Industry Canada Industrie Canada

Audit of Grants & Contributions
Advances, Loans, Receivables and Unamortized Discounts

Audit and Evaluation Branch

September, 2003

Canada

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1.0 EXECUTIVE SUMMARY

1.1 Introduction

Effective April 1, 2001, the department was required to implement full accrual accounting because of the financial information strategy (FIS). This resulted in significant changes in systems and procedures to ensure that revenues and expenses were properly captured in the period in which they became realizable or payable rather than when funds were received or cheques issued. Departments were required to report specific balance sheet items arising from Grants and Contributions (G&Cs) such as advances, accounts receivable, allowance for doubtful accounts, loans and unamortized discounts.

The Audit and Evaluation Branch (AEB) decided to audit the repayable contribution agreements for the major programs because of the difficulties and risks of implementing FIS and the substantial dollar amount of the G&Cs programs in the department. The programs selected were those which had significant repayable contribution agreements and included: Aboriginal Business Canada (ABC), Federal Economic Development Initiative for Northern Ontario (FedNor and Community Futures), and Information Highway Application Branch (IHAB). Also included in the audit is Program Policy Management Directorate (PPM) who administers sunsetted programs and the benefits phase projects for Technology Partnerships Canada (TPC). Since the Comptroller is also active in the processing of invoices and payments related to these agreements, we included these activities as part of the audit. The audit also covered advances from ABC, FedNor, IHAB, and the Ice Storm Relief Program.

1.2 Overall Assessment

We found that in the first year of reporting under FIS more work was required to accurately report the advances, receivables, loans and unamortized discount account balances. Hence, we are unable to provide assurance on the amounts reported for advances, receivables, loans and unamortized discount at March 31, 2002. However, to ensure more accurate reporting for the fiscal year ended March 31, 2003, the Comptroller has been taking significant action to resolve the difficulties of implementing FIS.

While the structure for monitoring and managing receivables is adequate for unconditionally repayable contributions, not all program areas have developed systems to deal effectively with conditionally repayable agreements. Specifically they are lacking systems to ensure consistent monitoring of timely reporting and repayment. This could result in the department not receiving monies due per the agreements.

We recommend that the department review the roles and responsibilities related to monitoring of the benefits stage of all conditionally or unconditionally repayable contribution agreements with the intended objective of improving the effectiveness and efficiency of these processes and of clarifying the accountabilities for their management. (Recommendation #1).

Other Findings

Our findings show that the managing and reporting of advances, receivables, loans, allowance for doubtful accounts for both receivable and loans required by FIS is not well understood by many who have the responsibility for its application. (Recommendations 3 to 7 and 10).

The financial reporting of advances and unamortized discount as of March 31, 2002 did not comply with FIS requirements (Recommendations 3 to 5, 11 and 13).

Our review of the planned procedures for advances and allowance for doubtful accounts for both receivables and loans for year end March 31, 2003 shows that a comprehensive review of the data is planned by the Comptroller in conjunction with the program areas which should generate reporting that complies with FIS and more accurately reflects the balances at the March 31, 2003 year end.

We did not find documented approval of authority to suspend interest in overdue accounts receivable. The Comptroller should also examine the feasibility of calculating all interest (simple and compound) in IFMS to eliminate manual calculations and possible errors (Recommendation #15).

We recommend that the Comptroller foster an improved understanding of the application of accounting principles and practices required under FIS for G&Cs, both within the Comptroller's Branch and across all implicated sectors (Recommendation #2).

Information Systems

Some of the reporting problems at fiscal year end March 31, 2002 stem from deficiencies in the ability of the contribution management system and the financial reporting system to track and report information required for FIS. Specifically, the contribution management system does not distinguish between amounts advanced for the current fiscal year and amounts advanced for the new fiscal year. The financial reporting system does not have a sub-ledger for tracking the balances of individual loans that make up the Industry Canada portfolio of loans. (Recommendation 8 & 9).

The current contribution management system (CMIS) is being replaced by a new contribution management system (GCMS) in the coming year.

We recommend that the Comptroller should address these issues on a priority basis in the new contribution management system (Recommendation 14).

2.0 MANAGEMENT RESPONSE

Below are the management responses received from the Associate Deputy Minister, the Comptroller's Branch, ABC, FedNor and Community Futures

Recommendation 1:

The department review the roles and responsibilities related to monitoring of the benefits stage of all conditionally or unconditionally repayable contribution agreements with the intended objective of improving the effectiveness and efficiency of these processes and of clarifying the accountabilities for their management.

Management Response Submitted by *the Associate Deputy Minister*

The Comptroller's Branch has been tasked to review the roles and responsibilities related to monitoring of the benefits stage of all conditionally or unconditionally repayable contribution agreements with the intended objective of improving the effectiveness and efficiency of these processes and of clarifying the accountabilities for their management.

