

**Review of the Business Advisory Centre of
Hamilton-Wentworth**

for the fiscal year 1997

**for the Internal Audit Bureau
of
Human Resources Development Canada**

December 7, 1999

**ARTHUR
ANDERSEN**

INDEX

	<u>Page</u>
Background	3
Key Procedures Performed	3
Key Observations	3-8
Surplus on a Fund-by-Fund Basis	Appendix I
Deferred Revenue Reconciliation	Appendix II
HRDC Surplus	Appendix III
	20(1)(b)(c)
HRDC Revenues by Project in 1997	Appendix V
“True” Deferred Revenue at December 31, 1997	Appendix VI
1997 HRDC Surplus in Entrepreneurial Programs	Appendix VII

BACKGROUND

The Internal Audit Bureau of Human Resources Development Canada (HRDC) asked for a review of the Business Advisory Centre (“BAC”) of the Region of Hamilton-Wentworth to determine the:

- 1) Existence of a surplus;
- 2) Source of surplus;
- 3) Reason for the surplus.

This review was conducted from July 26, 1999 to August 11, 1999.

20(1)(b)(c)

The major contributors funding the BAC are Human Resources Development Canada (“HRDC”),
 , Ministry of
 Economic Development for Trade and Tourism (“MEDTT”), and Industry Canada (“Industry”).

The scope of our review was limited to the 1997 year. We performed a high level review of years from 1993 to 1998 to understand the nature of the surplus. In this report we will indicate amounts that have been substantiated in the 1997 year and amounts that have been estimated for all other years.

KEY PROCEDURES PERFORMED

- Discussions with key staff of HRDC, the MEDTT and the BAC;
- Financial review/analysis of the surplus and identification of the source of the surplus;
- Detail testing of revenue and expenses by program for 1997;
- Analytic testing of allocation of funds among programs;
- Verification of cash balance as at December 31, 1997 and reviewed all monthly bank reconciliations;
- Review of external audit working paper files for 1997 pertaining to deferred revenue;
- Review and evaluation of internal control procedures over the accounting for program revenue and expenditures;

20(1)(b)(c)

KEY OBSERVATIONS

Our testing indicated that the BAC was maintaining accurate records. Based on work performed it is evident that a surplus does exist. As of December 31, 1997 the estimated accumulated surplus was

20(1)(b)(c)

(see Appendix I).

A portion of the surplus is a result of excess HRDC funding of (see Appendix III); \$30,000 relates to Jobs Ontario funding; \$333,000 is due to excess funding provided by the Region; \$18,000 has been earned in the Entrepreneurial Initiatives program and the source of this amount can not be determined. The remaining (see Appendix IV) was the opening surplus balance as per the 1993 audited financial statements.

20(1)(b)(c)

20(1)(b)(c)

We have determined that three main factors have contributed to the surplus:

- *Misunderstandings regarding the status of client living allowances*
\$80,000 in client living allowances were earmarked for the SEA-RB program to be given to the SEA-EI program. The BAC expected to expend the funds on an as needed basis. The funds were not expended in 1997;
- *HRDC claim forms submitted by BAC did not reflect actual expenses incurred.*
-

20(1)(b)(c)

For example, the \$27,000 received by Industry Canada for the Ontario Business Call Centre was not included in the original budget. The Region contributed this amount.

20(1)(b)(c)

20(1)(b)(c)

Existence of a Surplus

The calculation of the surplus as at December 31, 1997 has been derived by compiling audited financial statements of the BAC for the years 1993 to 1997. The calculation is as follows:

Opening Surplus as at December 31, 1992

20(1)(b)(c)

The excess revenues over expenses for 1993 – 1997 are as per the audited financial statements.

Surplus vs Cash Balance

The cash balance of _____ as at December 31, 1997 differs from the surplus by _____. The difference is made up of: \$70,000 in funding received in advance from HRDC for currently running programs (this being true deferred revenue) and _____. The remaining difference in cash _____ is due to changes in operations

20(1)(b)(c)

Source of the Surplus / Originating Source for Surplus

In order to determine the source of the surplus we accumulated the additions to the surplus from 1993 to 1997 on a fund-by-fund basis (see Appendix I) using the audited financial statements for those years. The financial statements separated the funds in the following manner:

- *Operating Funds* – used to run the Small Business Enterprise Centre

- *Entrepreneurial Programs* (“EP”) – funds allocated to run the HRDC funded Self-Employment Assistance programs for both Employment Insurance and Reachback (“SEA-EI” and “SEA-RB”) and Healthcare programs;
- *New Ventures* – used to run the HRDC funded Healthcare and Local Labor Market programs as well as a profit oriented fee-for-service program.

