Aboriginal Affairs and Northern Development Canada | Affaires autochtones et Développement du Nord Canada

Aboriginal Affairs and Northern Development Canada

Internal Audit Report

Audit of the Management Control Framework for Grants and Contributions 2012-2013 (Funding Approaches)

Prepared by:

Audit and Assurance Services Branch

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ACRONYMS

AANDC	Aboriginal Affairs and Northern Development Canada
AES	Audit and Evaluation Sector
AFA	Alternative Funding Arrangement
BC	British Columbia
CFO	Chief Financial Officer
G&C	Grants and Contributions
GA	General Assessment
MCF	Management Control Framework
PTP	Policy on Transfer Payments
TB	Treasury Board
T&C	Terms and conditions
TPCOE	Transfer Payments Centre of Expertise

EXECUTIVE SUMMARY

Background

Aboriginal Affairs and Northern Development Canada (AANDC or the Department) makes funding available to First Nations and other recipients through Grants and Contributions (G&C) for the delivery of programs and services, including education, land management, social development and community infrastructure. Total departmental spending on G&C was $6.4 billion in the 2011-12 fiscal year and $6.7 billion in 2012-13.

AANDC's transfer payment programs are administered in accordance with the Treasury Board (TB) *Policy on Transfer Payments* (PTP) and *Directive on Transfer Payments*, which took effect on October 1, 2008. In order to meet the expectations of the PTP, the Chief Financial Officer (CFO) Sector established the Transfer Payments Centre of Expertise (TPCOE), which has put in place the Management Control Framework (MCF) for G&C in order for the Department to effectively manage and monitor G&C programs, and ensure compliance to the Policy and Directive. AANDC's CFO is accountable for the overall management of transfer payment funds and, as such, is the custodian of this MCF. Program Management and Transfer Payment Management Control criteria are defined within the MCF, which all programs, Regions, and HQ Regional Operations must follow in the delivery of G&C programs.

G&C are managed through funding agreements with recipients which include precise terms and conditions (T&C) with which all parties must comply. Within each funding agreement, which dictates the flexibility the recipient has to manage the funds it receives, programs (within sectors and/or regions) are required to select the most appropriate funding approach. Key factors which should be used in the funding approach selection include the program's management regime, the program's risk profile and the recipient's risk rating according to results of the completed General Assessment. Based on the PTP, there are five funding approaches available to AANDC for transfer payments to recipients, as follows:

- Grant;
- Set Contribution;
- Fixed Contribution;
- Flexible Contribution; and,
- Block Contribution.

Audit Objective and Scope

The objective of the audit was to provide reasonable assurance to management that:

1. Programs are using the appropriate funding approaches to flow funding to recipients; and,

2. Adequate and effective internal controls are in place within governance/roles and responsibilities, eligibility assessment/agreement development, as well as agreement monitoring and reporting relative to these funding approaches.

The audit scope included all recipient funding agreements in place during the 2011-12 and 2012-13 fiscal years for all G&C programs, and four funding approaches used to distribute funds to G&C recipients. This included fieldwork at Headquarters and site visits to three regional offices: Atlantic, Ontario, and British Columbia.

The following four key elements of the MCF for G&C were examined, relative to funding approaches:

1. Governance;
2. Program Development/Selection of Funding Approaches;
3. Eligibility and Agreement Development; and,
4. Agreement Monitoring and Reporting.

The audit did not examine the eligibility of recipients to receive program-specific funding, nor did it examine compliance against the program/agreement terms and conditions. The audit did not include Grants in the scope of the audit.

Statement of Conformance

The Audit of the Management Control Framework for Grants and Contributions 2012-2013 (Funding Approaches) conforms with the Internal Auditing Standards for the Government of Canada, as supported by the results of the quality assurance and improvement program.

Observed Strengths

During the audit fieldwork, the audit team observed the following strengths:

- The funding approaches used by the regions to flow funds to recipients were compliant with those allowed as per the program terms and conditions; and,
- General Assessments were completed for all recipients sampled.