Recommendation 2:

We recommend that the Comptroller foster an improved understanding of the application of accounting principles and practices required under FIS for G&Cs, both within the Comptroller's Branch and across all implicated sectors

Management Response Submitted by the Comptroller's Branch

The Comptroller's Branch is aware of the accounting complexities which result from the variety of transfer payments within the department and very supportive of the recommendation to improve understanding of these requirements throughout the Department. Emphasis has been placed on improving the understanding of the transfer payment policy within the Comptroller's Branch by strengthening the links between the payment and receivables groups. The Comptroller's Branch supports that in conjunction with the departmental review of the roles and responsibilities noted in Recommendation 1, roles and responsibilities related to the management of transfer payment programs be reviewed to ensure they reflect new accountabilities resulting from the implementation of FIS.

Recommendation 3:

We recommend that the Comptroller's office implement their plan to co-ordinate a review by the relevant programs for the fiscal year ended March 31, 2003 of outstanding advances against the FIS criteria to determine the appropriate year end entry.

Management Response Submitted by the Comptroller's Branch

As part of the preparation for the implementation of GCMS, all year end entries have been reviewed to determine the appropriate accounting treatment and to ensure they will be processed appropriately in the new system.

Recommendation 4:

On a regular basis, the Comptroller should conduct a review by the relevant programs of outstanding advances in the contribution management system to ensure that appropriate follow up action is taken (obtain reporting from recipient, properly process reporting in contribution management system, request repayment of unused advances).

Management Response Submitted by the Comptroller's Branch

Advances will be reviewed on a regular basis and programs will be informed of action required to ensure the contribution management system accurately reflects the status of outstanding advances.

Recommendation 5:

The Comptroller should ensure that the programs are correctly applying the Treasury Board Secretariat *Policy on Transfer Payments* with respect to advance payments.

Management Response Submitted by the Comptroller's Branch

The Comptroller's Branch will monitor the issuance of advances by the various programs, especially at year end. At the recent year end, supporting documents were reviewed on a sample basis to ensure the proper application of the Policy on Transfer Payments.

Recommendation 6:

ABC, FedNor and Community Futures should ensure that payments, such as capital contributions to community capital corporations which are full and final payments, should not be recorded as advances unless there are specific reporting requirements that will trigger the advances being cleared. Outstanding advances that represent full and final payments should be adjusted accordingly.

Management Response Submitted by the ABC

Staff has been advised that capitalization of current and future loan funds to Aboriginal Capital Corporations are to be recorded as full and final payments. Past advance payments to capital corporations will be reconciled and the appropriate explanation to clear any outstanding advances will be posted to the Contributions Management Information System and files. This will be completed by December 31, 2003.

Response submitted by FedNor and Community Futures

Fednor and Community Futures does record capitalizations as advances until such time as we reconcile the advance contribution. Full and final payments are not recorded as advances but there are very few of these in our capitalization program.

Recommendation 7:

The Comptroller should review amounts invoiced within 30 to 45 days of the fiscal year end and make a year end adjustment for any amounts not due until the new fiscal year.

Management Response Submitted by the Comptroller's Branch

The Comptroller's Branch will review all amounts invoiced at year end and make adjustments to reflect amounts due in the appropriate fiscal year.

Recommendation 8:

We recommend that the Comptroller implement the plan to have an adequate allowance for doubtful accounts that will cover any doubtful receivables by considering the large dollar accounts receivable balances as of March 31, 2003.

Management Response Submitted by the Comptroller's Branch

The Comptroller's Branch will consider large dollar receivable balances outstanding at the year end when calculating the allowance for doubtful accounts.

Recommendation 9:

The Comptroller should implement a sub-ledger for loans receivable within the financial reporting system.

Management Response Submitted by the Comptroller's Branch

The importance of a subledger for loans receivable is recognized by the Comptroller's Branch. The Comptroller's Branch is investigating options to establish this control mechanism and is hopeful that a solution will be in place for the next fiscal year.

Recommendation 10:

When the final disbursement is made on an unconditionally repayable contribution, the Comptroller should check the amount recorded as loans receivable in the financial management system against the actual amount disbursed and the repayment terms in the contribution agreement. At the same time, the repayment schedule in the contribution management system should be checked to ensure it matches the actual amount disbursed.

Management Response Submitted by the Comptroller's Branch

This requirement will be incorporated into a checklist being developed by the Comptroller's Branch to address issues identified in our review as well as in this audit. This checklist will enhance our ability to place reliance on our financial information at year end.