20(1)(b)(c)

We noted a “Designated Surplus” fund on the 1997 BAC audited financial statements at December 31, 1997. Surpluses from the Operating fund

20(1)(b)(c)

were transferred to this “Designated Surplus” fund over the year reviewed. As per the notes in the December 31, 1997 financial statements, this fund was set aside for specified projects under the following programs:

- Business Advisory Centre of Hamilton-Wentworth
- Entrepreneurial Programs, and
-

20(1)(b)(c)

As part of our calculation of the surplus we took into account the transfers to this fund in order to accurately reflect the surplus. With the exception of the HRDC Healthcare and Local Labor Market programs, separate general ledgers and bank accounts were maintained for programs to track revenues and expenses. The separate tracking of programs provides good management control to monitor revenue and expenses related to each program. The following general ledgers and bank accounts were maintained:

- Operating Fund
-
- SEA-EI (part of EP)
- SEA-RB (part of EP)
- Entrepreneurial Initiatives (part of EP)
- Jobs Ontario
- Pathways Program

20(1)(b)(c)

We performed testing on revenues and expenses from the BAC general ledger for the 1997 year. This testing was performed to ensure completeness, accuracy, and appropriate accounting for funds received and dispersed. Our testing indicated that the BAC was maintaining accurate records.

HRDC

The estimated surplus associated with contributions made by HRDC, as of December 31, 1997 is \$239,000 (see Appendix III). This amount consists of \$193,000 of income transferred into “Deferred Revenue” over the years, , and \$7,000 (see Appendix I) of accumulated revenues in excess of expenditures per the audited financial statements from 1993-1997 for the Entrepreneurial Program . The 1997 HRDC contract with the BAC indicates that excess contributions over expenditures must be returned to the HRDC.

20(1)(b)(c)
19(1)

We reviewed the 1997 audit working papers belonging to the auditor for that year (forwarded to us by the current auditor of the BAC) to determine how the “Deferred Revenue” account was calculated. Revenues exceeding expenses for 1997 for the SEA-EI and SEA-RB programs were reversed out of income and added to deferred revenue. “Deferred Revenue” was calculated as excess revenues over expenditures rather than as *actual* “Deferred Revenue” (revenues in excess of expenditures for current projects that have not been completed). Therefore, in actuality the “Deferred Revenue” account consists of *actual* “Deferred Revenue” and “excess revenues over expenditures” from completed prior year projects.

The “Deferred Revenue” account on the financial statements as at December 31, 1997 was \$293,000. According to the 1997 audit working papers, the BAC’s Manager of Entrepreneurial Programs stated in an interview that, “SEA-RB and SEA-EI’s contracts with HRDC would require repayment of any surplus funds that arise. However for practical purposes instead of repaying the surplus, the programs would run until the funds have been exhausted.” However, the funds were never exhausted and these excess funds were never brought to the attention of HRDC when renewing contracts for subsequent programs.

We calculated actual deferred revenue for programs existing at December 31, 1997 as \$70,000 (see Appendix VI). The remaining \$223,000 (\$293,000-\$70,000) is not actual deferred revenue as it relates to contributions in excess of expenditures for 1997 and years prior to 1997. \$30,000 relates to excess contributions from Jobs Ontario and the remaining \$193,000 (see Appendix II) relates to HRDC funding. This includes \$ 10,000 from the Pathways program.

There is evidence of excess contributions over expenses for the SEA-EI and SEA-RB contracts for the 96/97 term. We noted a total difference of \$22,000 between claim forms submitted over actual expenses incurred for the program as per the general ledger. This amount (\$22,000) is included in the \$77,531 in Appendix V. We found that in 96/97, \$80,000 in living allowances was claimed. These amounts were not expended in 1997. We did not determine whether these amounts were actually expended subsequent to 1997 as this was beyond the scope of our review. Please note that the contract terms are not synchronized with the financial statement fiscal year (i.e. January 1 to December 31).

The HRDC expects the bank balance relating to a particular contract to be nearly exhausted (except for outstanding payables and cheques) prior to commencing the next contract. However, it is evident based on the testing performed that this did not occur. Interest has been earned on the bank balance over the years and is accounted for in the surplus amount indicated above. As per the 1997 HRDC contract interest earned on cash balances must also be returned to the HRDC.

There may also be surplus amounts relating to HRDC excess contributions within the Entrepreneurial Initiatives programs. The HRDC standard contracts for these programs indicate that accurate records must be kept for each program. The Healthcare and Local Labor Market programs were combined into the Entrepreneurial Initiatives general

ledger and bank account along with fee-for-service programs, therefore, tracking of expenses relating to each program is not possible.