Conclusion

Generally, the audit found that Regions are using eligible funding approaches to flow funding to recipients as allowed per program terms and conditions. However, we did note that the level of recipient risk is not always adequately considered in the establishment and selection of funding approaches and compliance activities within the Department. This does not completely align with the TB *Policy on Transfer Payments* which requires that program and recipient risk be considered as part of determining the funding approach, monitoring activities and reporting requirements. Further, the opportunity to embed additional flexibility into program management through the introduction of the flexible funding approach, and consideration of block funding for low risk recipients can be better leveraged by the Department.

Recommendations

The audit team identified areas where management control practices and processes could be improved, resulting in four recommendations as follows:

1. The Chief Financial Officer (CFO) should establish a process to better support the work of senior program managers in their development of program management regimes/program MCFs, which should more formally link the recipient and program/project risk to the funding approach selection, fully integrating recipient risk as per the General Assessment, program risk, and the nature and value of funding. All applicable funding approaches should be considered and the applicability of the flexible funding approach should be assessed for both core and non-core programs. The CFO, with the support of senior program/regional managers, should ensure monitoring and transparent reporting to senior management on the consistent application of these program management regimes/MCFs by regions.

2. The Chief Financial Officer (CFO) should develop a departmental program compliance framework for programs and regions to implement. To support the implementation, the CFO should establish a process to work with each program area, directly linking compliance activities (i.e. nature and frequency) to the funding approach (including block funding) and recipient risk. This framework should include periodic monitoring by the CFO to ensure its continued relevance and effectiveness.

3. The Chief Financial Officer (CFO), in collaboration with the Senior Assistant Deputy Minister of Regional Operations and the Assistant Deputy Minister of the Northern Affairs Organization, with the support of senior program managers, should develop and formally communicate to regions the Departmental position on moving eligible recipients to block funding. This should include tools and communication approaches to work with recipients to plan and prepare for block funding, where eligible. In addition, continued monitoring of regional take-up of this funding approach should be conducted by the CFO, with the support of senior program managers.

4. The Chief Financial Officer (CFO) should leverage the existing G&C governance structure to establish an oversight mechanism and monitoring program to support programs/regions in implementing the Treasury Board *Policy on Transfer Payments* relative to funding approaches. The oversight mechanism should ensure that program management regimes exist or are in development for each budget activity (program) associated with G&C funding.

Management Response

Management is in agreement with the findings, has accepted the recommendations included in the report, and has developed a management action plan to address them. The management action plan has been integrated in this report.

1. BACKGROUND

AANDC's Grants and Contributions

AANDC makes funding available to First Nations and other recipients through Grants and Contributions (G&C) for the delivery of programs and services, including education, land management, social development and community infrastructure. Total departmental spending on G&C was $6.4 billion in the 2011-12 fiscal year and $6.7 billion in 2012-13.

AANDC's transfer payment programs are administered in accordance with the Treasury Board (TB) *Policy on Transfer Payments* (PTP) and *Directive on Transfer Payments*, which took effect on October 1, 2008. The PTP outlines the expectations that risk-based approaches are adapted to the design of transfer payment programs, the preparation of terms and conditions, and funding agreements, and recipient monitoring and auditing.

At AANDC, the initial implementation of the TB *Policy and Directive on Transfer Payments* took place in March 2011. The objective of the Policy and Directive is to manage transfer payment programs with integrity, transparency and accountability, taking into account the risks, and to ensure that programs are effectively focused on citizens and beneficiaries, and are designed to achieve various Federal Government priorities and expected results.

In order to meet the expectations of the PTP, the CFO sector established the Transfer Payments Centre of Expertise (TPCOE), which has put in place the Management Control Framework (MCF) for G&C in order for the Department to effectively manage and monitor G&C programs and ensure compliance to the Policy and Directive. AANDC's CFO is accountable for the overall management of transfer payment funds and, as such, is the custodian of this MCF. The MCF establishes roles and responsibilities for the delivery of G&C – specifically to program management (the design and implementation of a program) and transfer payment operations (operations of a program with recipients). The MCF represents the Departmental expectations of how G&C are to be managed across regions and at Headquarters.