Recommendation 11:

We recommend that the Comptroller implement the plan to have all programs review the collectibility of loan account balances to establish the allowance for doubtful loans as of March 31, 2003. This review should consider both the status of amounts that are past due (included in accounts receivable) and any indications that the recipient will not be able to make future payments as they come due.

Management Response Submitted by the Comptroller's Branch

The Comptroller's Branch agrees that the programs are in the best position to assess the collectibility of loan balances; and plans to implement a review by programs at year end to support the establishment of the allowance for doubtful loans.

Recommendation 12:

The Comptroller should exclude loans from the unamortized discount adjustment at year end where the discount is less than 25% of the face value of the loan or have been fully provided under the allowance for doubtful loans.

Recommendation 13:

On a test basis, the Comptroller should check the data used in the unamortized discount calculation to ensure all unconditionally repayable loans (as recorded in the financial reporting system (IFMS) and the contribution management system) are included and that the repayment schedule reflects the actual amount to be repaid.

Management Response Submitted by the Comptroller's Branch

A review of the year end approach to accounting for unamortized discount will be undertaken to refine the current method used to calculate the unamortized discount. As final payments are made the determination of whether the discount factor will be applied will be made. This step will be incorporate into the checklist mentioned earlier.

Recommendation 14:

The Comptroller should address these issues on a priority basis in the new contribution management system.

Management Response Submitted by the Comptroller's Branch

The new contribution management system is scheduled for implementation in mid-February 2004. While these issues have been raised with those responsible for the design and development of the new system, the new system will not address all of these issues at the time of implementation. They will continue to be identified as enhancements to the new system as funding becomes available.

Recommendation 15:

In each case where interest is suspended, the Comptroller should ensure the circumstance and the approval by an appropriate level of authority is documented in writing. The Comptroller should also examine the feasibility of calculating all interest (simple and compound) in IFMS to eliminate manual calculations and possible errors.

Management Response Submitted by the Comptroller's Branch

All instances where interest is suspended must be documented in writing and signed off by the manager. Enhancements to the interest calculation programming within IFMS have been requested but will be considered only at the time of our next upgrade.

3.0 INTRODUCTION

Effective April 1, 2001, departments were required to follow generally accepted accounting principles as defined in the Canadian Institute of Chartered Accountants Public Sector Accounting Handbook as part of its financial information strategy. In making this change, the government moved from cash accounting to accrual accounting. Significant changes in systems and procedures were required to ensure that revenues and expenses were properly captured in the period in which they became realizable or payable rather than when funds were received or cheques issued.

Within Industry Canada, the dollar value of year end closing balances for grants and contributions (G&Cs) advances, loans, receivables and unamortized discounts is significant[1]. The Audit and Evaluation Branch (AEB) concluded that it would be appropriate to audit G&Cs as part of its 2002-2003 audit plan to provide assurance of the integrity of the amounts reported in the departmental financial statements for the accounts and contra accounts representing these assets for the year-ended 2001-2002 as well as the transactions occurring during the fiscal year 2002-2003.

Financial and program information related to the contribution programs is captured in the Contribution Management Information System (CMIS). The financial data is transferred to the Integrated Financial and Materiel System (IFMS) which serves as Industry Canada's FIS compliant accounting system. Since two systems are used to manage and report G&Cs, the balances of both systems should be synchronized and reconciled at a point in time to ensure data integrity. Section 6.6 reports the problems with synchronizing both systems. The department will be migrating CMIS to a new grants and contribution management system (GCMS) in fiscal year 2003-2004.

4.0 AUDIT OBJECTIVES

The overall objectives of the audit were to:

- evaluate monitoring and management of receivables;
- provide assurance of the integrity of the G&Cs advances, loans, receivable and unamortized discount account balances for the fiscal year 2001-2002 and transactions and opening balances for 2002-2003;
- assess compliance of these assets and contra accounts with the FIS requirements;
- report on the difficulties, potential problems and underlying root causes associated with the lack of synchronization of the two information systems (CMIS & IFMS) that interface and serve to administer and report the financial transactions of the G&Cs; and

[1] Definitions for these terms are provided in Appendix A.

- assess whether the IFMS interest calculating program/process for invoices is calculating the interest due on overdue accounts correctly.

5.0 AUDIT SCOPE AND APPROACH

The audit covered programs within the following branches that give rise to repayable contributions. The level of repayable contributions for each branch is detailed in Appendix B. Branches covered in the audit scope were:

- Aboriginal Business Canada (ABC);

- Federal Economic Development Initiative for Northern Ontario (FedNor and Community Futures);

- Program Policy and Management Directorate (PPM) of the Corporate Services Branch, Industry Sector, is responsible for administering sunsetted programs and the benefits phase projects for Technology Partnerships Canada's (TPC). Under the direction of TPC and an annual MOU, PPM administers recoveries for part of the TPC program; and

- Information Highway Application Branch (IHAB) (Learnware).

