, Health, Learning and E-Commerce.
- Precarn Projects being funded by Industry Canada through the Funding Agreement described in the previous section. These projects are within Precarn's Phase III Research Programs.
- CANARIE Intelligent Systems projects funded by Industry Canada through the Contribution Agreement and subsequently funded through the Project Delivery Agreement as enabled by the Memorandum of Understanding, also described in the previous section.

## 4 APPROACH

---

The audit approach was established in consultation with the Audit and Evaluation Branch of Industry Canada and included the following key elements.

- Interviews were held with Industry Canada to define their audit requirements, discuss the various funding programs, and review relevant background material.
- All relevant agreements and contracts providing the funding to projects which are included in the scope of this audit were identified and reviewed. To the extent appropriate, other documentation was also reviewed.
- Industry Canada officials selected projects for detailed review of the project claim process and project files in Precarn and CANARIE. These projects are identified in Appendix A.
- Initial meetings were held with management officials at Precarn and CANARIE to introduce the audit and review scope and objectives.
- Program Officers at Precarn and CANARIE were interviewed to discuss the project claim processes and document their practices, procedures and controls around projects and claim submissions.
- All project and claims files for projects selected by Industry Canada for review were reviewed and tested. Follow up meetings were held with Program Officers to clarify issues or questions resulting from review and testing.
- Accounting Managers were interviewed to review the requirements for claims processing, payment, and other claim related issues.
- Meetings were held with Accounting Managers to discuss preliminary audit results, validate observations and conclusions and obtain preliminary feedback on issues discussed.

## 5 AUDIT RESULTS

---

This section provides our overall conclusion. Detailed audit findings and recommendations supporting this conclusion are presented separately for Precarn and CANARIE in the following sections.

### 5.1 OVERALL CONCLUSION

The results of the audit with respect to the stated objectives and in consideration of the sample projects reviewed indicate the following:

- Projects reviewed were eligible for funding by Precarn and CANARIE. Processes exist to ensure that maximum allowable levels of government funding are not exceeded.
- Precarn and CANARIE are providing project status reports to Industry Canada on a regular basis.
- Precarn and CANARIE continue to experience forecasting challenges to meet Industry Canada requirements. Given the nature of the difficulties, the parties will need to discuss requirements and reach a mutually agreeable solution. CANARIE has started to implement some changes in an attempt to increase forecast accuracy at the project level.
- Precarn is making some changes to the description of fees charged to members to avoid any misunderstanding as to the nature of the charges.
- Precarn and CANARIE should ensure that holdbacks are taken on each project claim paid, to ensure that the organization is protected to some extent during the entire project duration.
- Precarn should enhance their claims review practices to ensure that projects are not charging for salaries, benefits or overheads in excess of actual cost. CANARIE has good practices in place to verify actual costs of project claims.
- Precarn should implement financial audits at the end of each project. CANARIE already follows this practice and is achieving good results in relation to the nominal audit costs incurred.
- Issues were identified to consider the appropriateness of retaining and investing holdback funds in CANARIE and the lengthy reimbursement process for incurred expenses by Lead Contractors.

## 6 PRECARN: DETAILED FINDINGS

---

### 6.1 CLAIM VERIFICATION - SALARIES

#### **OBSERVATION:**

The largest component of research project costs is labour. We note the following issues with respect to labour cost verification of project claim submissions:

- Precarn does not require Lead Contractors to provide proof of labour costs associated with individuals charging time to the project.
- On a quarterly basis, the Lead Contractors provide total hours and total a dollar claim for individuals working on a project. Using a salary tracking spreadsheet, Precarn calculates the hourly labour cost for individuals on the claim and compares it to the rate for that individual in the previous quarter; however, since the initial labour costs have not been substantiated by the individual, the effect of the review is limited to identifying significant changes in hourly rates charged between periods.
- Although Precarn requires contractors to maintain timesheets in their offices, the Lead Contractors do not provide timesheets or other backup to substantiate hours charged. Without this backup, it is not possible to determine whether individuals charged for non-eligible days such as statutory holidays or whether all hours charged agree to approved time sheets. Project Analysts are reviewing labour hours against project budget proposals.
- Analysts interviewed indicated that any over charges could be identified and claimed during the final project financial audit. This approach is inconsistent with information we received that Precarn does not intend to audit Phase III projects, other than those requested by CANARIE.
- To the extent that labour costs are incorrect, items such as benefits and overheads which are charged as a percentage of labour will be incorrect.