G&C are managed through funding agreements with recipients, which include precise terms and conditions, with which all parties must comply. Within each funding agreement, which dictates the flexibility the recipient has to manage the funds it receives, programs (within sectors and/or regions) are required to select the most appropriate funding approach. Key factors which should be used in the funding approach selection include the program's management regime, the program's risk profile and the recipient's risk rating according to results of the completed General Assessment (GA). To support the management of funding agreements and the selection of an appropriate funding approach, TPCOE developed and implemented the GA in the fall of 2010. The GA is a tool that provides an annual snapshot of the funding recipient's past performance, and identifies strengths and emerging risks that may impact the manner in which AANDC manages transfer payments to the recipient.

Funding Approaches for Grants and Contributions

The PTP requires that all federal departments apply a recipient-specific, risk-based approach when managing transfer payments. Based on the PTP, there are five funding approaches available to AANDC for transfer payments to recipients, as follows:

- *Grant* - a transfer payment that is subject to pre-established eligibility and other entitlement criteria. Recipients are not required to account for the Grant, but they may be required to report on results. The Grant funding approach can be used for any duration of time necessary to achieve program results. Grants are not normally subject to departmental audits but require specific Cabinet policy and Treasury Board program spending authorities.

- *Set Contribution* - a transfer payment that is subject to performance conditions outlined in a funding agreement. Set contributions must be accounted for and are subject to audits. This is the basic type of contribution commonly used in the past in which unspent funding is returned to the department annually.

- *Fixed Contribution* - an option where annual funding amounts are established on a formula basis or where the total expenditure is based on a fixed-cost approach. Fixed funding is distributed on a program basis. It is possible under this approach to allow recipients to keep any unspent funding provided that program requirements set out in the funding agreement have been met and the recipient agrees to use the unspent funding for purposes consistent with the program objectives or any other purpose agreed to by the Department. This approach replaced and has evolved from AANDC's previous Flexible Transfer Payment.

- *Flexible Contribution* - an option which allows funds to be moved within cost categories of a single program during the life of the project/agreement. However, unspent funds must be returned to the department at the end of the project, program or agreement. The flexible contribution approach can be used when:
    - The recipient has met certain assessment criteria (including GA results); and,
    - A program requires a two or more year relationship with a recipient to achieve objectives and can be funded under a multi-year funding agreement.

- *Block Contribution* – an option for providing transfer payments to a recipient where the various program objectives and the recipient's priorities can be better achieved by providing the recipient the flexibility to adjust the relative priority of programs in the block and to redirect funding among the block programs to address changing circumstances and the recipient's evolving priorities. Recipients accept responsibility to deliver all of the programs in the block which they are mandated to deliver and to demonstrate that progress toward program objectives is being achieved.

  The block funding approach can be used when:

    - The program is specifically targeted to Aboriginal people or has a component specifically targeted to Aboriginal people;
    - The recipient is to receive funding for a number of programs that are expected to require a five year relationship with the recipient to achieve program objectives;

- A single multi-year funding agreement commensurate with the achievement of multi-program objectives is appropriate to cover funding for all of the programs in the block;
- The stability of the relationship with the recipient is reflected and strengthened by allowing the recipient to retain unexpended funding remaining at the expiry of the funding agreement, provided that the obligations and objectives set out in the funding agreement are met and the recipient agrees to use the unexpended funding for the purpose consistent with the multi-program objectives or any other purpose reflecting the priorities of the recipient and agreed to by the Department;
- The recipient has demonstrated capacity to manage transfer payments and has met certain readiness assessment criteria (including GA results); and,
- The funding for the programs in the block can be determined on an annual basis and annual reporting of results achieved is sufficient.

AANDC's previous alternative funding arrangement (AFA) authority informed the development of the Block Contribution Approach.

Although there are five funding approaches available, AANDC uses four funding approaches (set, fixed, flexible and block contribution) for transfer payments to First Nation recipients.

