Internal Audit Bureau
Bureau de vérification interne

AUDIT REPORT

Audit of Eastern Arm Contribution Agreement

Project No.: 454/98

Project Team

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December 1998

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1.0 BACKGROUND

The Internal Audit Bureau has been asked to review and report on the handling by HRDC Officers of a Job Creation Partnership Contribution Agreement with Eastern Arm Enterprises Ltd. Some shortcomings in the consultation and approval processes had already been identified.

This report covers the entire cycle of the project, from the initial approval in November 96 to the reimbursement of the last expense claim in August 97. A second agreement covering the period from September 97 to February 98 was included in the review because it was found to be an extension of the first Agreement.

The review focused on processes and did not require a visit by the auditors of the project site. The auditors have had access to all the documentation related to the initial project held by HRDC and have obtained from Eastern Arm the supporting evidence requested.

The findings are preceded by the criteria that was used during the review.

Findings

1- Approval: The application is supported by an adequate business plan, proper consultations were conducted and the rationale for recommending the project is clearly stated in the project file.

The facts:

On November 19, 1996, the President of Eastern Arm Enterprises Ltd. sent directly to the Project Officer a two page description of a project called "Eastern Arm Enterprises Ltd. Tourist Resort". This project provided for the construction of an hotel, a golf course, a recreational vehicle trailer park, a day use areas, a hiking trail, a miniature community, and a marina. Eight persons were to be hired for the hotel and ten for the golf course when the resort is in operation.

The sponsor asked HRDC to provide $120 000 for the payment of participants wages and $30 000 for overhead. The application does not specify the nature of the overhead expenses for which a contribution is requested.

The project officer sent a copy of the proposal to the manager of the Rocky Harbour office, with the following comments:

> *"Attached is an outline of plans for the Tourist resort I just discussed with you. Sounds big!!! (the President) requested that all material from him be kept strictly confidential within HRDC (doubly underlined by the Project Officer). I assured him any info will not leave our office."*

The project file contains a copy of the proposal sent by the President of Eastern Arm to the Newfoundland and Labrador Department of Environment and Labour. They replied on July 6, 1996, that an environmental impact statement for the construction of the golf course was not required. All the other communications about this project found in the file are subsequent to the signing of the original contract.

Our assessment: the review criteria were not met completely:

- the applicant has submitted a general description of the project, not a business plan. There is no reference to a feasibility study and the document does not spell out how the project will be financed and by whom. The Provincial Department of Development and Rural Renewal has written to Eastern Arm to tell its President that his proposal lacked "critical information pertinent for decision making", but this was after the project had been accepted and the contract signed.

- The file does not indicate the rationale for recommending the project. It seems that the Project Officer has discussed the project with the manager of Rocky Harbour, where the project is located, but the content of these discussions are not known.

2- Consultations: Policies and protocols are established for consultations with interested parties respecting project proposals and are followed.

The facts:

There is no indication on the file that consultations have taken place with anyone inside or outside HRDC prior to the initial approval of the project. At least two factors help explain why.

- the Eastern Arm project was among the first contribution project to be contracted through the new Employment Benefits and Support Measures (EBSM) rules. Under the Canadian Job Strategy, consultation with the MP was not mandatory, but it was under EBSM. It is possible that the Project

Officer who handled the initial project was not aware of this new requirement.

- the request from the President of Eastern Arm that the project proposal sent to the Project Officer be kept confidential and would not leave the office.

- the project was signed before Labour Market Development Agreement policy made it mandatory that the province be consulted on all new contribution projects under Part II of the EI Act.

<u>Our assessment: the review criteria was not met because the mandatory consultation with the MP did not take place for the reasons given above. This has already been admitted by the Department which has taken action to prevent this from re-occurring.</u>

<u>3- Contracting:</u> A valid contract clearly stating the rights and obligations of the parties and specifying the nature of the services to be provided and allowable expenses are approved at the proper level.

The facts:

- A $150 000 Employment Benefit and Support Measure (EBSM) Job Creation Partnership Contribution agreement between HRDC and Eastern Arm Enterprises (EAE) Ltd. was signed by the recipient (identified as "President", (Signature unreadable) on **6 Dec. 96**, and by the Program Officer, on **18 Dec. 96.** The initial Agreement covered the period from **9 Nov. 96** to 25 Apr. 97.

- Several subsequent schedules (Identified as Schedule A) extending the duration of the project and increasing the contribution ceiling were issued, as indicated in the following chart:

Date signed	Duration	Signature for Dep.	Overhead	Allowances
29 Nov. 96	9/11/96 to 24/4/97	J. Parsons, Mgr.	$20 000	$130 000
25 Feb. 97	not shown	J. Parsons, Mgr.	$60 000*	$ 90.000
27 Mar. 97	9/11/96 to 31/7/97	J. Parsons, Mgr.	$110 000**	$190 000

* the reason given on the Appendix for the change is given as followed:

"Re distribute (amount erased) from allowances to overhead costs. Plumbing and electrical had to be sub-contracted. Workers were not available in the allowance structure."