Since a separate general ledger was not maintained, we could not determine the expenses of the Healthcare program. We performed an analytical review of the expenses of the Entrepreneurial Initiatives program to determine what portion of the expenses should have related to Healthcare. Total expenses for the Entrepreneurial Initiatives program for the period of May 1997 to May 1998 (the length of the Healthcare contract) was \$143,000. We noted that the Entrepreneurial Initiatives program had 37 clients. 11 of the 37 clients (approximately 30%) were from the Healthcare program. Since the same services were offered for both the Entrepreneurial Initiatives program and the Healthcare program, we calculated that \$43,000 ($\$143,000 \times 30\%$) of the expenses could directly relate to the Healthcare program. HRDC contributed \$114,000 to the Healthcare program. Since the expenses of the program were estimated to be \$43,000, HRDC overcontributed \$71,000 ($\$114,000 - \$43,000$). The portion of the overcontribution relating to 1997 is \$41,000 ($\$71,000 \times 7/12$). As this is an analytical calculation, we have not added this amount to HRDC's portion of the surplus.

20(1)(b)(c)

We reviewed the 1997 budget and noted that funding from the MEDTT was taken into account. We also reviewed the budget approved by the Region to ensure amounts matched the BAC's internal records. By comparing the 1997 budget to actual, we determined that estimated revenues were incorrect in two main areas. The estimated revenues received from the HRDC funded SEA-EI and SEA-RB program (payment for the CEO salary as agreed per the HRDC contract) were \$32,000 while the actual revenues received were \$71,000. The difference of \$39,000 (for the 1997 year) is refundable to the HRDC. Another error in estimation was that no amount was budgeted for grants received from Industry Canada (Canada Ontario Business Call Centre) of \$27,000 (see page 2). Although funding from the MEDTT was normally accompanied by funding from Industry Canada, MEDTT and Industry Canada had separate agreements with the BAC. Actual expenses appeared to exceed budgeted expenses due to salaries and benefits. However, total revenues received exceeded actual expenditures by _____ for 1997. It appears that the surplus build-up for 1997 is a result of inaccurate budgeting.

20(1)(b)(c)

Based on our review of each “Memorandum of Understanding” between MEDTT and the BAC, and between Industry Canada and the BAC, and conversations with both MEDTT and Industry Canada personnel, it is our understanding that the funding given to the BAC by both of these parties was a grant. Therefore, neither party is entitled to repayment of funds.

Jobs Ontario

The BAC has maintained a separate bank account and a separate general ledger for the Jobs Ontario program since its inception. The Jobs Ontario program is finished , however \$30,000 remains in its bank account with the BAC. Testing performed on revenues and expenses in 1997 indicated that amounts were accurately recorded in the general ledger and bank accounts for the various programs. A review of bank statements for 1997 indicated no activity in this account (i.e. transfers from other BAC held bank accounts). Therefore, the \$30,000 balance is excess funding provided by Jobs Ontario.

APPENDIX I

Surplus on a Fund-by-Fund Basis

	(Operating) BAC Fund	Entrep.Prog.	New Ventures	GTECH	Total
Surplus Beg. of 1993		-	-		<u><u> </u></u>
<u>1993</u>					
Net Income		121,043	-		
Admin.Fee		-	-		
<u>1994</u>	20(1)(b)(c)			20(1)(b)(c)	
Net Income		(57,115)	-		
Admin.Fee		-	-		
<u>1995</u>	20(1)(b)(c)			20(1)(b)(c)	
Net Income		(53,953)	-		
Admin.Fee		-	-		
<u>1996</u>					
Net Income		(19,109)	(24,854)		
Admin.Fee		-	-		
<u>1997</u>					
Net Income		16,253	42,422		
Admin.Fee		-	-		
Subtotal	<u><u> </u></u>	<u><u>7,119</u></u>	<u><u>17,568</u></u>	<u><u> </u></u>	<u><u> </u></u>
"Deferred Revenue"					<u><u> </u></u>
TOTAL SURPLUS					<u><u> </u></u>

Surplus by Organization

HRDC (See Appendix III)	239,650	20(1)(b)(c)
Region of Hamilton-Wentworth (See Appendix IV)		
Jobs Ontario	30,000	
Initiatives Program	17,568	
Opening Surplus (See Appendix IV)	<u> </u>	20(1)(b)(c)
TOTAL SURPLUS	<u><u> </u></u>	20(1)(b)(c)

APPENDIX II

Deferred Revenue Reconciliation

OPENING BALANCE (HRDC Cumulative Surplus Prior to 1997)	106,000
HRDC 1997 SURPLUS (see Appendix V)	77,531
PATHWAY	10,000
HRDC TOTAL CUMULATIVE SURPLUS AT DECEMBER 31, 1997	193,531
JOBS ONTARIO	30,000
TOTAL CUMULATIVE SURPLUS AT DECEMBER 31, 1997 (See Appendix I)	223,531
TRUE DEFERRED REVENUE (HRDC) (See Appendix VI)	69,581
DEFERRED REVENUE PER F/S, December 31, 1997	293,112