The following table summarizes the total G&C funding provided to all recipients for the 2011-12 and 2012-13 fiscal years broken down by funding approach:

Funding Approach	2011-12		2012-13	
	Amount	%	Amount	%
Grant	$ 1,042,575,395	16	$ 1,273,998,557	19
Set Contribution	$ 2,448,920,299	38	$ 2,264,553,337	34
Fixed Contribution/ Flexible Transfer Payment	$ 1,783,862,492	28	$ 1,903,707,116	28
Flexible Contribution	$ 74,120,258	1	$ 152,559,447	2
Block Contribution/ AFA	$ 1,133,700,825	17	$ 1,132,672,190	17
TOTAL	**$ 6,483,179,269**	**100**	**$ 6,727,490,647**	**100**

From a risk perspective, set funding is the most restrictive funding approach, while block funding is the most flexible. When a recipient is eligible for block funding, all programs eligible for block funding are included in the block funding agreement.

In conjunction with the MCF and the GA tool, the CFO Sector has issued *Directive 101 – Funding Approaches* to support programs in the appropriate selection of funding approaches. Program T&C that are approved by the Treasury Board outline the funding approaches that are eligible for use by the particular program.

2. AUDIT OBJECTIVE AND SCOPE

2.1 Audit Objective

The objective of the audit was to provide reasonable assurance to management that:

1. Programs are using the appropriate funding approaches to flow funding to recipients; and,
2. Adequate and effective internal controls are in place within governance/roles and responsibilities, eligibility assessment/agreement development, as well as agreement monitoring and reporting relative to these funding approaches.

2.2 Audit Scope

The audit scope included all recipient funding agreements in place during the 2011-12 and 2012-13 fiscal years for all G&C programs and four funding approaches used to distribute funds to G&C recipients.

Due to the inherent risks associated with the different funding approaches, the following four key elements of the MCF for G&C were identified in connection with this audit:

1. *Governance* - The scope of the audit included an assessment of the governance framework and roles and responsibilities to ensure consistent application and management of funding approaches across all programs and regions.
2. *Program Development/Selection of Funding Approaches* - The scope of the audit included an assessment of the appropriateness of the funding approach(es) selected by programs, considering the nature of the program objectives and the risks associated with the specific program. Further, the audit included an assessment of the tools provided to regional offices to aid in the selection of the appropriate funding approach.
3. *Eligibility and Agreement Development* - The scope of the audit included an assessment of the appropriateness of the eligibility criteria (to assess the recipient's ability and capacity to effectively manage themselves towards program objectives considering the risk associated with the program/funding) relative to each funding approach in place and whether there was a consistent application of established eligibility criteria across regions.
4. *Agreement Monitoring and Reporting* - The scope of the audit included an examination of the controls surrounding the monitoring and reporting of recipient activities to ensure alignment with the risk level of the program, compliance with agreement terms and conditions, demonstration of achievement of program objectives, and effectiveness of risk-based compliance and recipient auditing.

Through the development of a sampling approach, appropriate coverage was determined in terms of regional, program, and recipient selections. Audit fieldwork was conducted at Headquarters, and in a sample of three Regions: Atlantic, Ontario, and British Columbia. Within each region, 25 recipients were selected for testing across the four funding approaches in scope and the following five programs: Governance, Community Economic Development, Social

Development, Community Infrastructure and Education. Program related testing was also performed on a sample of funding agreements administered at Headquarters.

This audit focused on the four funding approaches available for use across the Department to flow funds to First Nation recipients (Set, Fixed, Flexible, Block). The audit did not include Grants in the scope of the audit as Grant decisions and authorities are determined by Cabinet and Treasury Board and are not monitored and reported on at the same level as the other funding approaches. The audit did not examine the eligibility of recipients to receive program-specific funding, nor did it examine compliance against the program/agreement terms and conditions.

3. APPROACH AND METHODOLOGY

The Audit of the Management Control Framework for Grants and Contributions 2012-13 (Funding Approaches) was planned and conducted in accordance with the requirements of the Treasury Board *Policy on Internal Audit* and followed the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*.

The audit team examined sufficient, relevant evidence and obtained sufficient information to provide a reasonable level of assurance in support of the audit conclusion.