** the reason given on the Appendix for the change is given as followed:

"To top up project to allow additional activities."

- The project files contained no schedules (generally identified as "Schedule B" in Contribution Agreements) describing what expenses the sponsor was allowed to claim for reimbursement.

- A cash flow forecast prepared by the Project Officer has been modified to reflect the increases from $20 000 to $110 000. The modifications are not dated nor initialed. The figures are as follows:

Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Total
5 000	5 000	5 000	~~5 000~~ ~~45 000~~ 75 000	5 000 ~~10 000~~	5 000 ~~10 000~~	5 000	5 000	110 000 ~~20 000~~

- On September 1997, a second Agreement was signed with Eastern Arm for an initial amount of $60 000 in allowance paid directly to the participants under parts I and/or II of the EI Act. The amount was raised to $95 970 on the 6th of February 1998, and to $119 970 on the 26 of February 1998. This new Agreement included a "Schedule B", which indicated that the entire contribution was to be paid directly to the participants as allowance, except for $20 000 which was to be used to contract out electrical and plumbing work.

<u>Our assessment: the criteria was partly met because the original and the subsequent contract were valid and approved at the proper level, but an important Appendix was missing from the first contract. Also, the rationale for amending the contracts and increasing the amount of the contribution is not clearly developed in the file.</u>

- The absence of an Appendix B with the first contract allows the sponsor to claim as expenses just about any expense; this may lead to an inadequate use of contribution funds.

- The initial project has not changed fundamentally from September 96 to June 98, and the reason why an initial contribution of $150 000 ended up to over $420 000 is not clearly stated. New Appendices refer to "continuation of the development of a world class tourist resort" but the description of the activities still refer to the construction of 20 hotel units and a golf course.

<u>4- Management:</u> The project is reviewed and monitored regularly for compliance with the terms and conditions of the contract, and for the achievement of the expected results.

The facts:

The project was visited several times by the Project Officer and the sponsor reported regularly on the progress of the construction of the hotel and golf. However, the absence of a clear definition of the allowable expenses ("Schedule B") in the initial Agreement limited the very purpose of financial monitoring since virtually all expenses related to the project were allowed. In addition, the Project Officer did not identify timing differences between the monthly reimbursement claimed and the actual project cash flow despite the fact that a monitoring report states that "… expenses to date (are) supported by invoices or adequate documentation".

<u>Our assessment: the criteria was partly met because regular monitoring took place but the absence of a legal description of what the contribution was to pay for reduced the monitoring visits to assessing the progress of the constructions</u>

<u>5- Expense reimbursement:</u> Expense claims are reviewed and approved in compliance with Section 34 of the Financial Administration Act.

The facts:

As indicated above, it was not clear in the original proposal what exactly HRDC had agreed to be paying for. The original request from the sponsor referred mainly to **wages** support. The cash flow prepared by the Project Officer referred to **overhead costs** excluding capital costs. Then all the claims presented by Eastern Arm referred incorrectly to **participant wages.**

Invoices supplied by Eastern Arm show that the expenses claimed by the Sponsor do not correspond to the project cash flow. For instance, between December 1996 and April 1997, the amounts claimed exceed the actual expenses. The amount of the monthly claims presented by the sponsor were not questioned and the amount requested was always paid.

Despite these discrepancies, the sponsor has produced expense invoices that exceed the total amount claimed to HRDC. The sponsor has explained afterward to a Project Officer during a monitoring visit that his bookkeeper simply claimed all monies paid out in that particular month and that it was left up to HRDC to adjust the amount actually advanced.

Our assessment: the criteria is partly met because the total amount claimed is supported with acceptable documentation. However, the discrepancies in the timing and the description of the expenses claimed and incurred should have been detected and addressed early in the Project.

2.0 CONCLUSION

The overall conclusion is that the project shows several weaknesses from the handling of the initial application to the last reimbursement. On the other hand, there is evidence that the sponsor used the contribution money in the development of the Resort, and that his expenses cover the total amount claimed.

The vagueness of the terms of the Agreement and the absence of a clear definition of allowable expenses have resulted in a situation where HRDC has very little control over the use of the Contribution funds by the sponsor. Virtually all expenses that can be related to the project and were actually incurred are admissible, even though they may not represent the most appropriate or effective use of the money under the circumstances. It is doubtful that further auditing would reveal additional relevant information.

Discrepancies exist in the timing of the monthly claims and the actual project cash flow and the description of some expenses on the claim may not match the definition of the actual disbursement. An overpayment could be established on these grounds, but the legal and technical confusion regarding the allowable expenses, the lack of diligence in the management and monitoring of the project and the lack of indication of bad faith on the part of the sponsor, do not support this option.

3.0 RECOMMENDATION

We recommend that the lessons learned in this project be shared with other Project Officers and Managers involved in the management and delivery of contribution projects. We do not recommend that an overpayment be established.