

FOUNDATIONS: AN UPDATE

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4 April 2005

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TABLE OF CONTENTS

	Page
INTRODUCTION	1
BACKGROUND INFORMATION	2
FINANCING.....	2
GOVERNANCE REGIME.....	3
ESTABLISHMENT.....	3
ACCOUNTING ISSUES.....	4
A. Recognition of Foundations and Transfers to Foundations	4
B. Accountability and Governance of Foundations	6
RECENT BUDGETARY ANNOUNCEMENTS	7
RECENT AUDITOR GENERAL REPORT ON THE ACCOUNTABILITY OF FOUNDATIONS.....	10
CONCLUSION.....	11
APPENDIX – GOVERNMENT EXPENDITURES TO FOUNDATIONS, AS OF 31 MARCH 2004	



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INTRODUCTION

The federal government implements its policies and delivers programs and services to the public through a variety of organizations such as departments, agencies and granting councils. Program delivery can also involve third parties that act as service providers or as agents for the federal government. Despite their variety, these mechanisms remain within the traditional model of program delivery: the federal government retains control of policy and operations, and department ministers are directly accountable to Parliament.

In recent years, however, the federal government has resorted more and more to the creation of new organizations with an accountability and governance structure that differ considerably from traditional forms of program delivery.⁽¹⁾ Under some of these new types of arrangements, the federal government delegates responsibility for program planning, design and delivery to third parties – entities outside government that are not directly accountable to ministers or Parliament.

Some argue that these arrangements offer the possibility of more efficient and client-oriented service delivery. At the same time, however, they pose a considerable challenge to long-established principles of parliamentary control and accountability. These new arrangements may put at risk the oversight and control of government expenditures and the proper use of federal spending authorities, unless special mechanisms are set up to ensure adequate transparency and accountability to Parliament and to the general public.

In recent years, the Office of the Auditor General of Canada has identified what it considers a certain number of weaknesses in the accountability framework of these new arrangements, many of which may jeopardize accountability and transparency with respect to Parliament. In the Auditor General's most recent Status Report (February 2005), she noted that

(1) Office of the Auditor General of Canada, November 1999 Report, Ch. 23, "Involving Others in Governing: Accountability at Risk," Ottawa, November 1999.

the federal government has made some improvements since April 2002, but she expressed continuing concern about the lack of adequate accountability. The recent creation and growth of organizations known as *foundations* and their corresponding financial commitments have already attracted considerable attention from parliamentarians, especially with respect to their accountability and governance relationship to the federal government and Parliament.

BACKGROUND INFORMATION⁽²⁾

Foundations are a governance arrangement whereby the government delegates to separate legal entities the discretionary authority to redistribute public money, use public assets, or deliver public services on the federal government's behalf.

The 2003-2004 Public Accounts of Canada reported that between 1997 and 2004, the federal government transferred approximately \$9.1 billion in funding to 15 foundations.⁽³⁾

FINANCING

One important feature that distinguishes foundations from other forms of delegated arrangements is the method by which they are funded. Foundations receive federal funding in the form of advance lump-sum payments or grants which are then redistributed to eligible recipients over a period of several years in accordance with formal funding agreements between the foundations and the federal government. A funding agreement is a legally binding contract that places obligations on both the federal government and the foundation. Funding agreements contain many common elements, including provisions for the publication of annual reports and the execution of independent financial audits and evaluations.

Because foundations receive significant financial assistance in the form of multi-year lump-sum transfers, concerns have been raised that they are not subject to the kind of scrutiny usually exercised by Parliament when funds are appropriated on an annual basis. These transfers are not conditional payments that ministers can be called upon to account for.

(2) Office of the Auditor General of Canada, April 2002 Report, Ch. 1, "Placing the Public's Money Beyond Parliament's Reach," Ottawa, April 2002.