Advances from ABC, FedNor, IHAB and Ontario Region for the Ice Storm Relief Program were examined in conjunction with the examination of the repayable contributions.

The audit also considered activities in the Comptroller's Branch related to accounts receivable billing and receipts, interest calculations, expenditures on repayable contributions and year end financial reporting procedures.

The audit approach included the following activities:

- comparison of departmental policies and procedures with the *Financial Information Strategy (FIS) Accounting Manual* to determine compliance of accounting for advances, receivables and loans to the requirements of the FIS policy;

- testing of 2002 fiscal year end balances and current year transactions to determine if data was completely and accurately captured in the accounting and project management systems;

- review of the capability of the accounting and project management system to support project management, program management and external reporting;

- review of processes in the Comptroller's Branch together with program processes to ensure that together they provided a good system of control for the reporting of advances, receivables and loans for the department and the public accounts; and

- review of year-end processes to ensure that they adequately and accurately captured all material adjustments required to the year-end accounts.

6.0 DETAILED FINDINGS

6.1 Overall Findings

We are unable to provide assurance on the amounts reported for advances, receivables, loans and unamortized discount at March 31, 2002 but are encouraged by the level of review planned in developing these balances for March 31, 2003.

While the structure for monitoring and managing receivables is adequate for unconditionally repayable contributions, not all program areas have developed systems to deal effectively with conditionally repayable agreements. This could result in the department not receiving monies due per the agreements.

6.2 Monitoring and Management of Receivables

The process of monitoring and managing receivables includes monitoring of reporting under the agreements; invoicing amounts as they come due; collection and interest on these amounts if they are not paid promptly; recoveries on agreements that have gone into default; and accurate record keeping on the amounts disbursed, repaid and the outstanding balance. Currently, each program within the Department is responsible for its own monitoring of reporting.

The Comptroller's office is responsible for processing invoices and payments using the financial reporting system. They are also responsible for responding to requests for confirmation of loan balances. The discrepancies between the two systems discussed in Section 6.6 below and the lack of a loans subledger as discussed in Section 6.3.4 often lead to long delays in responding to these confirmation requests.

6.2.1. Conditionally Repayable Contributions

The current systems do not have strong controls for conditionally repayable contributions for all programs. Each program is responsible for submitting a request for invoicing to the Comptroller's office based on the terms of the contribution agreement. Each conditionally repayable contribution agreement should include clauses that clearly detail what reporting is needed, how repayments will be calculated, and when they are due. The department waits for the contribution recipient to report monies due before an invoice is processed. Because the department is relying on the recipient for invoicing and recovery of amounts due, there is a higher risk of these amounts being missed. Hence, monies due the department could be lost.

ABC, FedNor and IHAB have not yet developed systems to ensure that timely reporting and repayment is received on conditionally repayable files. ABC is reviewing their overall approach to monitoring of contribution agreements and has developed a risk assessment which would automatically assign a high-risk rating and the most extensive monitoring to repayable contribution files. In our testing of ABC and FedNor files, we found that several files had no evidence of active monitoring. In our testing of IHAB files, while the recipient had been reporting on many aspects of the agreements, they did not address the repayment criteria in their reporting and in fact had repayable amounts that should have been remitted in fiscal 2001/2002 and fiscal 2002/2003.

The system to monitor conditionally repayable files should ensure appropriate steps are taken on a timely basis to monitor reporting and repayment. Non-compliance with reporting and repayment clauses needs to have consequences that motivate compliance even as far as being a condition for default and recoveries. To ensure segregation of duties, someone other than the project officer should be monitoring compliance with reporting and repayment criteria and that appropriate steps are taken on a timely basis.

6.2.2. Unconditionally Repayable Contributions

The contribution management and financial reporting systems currently in place provide an adequate structure to ensure that unconditionally repayable contributions are monitored and managed. For these contributions, the Comptroller's office invoices based on the repayment schedule set out in the contribution agreement. A repayment schedule is entered in the contribution management system when the project is approved. This schedule is used by the Comptroller's office to generate invoices/notices to the recipient as the amounts come due. If the amounts are unpaid by the due date, collection officers follow up with the recipient to request payment and interest is added to the accounts receivable account. Copies of the interest invoices are sent to the responsible project officer to advise them that payments are overdue. If reminders from the collection officer are not effective in getting payment, the responsible program and project officer are contacted to determine the next course of action. If the issue cannot be resolved, the project file is transferred to the Loan Insurance and Recoveries Directorate (LIRD) for recovery action. This system provides segregation of duties and time lines for actions in the case of delinquent payment.