The principal audit techniques used included:

- Interviews with key CFO Sector officials with responsibility related to the MCF for G&C;
- Interviews with key officials of the sampled programs at HQ and at a selection of regional offices;
- A review of relevant documentation related to G&C processes;
- Walk-throughs of key G&C processes at HQ and at a selection of regional offices; and,
- Testing of a sample of funding agreements at HQ and a selection of regions based on the sampling methodology outlined below.

In order to develop a sampling methodology that addressed the audit criteria, as identified in Appendix A, a sample of programs, regions and recipients were selected for testing. The following outlines the approach used to select samples from each of the three categories.

A) Selection of Programs to Audit

The first element of the sampling methodology considers the programs to be selected for testing. Factors in the selection of the programs to be sampled included the following:

- Size (dollar value) of projects funded across all regions; and,
- Variety of funding approaches leveraged by the program.

Based on the above analysis and with the objective being to assess funding approaches horizontally across regions and programs with varying levels of risk and coverage of projects, the following programs and sub-programs were selected as part of the conduct of on-site field testing at HQ and in the regions:

1. *The Government* - Governance and Institutions of Government: Payments to support Indians, Inuit and Innu for the purpose of supplying public services in Indian government support;
2. *The People* - Education: Payments to support Indians, Inuit and Innu for the purpose of supplying public services in education - Contributions to provide elementary and secondary education programs and services to Indians living on reserve and Inuit;
3. *The People* - Social Development: Payments to support Indians, Inuit and Innu for the purpose of supplying public services in social development - Contributions to provide income support to indigent on-reserve residents;
4. *The Land and Economy* - Community Economic Development: Payments to support Indians, Inuit and Innu for the purpose of supplying public services in economic development; and,
5. *The Land and Economy* - Community Infrastructure: Payments to support Indians, Inuit and Innu for the purpose of supplying public services in capital facilities and maintenance.

The total value of the programs listed above was approximately $3.4 billion for the 2011-12 fiscal year, representing 52% of the total G&C distributed for the year, and approximately $3.2 billion for the 2012-13 fiscal year, representing 48% of the total G&C distributed for the year.

B) Selection of Regions for Site Visits

The second element of the sampling methodology considered the regional offices to be visited. Factors in the selection of the regions to be visited included the following:

- Size (dollar value) of selected programs (selected above) funded by the regional office;
- Variety of funding approaches utilized by the regional office across the programs selected;
- Feedback obtained during the planning phase by individuals interviewed; and,
- Amount of time since last G&C internal audit was performed in the region.

Based on the above analysis and with the objective to assess funding approaches horizontally across the regions with varying levels of risk and coverage of programs, we selected the following regional offices to be visited as part of the conduct of on-site field testing (including the dates site visits took place):

1. Atlantic (March 11-13, 2013);
2. Ontario (March 18-20, 2013); and,
3. British Columbia (April 15-17, 2013).

C) Sample Size per Region

The third element of the sampling approach was the determination of the recipients to be tested within each of the regional site visits. Based on the fact that five programs were selected for detailed testing and there are four funding approaches scoped into the audit (Set Contribution, Fixed, Flexible and Block funding), a sample of 25 recipients were selected for detailed testing at each regional site visit, ensuring adequate coverage across all programs selected, as well as all funding approaches used by each program – in order to be in a position to conclude horizontally across the regions. These recipients were selected taking into account the dollar value of funding received and the variety of funding approaches leveraged.

4. CONCLUSION

Generally, the audit found that Regions are using eligible funding approaches to flow funding to recipients as allowed per program terms and conditions. However, we did note that the level of recipient risk is not always adequately considered in the establishment and selection of funding approaches and compliance activities within the Department. This does not completely align with the TB *Policy on Transfer Payments* which requires that program and recipient risk be considered as part of determining the funding approach, monitoring activities and reporting requirements. Further, the opportunity to embed additional flexibility into program management through the introduction of the flexible funding approach, and consideration of block funding for low risk recipients can be better leveraged by the Department.

5. FINDINGS AND RECOMMENDATIONS

Based on the evidence gathered through the examination of documentation, analysis and interviews, each audit criterion was assessed by the audit team and a conclusion for each was determined. Where a significant difference between the audit criterion and the observed practice was found, the risk of the gap was evaluated and used to develop a conclusion and to document recommendations for improvement initiatives.