(3) Public Works and Government Services Canada, *Public Accounts of Canada: 2003-2004*, Vol. I, Ch. 2, Ottawa, September 2004, p. 27.

GOVERNANCE REGIME

The federal government views its relationship with foundations as being “at arm’s length.” Once public money is transferred to a foundation, the government has limited leverage to influence the way the organization uses the funding, and must rely on the expertise and professionalism of the foundation’s directors and board members to perform their functions properly and achieve the foundation’s stated objectives. That relationship is created by a number of provisions in the funding agreement, such as the provision that restricts the federal government to appointing only a minority of members on the board of directors.

The governance structure of foundations is based upon the non-profit corporate structure established under the *Canada Corporations Act* (CCA), the federal statute that governs federally incorporated non-profit corporations.⁽⁴⁾ Under the existing foundation governance model, the board of directors and the members of the corporation are expected to have subject-matter expertise, and the federal government can appoint only a minority of both directors and officers. Although there are no shareholders in a non-profit corporation, the board of directors is expected to scrutinize the foundation’s activities with the same interest as shareholders would. Directors are also expected to operate the foundation in an open and transparent way. Public information is made available through annual reports, which include audited financial statements; in a few cases, an annual report is tabled in Parliament.

ESTABLISHMENT

Foundations have been established by the federal government in a variety of ways. The April 2002 Report of the Auditor General examined the 13 foundations existing at that time. It found that 8 had been established by individuals or organizations under the CCA, the federal non-profit framework law; 2 were incorporated under provincial law or under an

(4) On 15 November 2004, the federal government tabled Bill C-21 (Canada Not-For-Profit Corporations Act) in order to replace and update the CCA, with the objective of modernizing the governance framework for federal non-profit corporations. Many existing foundations will be subject to the provisions of the new regime. However, the Office of the Auditor General recently reviewed the provisions of the bill and indicated that it has some concerns about the proposed amendments to the external audit and evaluation regime. The Office of the Auditor General also believes that the bill still does not address the weak ministerial oversight of foundations. Bill C-21 was referred to Committee in November 2004 and (as of this writing) is currently under review.

existing federal statute; and only 3 foundations had been directly established by legislation.⁽⁵⁾ In the view of the Auditor General, foundations should preferably be established by legislative process, because that would allow Parliament the latitude to debate the purpose and need for the foundation, to design and develop the foundation's governance and accountability framework, and to maintain some control over it, through legislative amendments.⁽⁶⁾

Another element in a foundation's governance structure is the funding agreement. As the legally binding contract between the federal government and the foundation, the document contains provisions that can be quite prescriptive, defining the purpose and aim of the federal funding, the expected results to be achieved, the organization's transparency and accountability framework, codes of conduct, adherence to official language requirements, etc. Funding agreements are entered into between the foundations and the federal government through the responsible minister and are approved by the Treasury Board.⁽⁷⁾

ACCOUNTING ISSUES

A. Recognition of Foundations and Transfers to Foundations

Since 1997, the Auditor General of Canada has repeatedly expressed concerns about the federal government's accounting treatment of foundations.⁽⁸⁾ First of all, should foundations be included in the government's consolidated financial statements or should they be considered as separate entities? Second, how should the government recognize transfer payments to foundations: should they be recorded as expenditures in the fiscal year they are transferred to the foundation, or when the transfer amounts are paid to their ultimate intended recipients?

(5) Office of the Auditor General of Canada (2002). The three foundations established by direct legislation are the Canadian Millennium Scholarship Foundation, the Canadian Foundation for Innovation, and the Canada Foundation for Sustainable Development Technology. As of 31 March 2003, all three foundations had received a total of \$6.25 billion in government transfers. Of that total amount, \$5.58 billion was still held in the foundations' cash and investment accounts (see *Public Accounts of Canada: 2002-2003*).

(6) *Ibid.*

(7) Department of Finance, "Accountability of Foundations," Background, Ottawa, February 2005 (<http://www.fin.gc.ca/toce/2005/accfound-e.html>).