APPENDIX III

HRDC Surplus

1997 OPENING BALANCE (HRDC Cumulative Surplus from Prior Years)	106,000	
Entrepreneurial Program (See Appendix I)	7,119	
EP 1997 SURPLUS (see Appendix V)	77,531	
PATHWAY	10,000	20(1)(b)(c) 19(1)
 HRDC TOTAL CUMULATIVE SURPLUS AT DECEMBER 31, 1997	 <u><u> </u></u>	20(1)(b)(c)

Page exempted in its entirety

20(1)(b)(c)

19(1)

APPENDIX V

HRDC Revenues by Project in 1997

(Note: Total revenues for 1997 fiscal year – January 1 to December 31)

<u>ENTREPRENEURIAL PROGRAMS (“EP”)</u>					
<u>SEA-EI</u>			<u>SEA-R\B</u>		
<u>Deposit Date</u>	<u>Contract #</u>	<u>Amount</u>	<u>Deposit Date</u>	<u>Contract #</u>	<u>Amount</u>
Jan.3/97	X309586	24,351	Jan.14/97	x494412	83,720
Mar.4/97	X309586	22,882	Apr.3/97	x494412	172,605
Mar.27/97	X309586	31,926	Mar.4/97	x494412	43,885
Mar.27/97	X525199	77,530	May 9/97	x494412	48,885
May 9/97	X525199	39,600	Oct.24/97	x494412	31,047
June 9/97	X525199	25,407	Dec.16/97	x799869	47,207
July 30/97	X525199	32,930	Dec.16/97	x799869	50,062
Aug.1/97	X525199	41,594	Dec.24/97	x799869	47,030
Aug.22/97	X525199	32,930			
Sept.19/97	X525199	39,600			
Oct.24/97	X525199	32,930			
Dec.16/97	X525199	32,930			
Dec.24/97	X525199	39,600			
		474,210			524,441
Total EP Revenue					998,651
Total EP Expenses (per 1997 audited F/S)					(835,286)
Revenues in excess of expenditures					163,365
“Actual” Deferred Revenue					(69,581)
Income recognized (per 1997 audited F/S) (<i>See Appendix I – “Entrep Prog”</i>)					(16,253)
Difference*					77,531

APPENDIX VI (Cont.)

"True " Deferred Revenue at December 31, 1997

SEA - EI Advance Payment (Jan '98)	39,600
SEA - RB Advance Payment (Jan '98)	47,030
SEA - EI Unexpended Amount (97/98)- contract payments in excess of expenses for latest ongoing contract	(2,001)
SEA - RB Unexpended Amount (97/98)- contract payments in excess of expenses for latest ongoing contract	<u>(15,048)</u>
Total Deferred Revenue (See Appendix V)	<u><u>69,581</u></u>

APPENDIX VII

1997 HRDC Surplus in Entrepreneurial Programs (in 000's)

From Appendix V:

Total 1997 Revenue	998
True Deferred Revenue (1997)	(70)
Total	<u>928</u>
Total 1997 Expenses	835
HRDC SURPLUS FOR '97	<u>93</u> (16k recognized on F/S and 77k in deferrals)

LOCATION OF THE EXCESS:

	(As at December 31, 1997)						
	1997 HRDC SURPLUS			1997 TRUE DEFERRED			
	A	B	C=A-B	D	E	F=D+E	G=C-F
	1997	1997		January	1997	Deferred	Actual 97
	REVS	EXP	EXCESS	Adv.Pmt	Excess	Total	Excess
<u>REACHBACK PROGRAM</u>							
96/97	X494412	(Finished Contract)	427 (318)				109 *
97/98	X799869	(Current Contract)	97 (65)	47	(15)	32	-
<u>EI PROGRAM</u>							
96/97	X309856	(Finished Contract)	79 (95)				(16) **
97/98	X525199	(Current Contract)	395 (357)	40	(2)	38	-
			<u>998 (835)</u>				
			163				
True Deferred Revenue (included in 1997 Revs above)			(70)			70	
Excess			93				93

* This is the location of the 80k client living allowance and 18k excess claim forms (remainder is timing of expenses)

** This contains 4k of excess claim forms (remainder is timing of expenses)

Note>

The reason for the timing of expense differences is that the tail end of the 96/97 contracts that finish in 97 will have more expenses than revenues received (or vice versa). This depends on when the amounts were recognized for reporting purposes (fiscal year). However, all excess prior to the current contracts (97/98) are taken into account in the accumulated surplus.

Summary of 1997 HRDC Surplus:

Client Living Allowance	80
Other Excess Claims	22
Timing of Expense Differences	(9)
1997 HRDC Surplus	<u>93</u>