#### **RISKS:**

There is a risk that project labour costs are inaccurate and not in agreement with actual labour costs incurred by project participants.

#### **RECOMMENDATION:**

We recommend the following:

- Lead Contractors be required to provide signed employee timesheets supporting all labour charges billed in the period.
- To augment the quarterly analytical review presently being performed, Precarn should perform an initial verification of salary charges for all individuals charging time to projects.

### 6.2 CLAIM VERIFICATION - BENEFITS

#### **OBSERVATION:**

As noted earlier, the largest component of project costs is labour. The project contracts allow for project participants to claim actual employee benefit costs up to a maximum of 20% of total labour costs. The audit identified that project participants routinely claim 20% of total labour costs as their claim for benefits.

With respect to benefit claim charges we note the following:

- Project participants are not required to provide proof substantiating their actual benefit rates at the start of the project.

- Project participants are not required to provide proof substantiating their actual benefit rates during the course of the project or when project participation changes.
- Our review of similar organizations claiming benefit costs under projects administered by another third party organization indicated that benefit rates were often less than the 20% maximum.

**RISKS:**

There is a risk that project benefit costs are not accurate and not in agreement with actual benefit costs incurred.

**RECOMMENDATIONS:**

We recommend the following:

- Lead Contractors be required to provide a complete analysis of their benefit costs and rate calculations at the start of the project, including all necessary supporting documentation.
- Project Managers require supporting documentation to support benefit rates whenever significant participant changes occur.
- All project financial audits include in scope the requirement to verify benefit rates charged to the extent not previously verified.

**6.3 CLAIM VERIFICATION - OVERHEADS****OBSERVATION:**

As noted earlier, the largest component of project costs is labour. The project contracts allow for project participants to claim actual overhead costs incurred up to a maximum of 100% of total labour costs. The audit identified that project participants routinely claim 100% of total labour costs as their claim for overheads. With respect to overhead claim charges we note the following:

- Project participants are not required to provide proof of their overhead costs substantiating their overhead charge rates at the start of the project.
- Project participants are not required to provide proof substantiating their actual overhead rates during the course of the project or when project participants and activities change significantly.
- Our review of similar organizations claiming overhead costs under projects administered by another third party organization indicated that overhead rates, especially those for smaller organizations are generally less than the 100% maximum.

**RISKS:**

There is a risk that project overhead costs are not accurate and not in agreement with actual overhead costs incurred.

**RECOMMENDATIONS:**

- Lead Contractors be required to provide a complete analysis of their overhead costs and rate calculations at the start of the project, including all necessary supporting documentation.
- Project Managers require supporting documentation to support overhead rates whenever significant staffing or operation changes occur.
- All project financial audits include in scope the requirement to verify overhead rates charged to the extent not previously verified.

## **6.4 PROJECT FINANCIAL AUDITS**

### **OBSERVATION:**

Although the project agreements provide for financial audits, we noted the following issues with respect to these audits:

- The responsibility for conducting financial audits is not clear. Analysts indicated that they were unsure who would pay the costs for these audits, although they thought the costs should be born by the party requesting the audit.
- There is no process in place to require a financial audit on each project. The Project Managers indicated that it was felt that the contractual threat of a possible audit was considered sufficient to ensure contractor compliance (similar to individuals filing tax returns with CCRA and possibility of audits).
- We were informed that based on Phase 1 audit experience, audits were not proving to be cost effective, and were not performed on Phase 2 projects and were only planned for CANARIE Phase 3 projects.
- Completed projects have had the holdbacks approved for release and payment although no financial project audit has been completed.
- Certain financial audits have been performed at CANARIE's request for projects conducted on behalf of CANARIE. It was noted that contract amendments were signed to recognize the audits and include the audit costs as eligible costs. The contract amounts were increased to cover these additional costs.