(8) Receiver General for Canada, *Public Accounts of Canada: 2000-2001*, Vol. I, Ottawa, September 2001.

Between the 1997-1998 and 2003-2004 fiscal years, the federal government's accounts identified almost \$9.1 billion in transfer payments to 15 foundations to achieve stated policy goals. It is a clearly stated government policy that spending initiatives should be introduced only when it is reasonably certain that the necessary resources are available. The Auditor General considers this to be an appropriate and prudent approach to public financial management. Yet, as of 31 March 2004, \$7.7 billion of the \$9.1 billion (or almost 85%) in transfer payments was still in the foundations' bank accounts and investments, accumulating interest. These funds have yet to be distributed to their ultimate intended recipients or used for the ultimate purposes announced by the government for this spending.

The government's current accounting practice is to recognize these transfers as expenditures in the year when the funds in question are paid to the foundations. The Auditor General has argued that the economic substance of the transaction would be better represented in the government's consolidated financial statements if the expenditures were recorded in the years when the foundations make the payments to the ultimate intended recipients or for the ultimate intended purposes.

One consequence of the current accounting practice is that, by recording these transfers as expenditures, the government can report smaller annual budgetary surpluses. The Auditor General has repeatedly stated that decisions to transfer large amounts of public monies ought to be based on sound economic and policy analysis, and not undertaken merely to achieve a desired accounting result. In the view of the Auditor General, the current accounting treatment of transfers to foundations undermines the integrity and credibility of the federal government's financial reporting.⁽⁹⁾

The recognition of foundations in the consolidated accounts and the proper accounting treatment of government transfer payments are issues not limited to the federal government; they also affect the financial management and reporting of provincial and territorial governments. In order to clarify the question, the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants has undertaken two projects to review and revise the relevant accounting principles.

(9) Office of the Auditor General of Canada (2002), Ch. 1, p. 7, paragraph 24.

In March 2004, the PSAB issued revised standards⁽¹⁰⁾ on the government reporting entity to assist in determining whether or not outside organizations should be included in the government reporting entity – focussing on whether the government has “control” over the entity. In this context, the concept of control is defined as the power of a government to govern the financial and operational policies of another organization with expected benefits or risk of loss to the government resulting from the other organization’s activities. Whether foundations are effectively distinct third parties or part of the government reporting entity will need to be determined on a case-by-case basis according to the revised set of criteria and by the preponderance of evidence. The new standards are expected to be implemented by the 2005-2006 fiscal year. The federal government will reassess its relationship with each foundation and discuss the implications of this reassessment with the Office of the Auditor General of Canada.

The PSAB is still in the process of reviewing and revising standards on the proper accounting treatment of multi-year government transfers.⁽¹¹⁾ The current debate centres around the timing in the recognition of multi-year funding: should multi-year transfers be recognized once the transfer is authorized, estimable, and the related eligibility criteria have been met? Or should the transfers be considered as prepaid assets by recognizing the expenditures/expenses at the time when the funded services are actually delivered to recipients?

The PSAB review on multi-year transfer payments is expected to be completed by November 2005, with final approval by March 2006.

B. Accountability and Governance of Foundations

The Auditor General’s long-standing concerns about foundations extend beyond the issues surrounding the accounting of transfer payments to foundations. In summary, those concerns relate to the following elements of accountability and governance:

- Foundations’ reporting to Parliament needs to be strengthened for parliamentary requirements. In the past, none of the foundations have submitted corporate plans for tabling in Parliament; and only a few foundations have tabled annual reports with a credible description of results and accomplishments.

(10) http://www.cica.ca/index.cfm/ci_id/11374/la_id/1.htm.

(11) http://www.cica.ca/index.cfm/ci_id/3948/la_id/1.htm.