6.2.3 Receivables and Recoveries

PPM, in the Industry Sector, has their own collections officer who follows up on receivables for sunsetted programs and for TPC files in the benefits phase. PPM does not manage receivables for other programs. Collection services, on the other hand, are provided by LIRD in the Operations Sector. The responsibility for the file remains with the programs when it is sent to LIRD for collection. If delinquency in reporting, repayment or other issues lead to default under the agreement, the file is transferred from the program to LIRD for recoveries. Other than for PPM/TPC, repayable contributions are a minor component of the overall activity of the programs.

PPM/TPC has developed teams of administrative officers and project officers that work on a portfolio of files. PPM has also developed a "bring forward" system to ensure monitoring is timely and allow team management to track activity on files. Files are assigned a priority level for monitoring to ensure an appropriate level of monitoring is undertaken considering the risks and benefits associated with a file. PPM is using this system to monitor files assigned to them from sunsetted programs and to provide benefits stage monitoring on TPC files.

Recommendation 1:

The department review the roles and responsibilities related to monitoring of the benefits stage of all conditionally or unconditionally repayable contribution agreements with the intended objective of improving the effectiveness and efficiency of these processes and of clarifying the accountabilities for their management.

6.3 Integrity of Account Balances - Fiscal Year 2001-2002

Our findings, as described in the next sections, show that the managing and reporting of advances, receivables, loans, allowance for doubtful accounts (receivable and loans) required by FIS is not understood by many who have the responsibility for its application. As previously mentioned, FIS required significant changes in systems and procedures. Hence, the implementation of FIS was difficult and the learning curve is ongoing.

Recommendation 2:

We recommend that the Comptroller foster an improved understanding of the application of accounting principles and practices required under FIS for G&Cs, both within the Comptroller's Branch and across all implicated sectors.

6.3.1 Advances

No opening balance was recorded for Advances when the opening balance sheet for the Department was established effective April 1, 2001.

At year end March 31, 2002, the total outstanding advances in the contribution management system were booked as advances for financial reporting. However, under FIS, only advances made in one fiscal year for expenditures in the next fiscal year need to be recorded as advances. Since many of the outstanding advances were for expenditures in the current or previous fiscal years, the $80 million amount recorded for Advances at March 31, 2002 was significantly overstated.

Of the sample of 20 advances reviewed, 14 were for expenditures to March 31, 2002 and therefore did not meet the FIS definition for financial reporting of advances. Five were partially for expenditures prior to March 31, 2002 and partially for expenditures in the new fiscal year.

Only the portion of these five advances related to expenditures in the new fiscal year should have been included in advances for financial reporting under FIS. The one remaining advance was entirely for expenditures in the new fiscal year and was properly reported as an advance under FIS.

An additional concern was noted on one of the six advances that included amounts for the new fiscal year. This advance included amounts for more than one month of expenditures in the new fiscal year which contravenes the Treasury Board Secretariat *Policy on Transfer Payments* that restricts advances to no more than one month of expenditures in the new fiscal year.

Included in the sample of advances reviewed were 5 advances made under the Ice Storm Relief program in 1998. Our review showed that in 1999 the recipients had provided accounting for these amounts including repayment of unused amounts but the appropriate entries had not been made in the contribution management system to clear these advances. The required entries were made in the fiscal 2003 year as a result of an initiative by the Comptroller to co-ordinate a review by the responsible programs of outstanding advances.

Programs such as ABC, FedNor and Community Futures make capital contributions to community capital corporations. ABC has been advised by Legal Services that payments of this nature that are full and final payments need not be set up as advances. The list of outstanding advances shows many payments of this nature that have not been cleared. Therefore, advances do not comply with FIS.

Recommendation 3:

We recommend that the Comptroller's office implement their plan to co-ordinate a review by the relevant programs for the fiscal year ended March 31, 2003 of outstanding advances against the FIS criteria to determine the appropriate year end entry.

Recommendation 4:

On a regular basis, the Comptroller should conduct a review by the relevant programs of outstanding advances in the contribution management system to ensure that appropriate follow up action is taken (obtain reporting from recipient, properly process reporting in contribution management system, request repayment of unused advances).

Recommendation 5:

The Comptroller should ensure that the programs are correctly applying the Treasury Board Secretariat *Policy on Transfer Payments* with respect to advance payments.

Recommendation 6:

ABC, FedNor and Community Futures should ensure that payments, such as capital contributions to community capital corporations which are full and final payments, should not be recorded as advances unless there are specific reporting requirements that will trigger the advances being cleared. Outstanding advances that represent full and final payments should be adjusted accordingly.