### **RISKS:**

- Given that the monthly review of costs by Project Analysts is a reasonableness review, Precarn is at risk of not identifying and recovering non-eligible costs submitted by project participants.
- Holdbacks are released prior to establishing that all costs are valid project costs.
- Precarn is at risk of requiring contract amendments to define audit requirements in other project agreements.

### **RECOMMENDATIONS:**

We recommend that:

- Precarn establish an audit plan to ensure that all projects receive a financial audit prior to project acceptance and sign-off.
- Precarn establish contract terms and conditions, which ensure that project recipients are liable for all costs of financial audits.
- Holdbacks be retained until satisfactory completion of all project deliverables, including the financial audit.

## **6.5 HOLDBACKS**

### **OBSERVATION:**

The project agreements provide for a holdback of 10% of the claim amount to be deducted from the claim payment until all project deliverables are met. The testing performed indicated that holdbacks are not being taken against each claim, rather they are being applied at the end of the project. The reasons received for this approach indicated that taking holdbacks at the early stages of a project would adversely impact the project cash flow, especially in the cases of smaller organizations. The Project Managers interviewed indicated that it was their belief that taking holdbacks at the end of the project satisfied contractual requirements.

**RISKS:**

Although the project agreement terminology can be subject to differing interpretations, the general intent of holdbacks is to withhold a portion of payment until all deliverables have been received. This expectation is applicable to all claims since the project can be subject to default at any time during the life of the project. Applying holdbacks at the end of the project does not provide any financial protection to Precarn throughout the project.

**RECOMMENDATIONS:**

We recommend the following:

- Operating procedures be modified to apply the holdback provisions of the contract to all claim submissions.
- Holdbacks be released upon satisfactory completion of all technical and financial audits of the project.

**6.6 APPROPRIATE CLAIM BACKUP****OBSERVATION:**

The terms of the contract require that Lead Contractors provide invoice backup in the following situations:

- Special Purpose Equipment acquired cost in excess of \$25,000.
- Travel costs exceeding \$2,000.
- Direct materials costing in excess of \$5,000.
- Other costs including rentals, testing, and training exceeding \$2,000.

The testing performed indicated that generally invoices are not being received by Precarn since the values of charges for goods, non-labour services and travel do not exceed the thresholds established.

**RISKS:**

There is a risk that Precarn is incurring charges from Lead Contractors, which are not appropriate.

**RECOMMENDATIONS:**

Precarn should consider revising the threshold requirements in future contracts to a reasonable level which would require contractors to provide invoice backup while not requiring excessive administrative effort on the part of Precarn or the Lead Contractor.

**6.7 EARLY PAYMENT****OBSERVATION:**

Precarn is responsible for delivery of the Intelligent Systems projects on behalf of CANARIE. CANARIE operates on a contribution basis and only reimburses claimants upon receiving invoice backup and proof that funds have been expended towards the project. This process, including various levels of review, approval and turn around time to issue cheques is lengthy. We were informed by the Precarn Financial Manager that instead of making Lead Contractors wait up to six months from the time they incur expenses to the time funds are reimbursed from CANARIE, they will pay the Lead Contractor using funds on hand from the grant program. We were informed that Precarn made a policy decision to perform this practice.



**RISKS:**

Precarn is at risk as follows:

- Precarn may not be in compliance with the agreement governing the grant funds received from Industry Canada.
- There is an expectation in Industry Canada that grant funds be invested and interest on these funds be returned into the program to further fund eligible programs. To the extent that funds are borrowed and used to pay Contractors, they are not available for investment and the grant program loses investment income.
- Precarn may be at risk of not receiving reimbursement funding from CANARIE to the extent that CANARIE is not in agreement with funds expended and claimed for the quarter.

**RECOMMENDATION:**

We recommend the following:

- CANARIE and Precarn review and streamline the reimbursement process to shorten the time that Lead Contractors have to wait for reimbursement of their expenses from CANARIE.
- Precarn consider the appropriateness of borrowing against the grant funds to early pay claims for projects under the Intelligent Systems program undertaken on behalf of CANARIE.