- The detailed and prescriptive nature of funding agreements raises questions about foundations' independence vis-à-vis the government.
- Foundations have been established in an ad hoc fashion, and Parliament has not had an opportunity to fully consider the resulting changes in how it authorizes and oversees this public spending.
- Weak oversight of foundations limits the responsible ministers' answerability to Parliament. The accountability framework provides very little in terms of effective mechanisms that allow sponsoring ministers and their departments to collect strategic information about foundations and make adjustments should things go wrong, or should government policy or priorities change. In the past, ministers had almost no powers to intervene, short of taking legal action if a foundation's funding agreement was breached. Recent changes have been made to strengthen default provisions of the funding agreements so that more corrective actions can be taken if things go wrong. Moreover, funding provisions and legislative changes have been made to permit the recovery of unspent funds should the foundation be wound down.
- Parliament is not receiving independent and comprehensive audit reports on foundations. The required reports should be independent and broad-scoped audits that not only examine foundations' financial statements, but also verify compliance with authorities, propriety and value for money.

RECENT BUDGETARY ANNOUNCEMENTS

In response to the long-standing criticisms levelled at foundations and their accountability regime, the federal government announced in its 18 February 2003 budget⁽¹²⁾ (and reiterated in its 23 March 2004 budget) a number of clarifications of the principles guiding the government's use of a foundation to deliver public policy:

1. Foundations should focus on a specific area of opportunity, in which policy direction is provided generally through legislation and/or a funding agreement.
2. Foundations should harness the insight and decision-making ability of an independent board of directors with direct experience and knowledge about the issues at stake.
3. Decisions by foundations should be made using expert peer review.
4. Foundations should be provided with guaranteed funding that goes beyond the annual parliamentary appropriations to give the foundations the financial stability needed for the comprehensive medium- and long-term planning that is essential in their specific area of opportunity.

(12) Department of Finance, *The Budget Plan 2003*, Ottawa, 18 February 2003.

5. Foundations should have the opportunity and hence the ability to lever additional funds from other levels of government and the private sector. Upfront funding is an essential requirement for leveraging such additional funds. Contributors would be reluctant to make funding commitments if they were worried that the financial tap could be turned off in mid-stream.⁽¹³⁾

According to the federal government, these policy principles are consistent with the Treasury Board's policy on Alternative Service Delivery, which came into effect on 1 April 2002.

Taking into consideration the Auditor General's observations, comments and concerns about foundations, the federal government announced a number of changes to improve the transparency and accountability of foundations to Canadians and Parliament.

Parliamentary Approval: the federal government is taking the following steps to ensure that the establishment and funding of foundations are adequately reviewed by Parliament.

- The Government is committed to parliamentary approval of purpose and funding through direct legislation for those foundations that are significant either from a policy or financial perspective. In all cases, Parliament will need to approve funding for foundations. ... The Government's use of foundations will respect the requirements of the Treasury Board's Policy on Alternative Service Delivery.⁽¹⁴⁾

Public Reporting: the government will implement the following measures to improve the transparency and accountability of foundations to the public:

- Foundations are required to provide corporate plans annually to the Minister responsible for administering the funding agreement over [its] duration. ... Such corporate plans will include planned expenditures, objectives and performance expectations relating to the federal funding. Summaries of these plans will be made public by the responsible Minister and provided to Parliament.
- ... Departmental Reports on Plans and Priorities, which are tabled in Parliament, will now incorporate the significant expected results to be achieved by the relevant foundations and situate these within the department's overall plans and priorities. As well, the department responsible for administering the funding agreement will report on the significant results achieved by the foundation(s) in its Departmental

(13) Department of Finance, "Accountability of Foundations" (2005).

(14) Department of Finance, *Budget 2004*, Annex 8, "The Government's Response to the Auditor General's Observations on the 2003 Financial Statements" (<http://www.fin.gc.ca/budget04/bp/bpa8e.htm>).

Performance Report for the duration of the funding agreement and situate these within the department's overall results achieved.