6.3.2 Accounts Receivable

The IFMS financial reporting system maintains a subledger of accounts receivable by recipient. Concurrent with the timing of this audit, the Comptrollers Branch had undertaken a review to reconcile the information in this system to information on outstanding amounts in the contribution management system. Accounts receivable invoicing is typically processed one month before amounts are due to allow time for the notice to be received and the payment submitted. At year end, this creates a timing issue in that amounts due in the new year are invoiced in the old fiscal year. Our audit testing showed that $23 million of accounts receivable recorded at March 31, 2002 was not due until the new year. The effect of this was to overstate receivables by $23 million, understate loans (unconditionally repayable contributions) by $2 million and understate expenditures, i.e. overstate recoveries on program expenditures of $21 million.

Recommendation 7:

The Comptroller should review amounts invoiced within 30 to 45 days of the fiscal year end and make a year end adjustment for any amounts not due until the new fiscal year.

6.3.3 Allowance for Doubtful Accounts - Receivables

At year end March 31, 2002, the allowance for doubtful accounts was determined by applying a percentage to the outstanding amounts. Our review of large accounts receivable that were more than a year overdue indicated that an allowance of $190 million (compared with the year end allowance of $82 million) would be required assuming all these amounts were uncollectible. Hence, the allowance of $82 million was not sufficient to cover the doubtful accounts.

Recommendation 8:

We recommend that the Comptroller implement the plan to have an adequate allowance for doubtful accounts that will cover any doubtful receivables by considering the large dollar accounts receivable balances as of March 31, 2003.

6.3.4 Loans

The IFMS financial reporting system does not maintain a subledger of loans receivable by recipient. This makes it difficult to readily determine the dollar amount of any individual loan within the financial reporting system. Without a clear and up to date listing of what makes up the loans balance, it is difficult to reconcile with the CMIS system or to report to recipients on the amount outstanding. We noted journal entries totaling $12 million that reduced the Loan balance but should have reduced the balance of Accounts Receivable.

Our testing found that disbursements for some loans had not been coded to the Loan account in the IFMS system. The Comptroller's office is planning to review these to determine if they were input errors or errors in coding between the two systems. We also found other discrepancies in some loan balances between the financial reporting system and the contribution management system. The Comptroller is planning a reconciliation of the account balances in the two systems.

The loan repayment schedule in the contribution management system is used to generate the invoice notices as amounts come due. Our testing found one case where the repayment schedule had not been entered in the contribution management system and several cases where the repayment schedule had not been adjusted to reflect the fact that the actual disbursements were less than the authorized amounts under the contribution agreement. We found one case where this type of error resulted in invoices and payment demands being sent to a recipient who had already repaid their loan in full on a timely basis.

Recommendation 9:

The Comptroller should implement a sub-ledger for loans receivable within the financial reporting system.

Recommendation 10:

When the final disbursement is made on an unconditionally repayable contribution, the Comptroller should check the amount recorded as loans receivable in the financial management system against the actual amount disbursed and the repayment terms in the contribution agreement. At the same time, the repayment schedule in the contribution management system should be checked to ensure it matches the actual amount disbursed.

6.3.5 Allowance for Doubtful Loans

At year end March 31, 2002, the allowance for doubtful loan was determined by applying a percentage to the outstanding amounts. We believe the allowance understated the true exposure to doubtful loans as the allowance was less than the dollar value of loans in default at that time.

Recommendation 11:

We recommend that the Comptroller implement the plan to have all programs review the collectibility of loan account balances to establish the allowance for doubtful loans as of March 31, 2003. This review should consider both the status of amounts that are past due (included in accounts receivable) and any indications that the recipient will not be able to make future payments as they come due.

6.3.6 Unamortized Discount

No opening balance was recorded for Unamortized Discount when the opening balance sheet for the Department was established effective April 1, 2001. By not including an amount for unamortized discount in the opening balance sheet, the cumulative impact of all outstanding interest free loans is reflected in the current year, rather than just the cost of new loans issued in the current year. There is no impact on closing equity or the closing balance sheet.

Unconditionally repayable contributions are typically interest free as long as payments are made as they come due. For financial reporting purposes, the adjustment for unamortized discount reflects the present value of the future repayments and the cost of providing interest free loans. The adjustment is calculated by discounting the future repayments as reflected in the contribution management system using a "rate" that reflects the government's cost of borrowing.

Under FIS, an adjustment is only required if the amount of the discount is more than 25% of face value of the loan. The year end adjustment for March 2002 reflected a discount for all loans, not just those where the discount was 25% or more. In our sample, 13 of the 26 calculations tested resulted in a discount of less than 25%.