5.1 Funding Approaches – Non-Block Funding

When a program allows for multiple funding approaches, regional staff determine the program-appropriate funding approach based on recipient risk within the constraints of program terms and conditions. TPCOE has developed guidance such as Directive 101 and the GA tool to assist in the selection of an appropriate funding approach. During audit testing, it was observed that although GAs are being completed for each recipient and that the selection of funding approaches were eligible per program terms and conditions, we found that for non-block funding (both core and targeted programs), the selection of the funding approach in the region is not consistently based on the recipient's GA risk level.

Core Funding

For the purpose of this audit, core funding is defined as any non-proposal based funding transferred from AANDC to a recipient to support ongoing operations such as the education, social development, community infrastructure, and community economic development. Core funding is transferred to recipients through various funding approaches, including set, fixed and block. In the regions visited, the selection of funding approach for non-block core funding is determined by the annual national chart of accounts and the default funding approach available. When multiple funding approaches are available (generally set and fixed), the region may change the default funding approach for the program based on perceived program risk within the region. As a result, the selection of a funding approach is not necessarily based on an individual recipient risk (i.e. GA score).

Proposal Based/Targeted Funding

Within the proposal based/targeted funding programs, it was observed that two of the programs sampled, Community Infrastructure and Community Economic Development, had in place a program management regime/program MCF that enabled the selection of a funding approach based on recipient risk. For these programs, the program management regime lays out the available funding approaches, whereby the recipient risk assessment contributes to the decision of which funding approach to use for the specific recipient. The remainder of the targeted funding programs did not select a funding approach based on recipient risk; rather, the region was applying the same funding approach to all recipients within the program.

Currently, the majority of programs do not have in place a program management regime/program MCF to guide the regions in the selection of funding approach that clearly links the selection of funding approach with recipient and project/program risk.

As a result, AANDC is not fully aligned with the expectations of the PTP, as the Department has not yet fully adopted a risk-based approach to the management of G&C. This results in AANDC not fully utilizing/maximizing the flexibility available within the funding approaches as intended by the PTP by not linking risk with the funding approach. This leads to a potential for an increased administrative burden (for both the recipient and the Department) and increased effort for oversight with regard to restrictive funding distributed to low risk recipients. Conversely, there is potential that a higher risk program area does not have the correct oversight if a funding approach that is too flexible is used.

Further, there is also a risk that AANDC is not fully in compliance with the MCF for G&C relative to several requirements including:

a) The MCF requires that "a risk-based analysis is performed to determine the appropriate funding mechanisms and associated requirements that are most appropriate based on the composition of the intended recipients and the objectives of the program." (MCF A5.1); and,

b) "Program policies and procedures are developed based on program risks and approved terms and conditions and provide program and regional managers with the information required to operate within approved terms and conditions (program-specific management control framework)." (MCF A5.2)

Recommendation

1. The Chief Financial Officer (CFO) should establish a process to better support the work of senior program managers in their development of program management regimes/program MCF's, which should more formally link the recipient and program/project risk to the funding approach selection, fully integrating recipient risk as per the General Assessment, program risk, and the nature and value of funding. All applicable funding approaches should be considered and the applicability of the flexible funding approach should be assessed for both core and non-core programs. The CFO, with the support of senior program/regional managers, should ensure monitoring and transparent reporting to senior management on the consistent application of these program management regimes/MCFs by regions.

5.2 Flexible Funding Approach

As per the MCF for G&C, in order to use the flexible contribution funding approach, the program must have in place a program management regime/program MCF which outlines how the program will manage the flexible contribution funding, including a risk assessment. Based on the programs selected for testing, it was noted there is currently no use of the flexible funding approach for core programs and limited use for targeted funding.