- The annual report for each foundation, including relevant performance reporting, audited financial statements and evaluation results, will be presented to the Minister responsible for the funding agreements and made public. The annual reports of foundations created explicitly through legislation will be tabled in Parliament by the responsible Minister.
- All foundations' annual reports will contain performance information as well as audited financial statements prepared in accordance with generally accepted accounting principles. As foundations are independent, not-for-profit organizations that have their own governance structures and members, it is the members, as "shareholders" of the foundation, who appoint their external auditor and to whom the external auditor reports.⁽¹⁵⁾

The appointment of external auditors to foundations remains a sticking point between the federal government and the Auditor General. In the past, foundations only provided audits of financial statements and had few or no provisions for independent, broad-scope audits that cover propriety, compliance with authorities, and value for money in the use of federal funds. To provide assurance and intelligence to Parliament on how well federal funds are used, the Office of the Auditor General argues that it should be appointed as external auditor of foundations.

Compliance with Funding Agreements: the federal government has committed itself to additional measures in order to strengthen foundations' accountability to Canadians and Parliament:

- Foundations are required to conduct independent evaluations, to present these to the Minister responsible and to make them public. Departments are to incorporate any significant findings in their annual Departmental Performance Reports, which are tabled annually in Parliament.
- Funding agreements reached with foundations arising from the 2001 budget contain provisions for independent audits of compliance with funding agreements and for program evaluations. Also, there are now provisions for intervention in the event the responsible Minister feels there have been significant deviations from the terms of the funding agreement. The provisions provide for dispute resolution mechanisms.

(15) *Ibid.*

- Further, in all new funding agreements, provisions must be put in place so that the responsible Minister may, at his/her discretion, recover unspent funds in the event of [the foundation's] winding up.⁽¹⁶⁾

Since the announcement of these new provisions in the 2003 federal budget, the federal government has been renegotiating existing funding agreements with foundations with a view to incorporating as many of these provisions as possible. Any new funding agreements are expected to contain the revised provisions.

RECENT AUDITOR GENERAL REPORT ON THE ACCOUNTABILITY OF FOUNDATIONS

In February 2005, the Office of the Auditor General of Canada followed up on the federal government's recent initiatives by tabling in Parliament another report⁽¹⁷⁾ on the accountability regime of foundations. The report found that although improvements had been made in reporting to Parliament and in the framework for foundations' accountability to Parliament, there remained a number of important gaps in the external audit regime and in ministerial oversight. In particular, there was insufficient provision for performance audits of foundations and the reporting of such audits to Parliament.

The federal government has yet to make any commitments in this regard, because it is concerned that by imposing public-sector-type standards and operations on foundations, as well as appointing the Auditor General of Canada as the external auditor, it would undermine the foundations' independence, erode their operational flexibility and organizational effectiveness, and thus reduce their usefulness in achieving the government's policy objectives.

Another significant concern of the Auditor General pertains to the adjustment mechanism. A mechanism is needed to allow sponsoring ministers to intervene not only when a foundation is not meeting its purpose, but also when circumstances in a specific public policy area have changed considerably since the foundation's creation. The Auditor General feels that such a mechanism is needed in addition to current provisions that give the government the right to terminate an agreement in extreme circumstances.

(16) *Ibid.*

(17) Office of the Auditor General of Canada, *2005 Status Report*, Ch. 4, "Accountability of Foundations," Ottawa, February 2005.

The federal government has taken issue with the Auditor General's assessment. It believes that, in general, real progress has been achieved in terms of improving the accountability and transparency of foundations. It recently announced that it intends to continue to explore the areas of disagreement with the Auditor General in an attempt to find solutions that respect foundations' independence as well as the government's overall policy objectives.

CONCLUSION

In recent years, the federal government has created and funded an increasing number of foundations to deliver public policy. The flexibility of this type of organization makes it a useful and effective tool for implementing policy and delivering programs and services. However, this same flexibility puts at risk the governance and accountability relationship between foundations and Parliament.