Loans that were in default, code 607 in CMIS, were included in the calculation. Any amounts that are provided for in the allowance for doubtful loans as discussed in 6.3.5 do not also need to be further adjusted for unamortized discount. In the calculation of unamortized discount for March 2002, 55 of 202 loans were coded as in default.

Our review of the calculation found some discrepancies in the data that was extracted from the contribution management system. In some cases, the total future repayments were more than the outstanding balance because the repayment schedule had not been adjusted to reflect the actual rather than the authorized assistance. In one case, the repayment schedule for one loan seems to have been applied to the next loan in the calculation as well. Other discrepancies were noted between the balance in the IFMS system and the balance in the CMIS system.

Some short comings were noted in the calculation itself. For instance, if the repayment schedule ran more than 10 years in the future, the payments past 10 years were not included in the calculation. The interest rate chosen was for a 10 year period but the majority of the loans will expire in approximately 6 years.

Recommendation 12:

The Comptroller should exclude loans from the unamortized discount adjustment at year end where the discount is less than 25% of the face value of the loan or have been fully provided under the allowance for doubtful loans.

Recommendation 13:

On a test basis, the Comptroller should check the data used in the unamortized discount calculation to ensure all unconditionally repayable loans (as recorded in the financial reporting system (IFMS) and the contribution management system) are included and that the repayment schedule reflects the actual amount to be repaid.

6.4 Opening balances for 2002-2003

Opening balances for 2002-2003 were carried forward in the financial reporting system from the year end balances for 2001-2002.

6.5 Compliance of Asset and Contra Accounts with FIS Requirements

The financial reporting of Conditionally Repayable Contributions, Accounts Receivables, Loans and related allowances comply with FIS requirements. Issues were identified with advances and unamortized discounts as described in the balance of this section.

6.5.1 Advances

As noted in Section 6.3.1, FIS only requires reporting of advances that are for expenditures in the next fiscal year. At year end March 31, 2002, the total outstanding advances in the contribution management system were booked as advances for financial reporting. Many of these advances were for expenditures in the current or previous fiscal year. Action already planned by the Comptroller for the fiscal year ending March 31, 2003 should adequately address this issue.

6.5.2 Unamortized Discount

Under FIS, an adjustment is only required if the amount of the discount is more than 25% of face value of the loan. The year end adjustment reflected a discount for all loans, not just those where the discount was 25% or more. Recommendation 12 already addressed this issue.

6.6 Synchronization of CMIS and IFMS

The Comptroller and the Sectors use a combination of the contribution management system (CMIS) and the financial reporting system (IFMS) to administer and report the financial transactions related to G&C's with respect to advances, receivables and loans. The two systems are linked so that transactions posted in one system should also update information in the other system. However, a variety of problems lead to synchronization issues between the two systems.

Many of the problems relate to fundamental design issues in the two systems. These include:

- CMIS compiles information based on project codes while IFMS compiles information based on vendor (recipient) codes. A recipient may be involved in a number of projects and the status of any particular project within IFMS can only be determined by manual calculation.

- Reporting from CMIS is a real time "snap shot". It cannot report on information as of a previous date. This makes it difficult to compare information as of a specific date.

- CMIS has an ad hoc report generation capability but it can be complicated to set up the correct filters to retrieve the specific information required.

- IFMS does not have a loans subledger and thus cannot readily provide the current balance outstanding on a particular loan. No records were retained of how the opening balances for the individual loans within the loans account of IFMS were determined. This makes it difficult to determine the source of discrepancies between the two systems. Implementation of Recommendation 9 will address this issue.

- CMIS was not designed to support the more detailed reporting on advances required by FIS. The determination of advances made for expenditures in the new fiscal year must be done manually.

- Some contribution agreements include both repayable and non-repayable components. Neither CMIS or IFMS are designed to deal with combined agreements of this type. Manual intervention is required for such things as changing the coding to set up part of the contribution as a loan receivable.

CMIS is scheduled for replacement in fiscal 2003/2004. The Comptroller is aware of the system limitations identified above and is attempting to address them within the new contribution management system.

In the past year, the Comptroller has undertaken a reconciliation review of the accounts receivable balances within the two systems. A reconciliation of the loans balance is planned for the near future. PPM has also undertaken a reconciliation review of their own conditionally repayable agreements.

Recommendation 14:

The Comptroller should address these issues on a priority basis in the new contribution management system.

6.7 Calculation of Interest by IFMS

The interest calculating program within IFMS can calculate simple monthly interest but if the situation requires a calculation including compounding of interest, the calculation must be done manually by the Accounts Receivable Clerk.

In some cases, such as when a delay or error in processing of payments occurs, interest is suspended until the problem in resolved. We did not find documented approval of authority to suspend interest.