The flexible funding approach is a new funding approach for multi-year agreements which allows the recipient to move unspent funds within the program/project to subsequent fiscal years; however, unspent funds at the end of the program/project must be returned to the Department. Within the programs tested, we found that only Capital Infrastructure and Community Economic Development were leveraging the flexible funding approach for targeted programs. For these two programs, management has developed a MCF to determine the appropriate funding approach (set, fixed, flexible) using a risk-based approach. Using a program management regime/program MCF, a region is expected to determine the most appropriate funding approach based on the evaluation of project specific risks and recipient risk. It was also noted that the Social Development program has drafted a MCF for the Income Assistance Reform program; although, this framework was not in place during the audit scope period.

From a departmental perspective, it does not appear that a systematic evaluation of existing programs was performed to determine how programs would benefit from introducing the flexible funding approach for both core and targeted funding. It was observed that 1.2% and 2.3% of total funding leveraged the flexible funding approach, introduced as part of the PTP, for fiscal years 2011-12 and 2012-13, respectively.

It is the expectation of the PTP that “administrative requirements on applicants and recipients, which are required to ensure effective control, transparency and accountability, are proportionate to the level of risks specific to the program, the materiality of funding, and to the risk profile of the applicants and recipients”. Without considering the use of flexible funding for targeted and core funding, the Department may not be fully meeting the expectations of the PTP.

Additionally, without considering the flexible funding approach, it is unclear how specific programs are meeting the objectives of the MCF for G&C, specifically:

- “A risk-based analysis is performed to determine the appropriate funding mechanisms and associated requirements that are most appropriate based on the composition of the intended recipients and the objectives of the program.” (MCF A5.1);
- “Program-specific management control framework has been reviewed and approved by senior executive committees.” (MCF A6.2); and,
- “The recipient’s accountability and management capacity, past performance in meeting commitments and objectives, and overall risk-level are considered in determining the funding type, priority, and support administered.” (MCF C2.4).

Recommendation

See recommendation #1 which includes a consideration of the use of the flexible funding approach.

5.3 Compliance

Through the audit work performed at HQ and in the regions, it was observed that the performance of program compliance activities is not consistently aligned to the risk associated with the recipient (GA score) and/or funding approach used. The majority of program compliance activities in the region was cyclical and focused on Income Assistance and Education.

It was also noted that, with the exception of the Social Development Program, none of the programs tested have a compliance framework that is tied to the risk of the recipient or funding approach. The Social Development Program has developed, and is still implementing a compliance framework that takes into consideration the recipient program risk score when developing the compliance activities plan.

The PTP requires that “monitoring, reporting and auditing [activities] reflect the risks specific to the program, the value of funding in relation to administrative costs, and the risk profile of the recipient”. This is echoed by the Department’s MCF for G&C which requires that:

- “Program activities are conducted in compliance with program policies and procedures. Identified program issues/risks are addressed.” (MCF B3);
- “Performance results received are adequately reviewed to ensure recipients are in compliance with their funding agreement and funds are used for the purposes intended.” (MCF D2.2); and
- “Recipient compliance to program terms and conditions and the funding agreement is monitored and feedback to recipients is provided regarding opportunities for improvement.” (MCF D5)

Testing of the sampled programs revealed there are no Department-wide compliance activities; rather, programs are responsible for their own compliance regimes. It was noted that:

- Social Development and Education: Compliance activities are historically performed on a cyclical basis (every 2 to 3 years) for these programs. During 2012-13, there was a push to perform compliance on 100% of the recipients for Social Development Programs, with the exception of the Atlantic region, which is not performing such compliance at the time of this report due to a court injunction;
- Capital Infrastructure and Community Economic Development: These programs typically perform their own compliance on their projects, based on a project management approach, throughout the conduct and completion of the project; and;
- Governance: There are no specific compliance activities being performed by program or compliance representatives within the regions.

For block funding, there is generally no compliance performed during the duration of the agreement, with the exception of the last year of the agreement, prior to renewal. At that time, compliance activities may be performed to support renewal or rebasing of funding formulas. For block funding, compliance activities can provide the Department with greater comfort that program delivery standards are being met during the course of the agreement.

It was noted that the old Alternative Funding Arrangement funding approach did not have compliance or fund recovery clauses embedded, and, as a result, program officers were not conducting any compliance activities of these agreements. Under the new Aboriginal Recipient Funding Agreements, AANDC has added these clauses.