**6.8 INVESTMENT PROGRAM****OBSERVATION:**

Precarn received grant funding from Industry Canada at the beginning of the program. To the extent that the money is not expended on projects, Precarn invests this money to earn investment income. Precarn has established an investment policy written and approved by the Investment Management Committee of the Board. Additionally, the organization has hired an investment management firm to manage investments under the direction of Precarn's Financial Manager and the Investment Management Committee. Precarn's Financial Manager updates a spreadsheet to track investment income and remaining grant funds.

Since the start of investment activity by Precarn, Treasury Board Secretariat (Treasury Board) has issued guidelines restricting the type of investments government organizations can hold. Although Precarn has indicated that it is their opinion that they are not bound by the new Treasury Board guidelines, they have the intent of moving their portfolio to a position of compliance.

We were informed that in using grant funds, Precarn does not necessarily liquidate holdings that are not in compliance with Treasury Board guidelines, since they are yielding higher returns. Although the intent is to move to compliance with the Treasury Board guidelines, the actions of retaining higher yielding investments indicates that a program is not in place to reach full compliance. Precarn has indicated that by retaining certain higher yielding investments, they meet the Treasury Board requirements of investing in a prudent manner.

**RISKS:**

Regardless of whether or not compliance with TBS guidelines is required, there is a risk that Precarn could be perceived to be investing public money outside of Treasury Board guidelines.

**RECOMMENDATIONS:**

We recommend that Precarn review the appropriateness of their investment activities in light of prevailing funding contracts and Treasury Board guidelines. Consideration should be given to developing a plan with targets for the Investment Manager to migrate Precarn's portfolio to be in compliance with Treasury Board guidelines on permitted investments.

## **6.9 FOREIGN CURRENCY CONVERSION**

### **OBSERVATION:**

One of the projects reviewed included several charges for goods purchased in US dollars (USD) throughout the year. It was noted that the Contractor applied a multiplier of 1.54 to all USD items purchased in all months of the year. The Project Analyst indicated that Contractors are required to submit actual costs incurred and this would apply to foreign exchange costs.

### **RISKS:**

The risk is that Contractors are not invoicing Precarn actual project costs in accordance with the requirements of the contract.

### **RECOMMENDATION:**

We recommend that Precarn's claim verification process include a step to ensure that any claims, which include purchases made in foreign currencies, are converted to Canadian dollars at the actual prevailing exchange rate appropriate for the period.

## **6.10 FORECASTS**

### **OBSERVATION:**

We note that both Industry Canada and the recently issued Consultant's Report expressed issues around the accuracy of forecast information received from Precarn. In the context of the projects selected for review we discussed forecasting practices with the Financial Manager and were informed that there are numerous factors impacting the ability to prepare consolidated forecasts. These factors include:

- Several Lead Contractors are small organizations and do not have the expertise and resources to prepare forecast information. For example, BPI was cited as not having any expertise or ability to meet this requirement.
- Lack of time at quarter and year ends. Considerable effort is applied to obtain actual financial reports from reporting organizations within 15 days of quarter or year end and to consolidate figures which does not leave adequate time for additional requirements.
- If the Project managers are unable to obtain information, the Financial Manager applies a "best-guess" approach relying on financial history to project forecast information.
- The requirement from Industry Canada to prepare accurate forecasts 6-9 months prior to the end of the year is difficult given the large number of unpredictable research projects and the number of other unknown variables to consider.
- These unknowns compounded over many projects were given as reasons for maintaining the current practice.

### **RISKS:**

The risks are that:

- Management may not be receiving sufficient accurate forecast information for ongoing management of projects
- Users such as Industry Canada are not receiving accurate forecast information.

### **RECOMMENDATIONS:**

We recommend the following:

- As a condition of receiving program funding, all project participants should be required to provide updated forecast information on a timely basis to Precarn.
- The Financial Manager meet with Industry Canada and CANARIE officials to determine forecasting requirements suitable for all parties.

## **6.11 SITE VISITS**

### **OBSERVATION:**

A key activity to maintain awareness and to assess project activities is the site visit. We noted that Project Managers do not have standard documentation criteria around site visits performed, discussions held or decisions made at site visits.

### **RISKS:**

There is a risk that project assessments and all decisions and evaluative assessments are not fully documented.

### **RECOMMENDATIONS:**

We recommend Precarn consider developing a template to capture and record all information, discussions and decisions arising from site visits and to serve as a record that site visits are being performed on a regular basis.