Recommendation 15:

In each case where interest is suspended, the Comptroller should ensure the circumstance and the approval by an appropriate level of authority is documented in writing. The Comptroller should also examine the feasibility of calculating all interest (simple and compound) in IFMS to eliminate manual calculations and possible errors.

APPENDIX A: DEFINITION OF TERMS USED

Advances: Contribution payments made in advance of expenditure by the recipient. Recipient must provide accounting for use of the funds in accordance with the contribution agreement. For financial reporting under FIS, only advances made in one fiscal year for expenditures to be made in the next fiscal year should be reported as advances.

Accounts Receivable: Amounts due from recipients where the due date has past.

Contributions: These are conditional transfer payments to an individual or organization for a specified purpose pursuant to a contribution agreement that is subject to being accounted for and audited. Should the individual or organization use the transfer payment in the manner specified by the contribution agreement, the government does not expect to receive any goods or services directly in return, to be repaid or to receive a financial return.[2]

Loans: Expenditures on Unconditionally Repayable Contributions that have not yet come due according to the repayment schedule.

Repayable Contributions:[2] These are contributions, where the recipient is expected to repay all or part of the amount or the government expects to receive a financial return. The terms may specify a date or dates for repayment, or may describe the particular time(s) or circumstance(s) that will determine repayment. (PS 3050.07) Repayable contributions are further classified as unconditionally repayable and conditionally repayable. They require separate treatment for recording and reporting under accrual accounting.

a) ***Conditionally repayable contributions*** (CRC) are contributions, all or part of which is repayable, if conditions spelled out in the contribution agreement come into being. Repayments are typically based on a royalty per dollar or per unit sold. The contribution agreements sets reporting dates for information to calculate the repayments. Due to the uncertainty over timing and amount of future recoveries, conditionally repayable contributions are not set up as an asset of the department until the amount of the repayment is established and has come due. At that time, the current amount due is set up as accounts receivable.

b) ***Unconditionally repayable contributions*** (URC) are contributions that require repayment without qualification. The contribution agreements contain specific repayment terms that set out the time and amount of payment(s) due. These contributions are interest free as long as the payments are made according to the schedule. Unconditionally repayable contributions are set up as a loan by the department when the expenditure is made. The current amount due is transferred to accounts receivable when the invoice/reminder notice is sent to the recipient.

[2] Treasury Board Accounting Standard 3.2 – Transfer Payments (Grants and Contributions)

Unamortized Discount: In cases where the unconditionally repayable contribution has significant concessionary terms, such as a low or no interest rate, it shall be accounted for in accordance with PS 3050.20[2] by adjustment for unamortized discount. The discount adjusts for the present value of the future repayments and the cost of providing interest free loans. The adjustment is calculated by discounting the future repayments as reflected in the contribution management system using a "rate" that reflects the governments cost of borrowing (Consolidated Revenue Fund Lending Rate). Under FIS, an adjustment is only required if the amount of the discount is more than 25% of face value of the loan.

2 Treasury Board Accounting Standard 3.2 – Transfer Payments (Grants and Contributions)

APPENDIX B: PROGRAMS INCLUDED IN THIS AUDIT

Program Name	Program Objective	Planned G&C Spending 2002/2003	Advances	Conditionally Repayable Contributions	Unconditionally Repayable Contributions
				Dollar values are original disbursement under agreements	
Information Highway IHAB - Learnware	Build partnerships necessary to establish a competitive industry in multimedia learnware and Internet applications in Canada	none	yes, in IHAB as a whole	3 Agreements totaling $19M	none
Aboriginal Business Canada (ABC)	Support businesses and capital corporations owned by Aboriginals in Canada	$34 million	few	7 agreements $1.8M	17 agreements, $11.7M
FedNor/Community Futures	Promote economic development in Northern Ontario	$50million	yes	22 agreements $12.6 M in total	44 agreements
Program Policy and Management (PPM)	Project management in the reporting/ repayment phase for sunsetting programs	none	none	235 agreements $1,738 million	23 agreements $108 million
Technology Partnerships Canada	Invest in technology research and development. Benefits phase, when the technology is applied by the company to its products and processes, and many of the economic benefits of the project are realized, including repayment of the TPC contribution.	N / A	none	80 agreements $826 million (1)	1 agreement $500,000
Ice Storm Relief	Restore to pre-ice storm level the economic activity in the business and tourism sector of Eastern Ontario adversely affected by the January 1998 ice storm.	none	Yes	none	none

(1)The amounts shown are those managed by PPM for TPC and have been included in this audit. As reported by TPC, of a total of $1.8 billion, a total of $1.2 billion of assistance has been disbursed as of March 31, 2002.

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