Some progress has been achieved concerning the proper accounting treatment of foundations. Revised standards have been issued with regard to foundations' inclusion as part of the government reporting entity, although determinations will have to be made on a case-by-case basis. As for the issue concerning multi-year transfer payments, an eventual clarification of this accounting policy is expected by the end of the 2005-2006 fiscal year.

Proposals made in the 2003 and 2004 budgets indicate a convergence of positions between the federal government and the Office of the Auditor General with regard to the necessity of strengthening the governance and accountability framework of foundations. The question remains, however, as to the extent to which the government intends to implement these reforms. Although the government is currently renegotiating existing funding agreements with a view to incorporating the new provisions, the timing remains uncertain. Furthermore, there remains the issue of external audit: should the selection of external auditors be left to the discretion of foundations themselves, or should Parliament appoint the Auditor General as the foundations' external auditor?

The federal government is expected to exercise due diligence and demonstrate proper stewardship of the resources and assets at its disposal, at all times. It may thus be expected to take all the required steps to strengthen the governance and accountability framework of foundations in order to ensure that they are providing value for money, given the large amounts of public monies already invested in them.

APPENDIX

Government Expenditures to Foundations, as of 31 March 2004

Foundation ¹	Year announced	Funding received ²	Grants provided ³	Interest earned	Adminis- tration	Balance March 31, 2004 ⁴	Funding commitments signed ⁵
(\$ millions)							
Canada Foundation for Innovation	1997	3,651	1,230	740	39	3,122	1,529
Canada Millenium Scholarship Foundation	1998	2,500	1,155	690	47	1,988	9
Canada Health Infoway Inc.	2001	1,200	51	83	30	1,202	42
Endowment Funds ⁶	Between 2000 and 2002	389	10	48	11	416	104
Genome Canada	2000	375	188	52	19	220	198
Aboriginal Healing Foundation	1998	350	241	86	43	152	139
Foundation for Sustainable Development Technology	2001	350	6	10	7	347	37
Canadian Health Services Research Foundation	1997	152	37	14	7	122	21
Other foundations under \$125 million ⁷	Between 2000 and 2002	120	36	13	4	93	16
Total		9,087	2,954	1,736	207	7,662 ⁸	2,095

¹ The foundations reflected in this Table have each received over \$10 million in total funding from the Government since 1997, specifically for spending in a future year more than a year ahead.

² Transfers include \$100 million announced in the March 2004 Budget that were receivable by the foundations at March 31, 2004.

³ In addition to grants, this column includes eligible project expenses.

⁴ These balances are at the date of the latest annual reports, where March 31, 2004 financial statements are not yet available – modified to include the \$100 million announced in the March 2004 Budget.

⁵ Figures based on representations from foundations, where not disclosed in their financial statements.

⁶ For endowment funds only the earnings are disbursed: these include Green Municipal Investment Fund; Pierre Elliott Trudeau Foundation; Clayoquot Biosphere Trust Society; Pacific Salmon Endowment Fund Society; Canadian Institute for Research on Linguistic Minorities, University of Moncton; and Frontier College Learning Foundation.

⁷ These are Foundation for Climate and Atmospheric Sciences and Forum of Federations.

⁸ In addition to funding for foundations and endowments, \$550 million had been transferred to other organizations at arm's length from the Government, \$391 million of the transferred amount had yet to be used at March 31, 2004. These organizations are Canadian Institute for Health Information; Green Municipal Enabling Fund; Precarn; Canadian Network for Advancement of Research, Industry and Education; Canadian Institute for Advanced Research and Canadian Centre for Learning.

Source: *Public Accounts of Canada, 2004*, Vol. 1, p. 50,
http://epe.lac-bac.gc.ca/100/201/301/public_accounts_can/2004/v1pa04e.pdf.