## **6.12 UNCORRECTED ERROR**

### **OBSERVATION:**

The statement of expenditures reviewed in this audit for the project identified as 'Biochips' indicates that the Precarn budget amount for this project is \$948,320. This figure is not in agreement with other reports which indicate that the Precarn budgeted amount for 'Biochips' is \$1,000,000. After reviewing the difference, the Financial Manager indicated that the number was incorrectly recorded based on the proposal and did not include GST.

### **RISKS:**

There is a risk of incorrect project reporting.

### **RECOMMENDATIONS:**

We recommend that the statement of expenditures be reviewed to identify other possible instances where figures may have been incorrectly entered from proposals. The reports for the 'Biochips' project should be corrected to reflect consistent, accurate budget figures on all project reports.

## **7 CANARIE: DETAILED FINDINGS**

---

### **7.1 HOLDBACKS**

#### **OBSERVATION:**

The project agreements provide for a holdback of 10% of the claim amount to be deducted from the claim payment until all project deliverables are met. The testing performed indicated that holdbacks are not being taken on a consistent basis. The Project Analysts for e-business informed us that holdbacks were viewed as a technique that could be applied at the discretion of the Project Analyst. The Project Analyst indicated that the holdback would not be applied in the early stages of project claims in order to provide recipients with more cash flow; however, attempts would be made to claim more than 10% on subsequent claims in order to arrive at a total 10% holdback position by the end of the project.

#### **RISKS:**

The purpose of holdbacks is to afford the organization a minimum level of financial assurance that project deliverables will be met. This expectation is applicable to all claims since the project is subject to default at any time during the project. Applying the holdbacks only at the end of the project does not provide any financial protection to CANARIE throughout the project.

#### **RECOMMENDATIONS:**

We recommend the following:

- Procedures be modified to apply the holdback provisions of the contract to all claim submissions.

### **7.2 HOLDBACK FUNDS INVESTED**

#### **OBSERVATION:**

Apart from exceptions noted elsewhere, CANARIE is withholding 10% of each claim as a Holdback which is invested and subsequently released to the Lead Contractor once the technical and financial audits of the projects have been completed. The testing identified a situation where a project was terminated early and the holdback was not paid out resulting in a repayment of the holdback principal to Industry Canada. With respect to the holdbacks, the following issues are noted:

- Any interest earned by invested holdback funds are co-mingled with CANARIE's other investment income and are not apportioned to Industry Canada with the returned Holdback.
- CANARIE's claims to Industry Canada are calculated net of holdbacks, thus resulting in the receipt of total funds by CANARIE although not all funds are paid to Lead Contractors at that time. This results in CANARIE investing and accounting for holdback funds until project completion and final payout of the holdbacks.

#### **RISKS:**

There are the following risks:

- CANARIE may not by itself be able to achieve the quality and yield of investments which the Government of Canada may receive.
- There is an impression that claims are made to Industry Canada for reimbursement of funds to be immediately expended in the claim cycle. Holdbacks by nature will not be disbursed in the immediate claim cycle and as such these claims can be seen as advancing funds not yet required or incurred.

**RECOMMENDATIONS:**

We recommend that Industry Canada and CANARIE discuss whether other opportunities exist which could result in higher yielding investments on holdback funds while continuing to allow CANARIE to pay out these monies once all conditions to clear the holdback have been satisfied.

**7.3 FORECASTS****OBSERVATION:**

We note that both Industry Canada and the recently issued Consultant's Report expressed issues around the accuracy of forecast information received from CANARIE. In the context of the projects selected for review we discussed forecasting practices with the Financial Manager and were informed that there are numerous factors impacting the accuracy of long term forecasts. These factors include:

- The capability to forecast varies by the nature of the program. For example, in e-business programs the concept of forecasting is understood and they provide reasonably good forecasts as required, whereas in e-health they may not be as comfortable with forecasting and this impacts the quality of forecasts received.
- Precarn was cited as not providing good forecasts for the Intelligent Systems program that Precarn delivers on behalf of CANARIE.
- The requirement from Industry Canada to prepare forecasts 6-9 months prior to the end of the year is difficult.

The forecasting issue is not new; however CANARIE has initiated some changes to the way Project Analysts will do forecasts in the future.

**RISKS:**

The risks are that:

- Management is not receiving sufficient information for ongoing management of projects.
- Users, such as Industry Canada, are not receiving accurate forecast information.

**RECOMMENDATIONS:**

We recommend the following:

- As a condition of receiving program funding, all project participants should be required to provide updated forecast information on a timely basis to CANARIE.
- The Financial Manager meet with Industry Canada and Precarn officials to determine forecasting requirements suitable for all parties.

**7.4 CONTRACT REQUIREMENTS****OBSERVATION:**

Precarn and CANARIE have a contractual relationship whereby Precarn delivers CANARIE's Intelligent Systems projects. With respect to this relationship, we note that there are certain issues as follows:

- It is Precarn's responsibility to review project claims in detail. If properly signed documentation is received from Precarn, the claims are processed for payment.
- After some negotiations, Precarn agreed to use their financial auditors to conduct financial audits of completed projects.
- There have been difficulties experienced in obtaining detailed information from Precarn which has led to CANARIE establishing extensive monitoring spreadsheets to ensure that claims are

within guidelines. Additionally, CANARIE is maintaining holdbacks against all Intelligent Systems projects.

The observation points highlighted above indicate that the contract between Precarn and CANARIE for the delivery of Intelligent System projects by Precarn may not be detailed enough to satisfy all the requirements of CANARIE.

**RISKS:**

There is a possibility that the Intelligent Systems projects may be incurring costs which otherwise would not be allowed if CANARIE was able to perform monthly detail claims reviews and direct the project financial audit process.

There is a risk that the terms and conditions of the contract with Precarn may not reflect the requirements of CANARIE'S funding agreement when project delivery and management is subcontracted to another third party delivery agency.

**RECOMMENDATION:**

We recommend that any future contracts be negotiated to include terms and conditions to meet all CANARIE'S operational reporting requirements and expectations.

## **7.5 CLAIM PROCESSING**

**OBSERVATION:**

CANARIE has established certain practices and requirements to ensure that claims paid to recipients are accurate and are to reimburse costs paid by project members. These requirements include reviews to determine that salaries, overhead and benefit rates are verified to supporting documentation and to review that cost claims were paid by project members. The testing performed indicated the following issues:

- Documentation for verification of salaries and overheads was inconsistent.
- In one claim file, the proof of salaries constituted of screen printouts, which were so dark, they were black and essentially illegible.
- Some of the documentation accepted and filed, as 'proof of payment' does not prove that payment was actually made. For example, copies of cheques issued by vendors were placed on file as proof of payment, however this does not ensure that the vendor, in fact, issued the cheque.

**RISKS:**

There is a risk that the claim review is not meeting all of the standards established by CANARIE.

**RECOMMENDATIONS:**

We recommend the following:

- Guidance be developed for Analysts as to what documentation constitutes proof of payment.
- Verification of overhead and benefit rates be performed and documented for all projects.
- Verification of all items, including salaries, be obtained in a manner such that the information is clearly legible for future reference and to support the verifications performed.

---

---

## APPENDIX A

---

---

Representatives of Industry Canada selected the following projects for review.

### CANARIE PROJECTS

<b>Project Name</b>	<b>Project Area</b>	<b>Budget</b>
<i>EP-07 My Legal Answer</i>	E-business	\$1,238,785
<i>Marine Talk</i>	E-business	\$2,600,000
<i>DX Net</i>	E-business	\$318,000
<i>The Caretinuum</i>	E-health	\$549,917
<i>MIST</i>	E-health	\$100,000
<i>Diabetes Self Management Network</i>	E-health	\$225,000
<i>EduSource</i>	E-learning	\$4,250,000
<i>Etraffic Solutions</i>	E-learning	\$1,399,438
<i>Canal Savoir</i>	E-learning	\$1,569,679

### Precarn PROJECTS

<b>Project Name</b>	<b>Project Area</b>	<b>Budget</b>
<i>Biochips</i>	I.S.	\$2,515,380 total / \$1,000,000 - CANARIE
<i>IPDC</i>	I.S.	\$1,736,000
<i>KMS</i>	I.S.	\$2,780,000
<i>IBAUTS</i>	I.S.	\$2,503,364



---

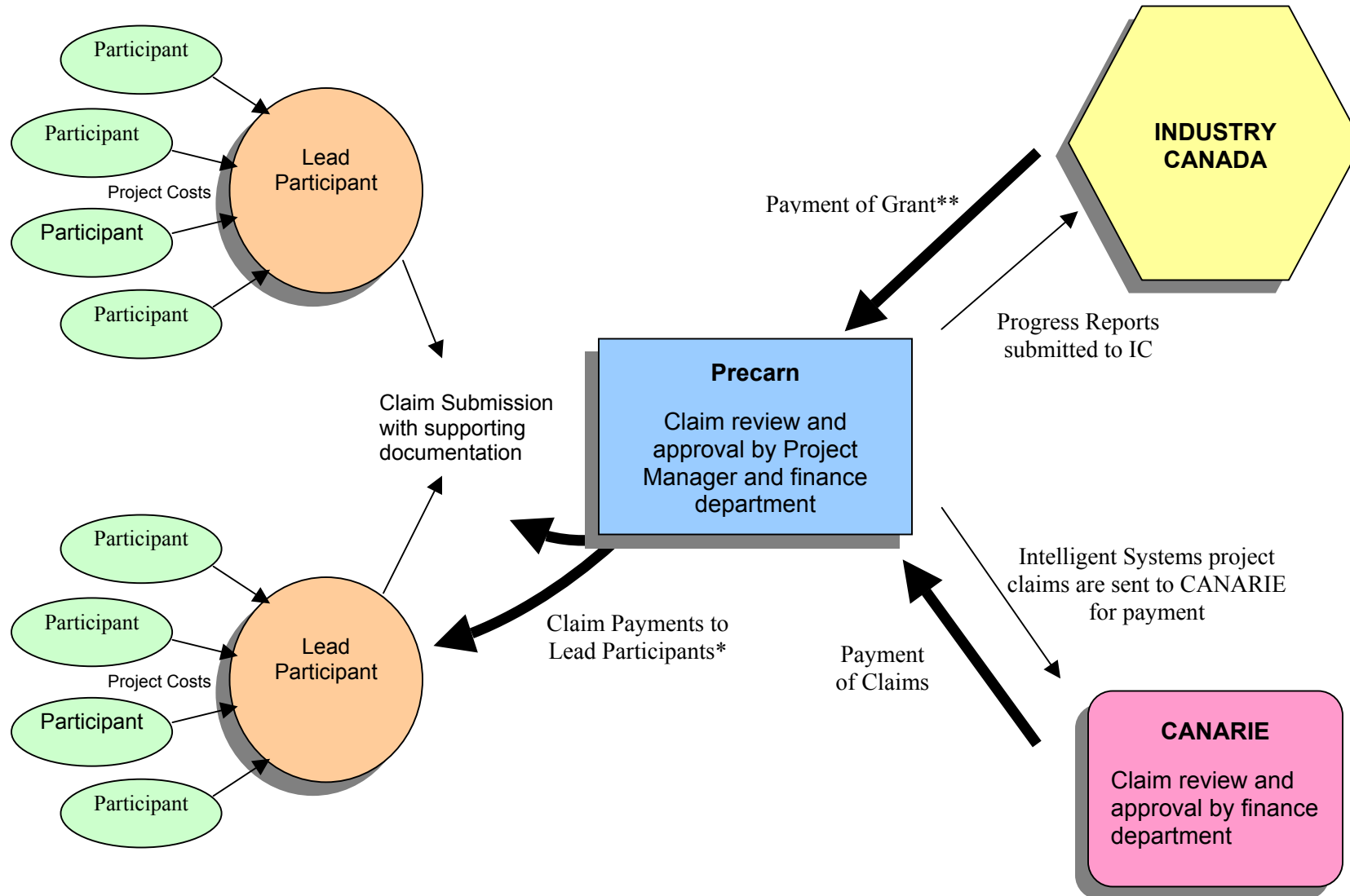
---

## APPENDIX B

---

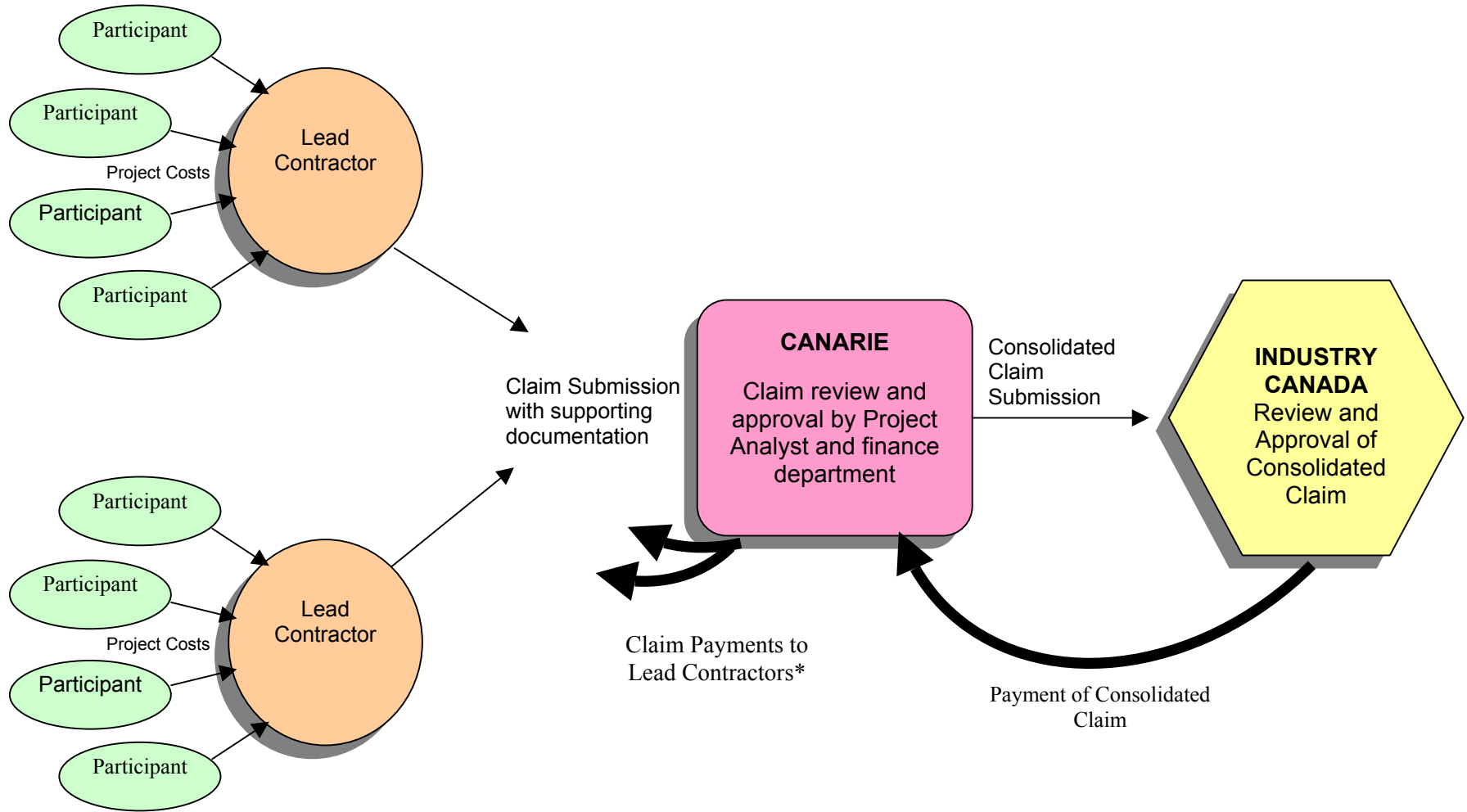
---

### Precarn CLAIMS PROCESS



\* Claim payments are equal to the approved claim amount, until such time as 90% of the funds have been paid to a project, at which time the remainder is held back until the final deliverable is received.  
 \*\*Grant is paid upon start of program once Funding Agreement is in place.

## CANARIE CLAIMS PROCESS



\*Claim payments are equal to the approved claim amount less a standard 10% holdback.

---

---

## APPENDIX C

---

---