Without a risk-based approach to compliance activities, the Department is not fully compliant with the PTP, which states that Deputy Heads are responsible to ensure that the administrative requirements applied to recipients are proportionate to the risk level. In particular, the PTP requires that monitoring, reporting and auditing reflect the risks specific to the program, the value of funding in relation to administrative costs, and the risk profile of the recipient.

Additionally, there is the potential that AANDC may be performing a disproportionate amount of compliance activities in areas of low risk, and an insufficient amount of compliance activities in areas of high risk.

Recommendation

2. The Chief Financial Officer (CFO) should develop a departmental program compliance framework for programs and regions to implement. To support the implementation, the CFO should establish a process to work with each program area, directly linking compliance activities (i.e. nature and frequency) to the funding approach (including block funding) and recipient risk. This framework should include periodic monitoring by the CFO to ensure its continued relevance and effectiveness.

5.4 Block Funding Approach

The current departmental position is that block funding should be leveraged as much as possible to provide low risk recipients (pre-requisite for eligibility) with greater flexibility while reducing the administrative burden to the Department and the recipient. Audit testing identified an inconsistent use of the block funding approach across the Department.

The percentage of low risk recipients in block funding differs across each region. The following table outlines the overall number of low risk recipients (as per Part A of the GA tool) within our sample of regions and the corresponding number of recipients in block funding:

	Atlantic	Ontario	BC
Sample Size	25	25	25
Number of Low Risk Recipients (GA Part A)	16	22	25
Number of Low Risk Recipients in Block	14	8	8
% of Low Risk Recipients in Block	88%	36%	32%

It was noted that the Atlantic region works proactively to move low risk recipients into Block funding; 88% of its low risk recipients are currently in Block funding.

The difference in the number of low risk recipients in block funding agreements relates to a philosophical difference as to the perceived benefits of block funding agreements across regions and recipients. In some regions, it is perceived that block funding agreements provide recipients with the greatest flexibility to manage their funds and allow the recipient to move closer to self-governance. Conversely, in other regions, block funding agreements are perceived to transfer the majority of risks to the recipient and are therefore not being considered for many eligible recipients.

At a Departmental level, TPCOE has established a well defined process and guidelines on assessing a recipient's eligibility for block funding; however, the Department has not effectively communicated to the regions a position on moving low risk recipients to block funding. Without a well communicated departmental position, inconsistencies regarding the use of block funding will remain across regions.

For low risk recipients (as established by Part A of the GA tool) eligible for block funding, Part C of the GA tool is used to support the decision to enter into a block funding agreement. Part C currently assesses the risk and the capacity of an ongoing, multi-program recipient as an entity. An assessment is made of the recipient's governance and program specific strengths and weaknesses relevant to the delivery of AANDC funded programs and services. Once a decision is made to use block funding for a recipient, all block funding eligible programs must be included for that recipient.

For block funding arrangements up for renewal, Part C of the GA tool is completed again to ensure that the recipient continues to be eligible and should remain in block funding. Although program specific risks are considered in the Part C assessment, there is no mechanism for block eligible programs to evaluate whether block funding is the most appropriate funding approach for a recipient to most effectively achieve program objectives.

Recommendation

3. The Chief Financial Officer (CFO), in collaboration with the Senior Assistant Deputy Minister of Regional Operations and the Assistant Deputy Minister of the Northern Affairs Organization, with the support of senior program managers, should formally develop and communicate to regions the Departmental position on moving eligible recipients to block funding. This should include tools and communication approaches to work with recipients to plan and prepare for block funding, where eligible. In addition, continued monitoring of regional take-up of this funding approach should be conducted by the CFO, with the support of senior program managers.

5.5 Governance – Oversight and Monitoring

In response to the new PTP, the CFO sector, through TPCOE, took steps to provide direction and guidance to programs on the implementation of PTP, including the development of a departmental MCF, *Directive 101 - Funding Approaches*, and the implementation of the GA Tool that is used to assess recipient risk. Additionally, TPCOE provides ongoing support and guidance to programs and regions, as requested, on the administration of G&C. The concept of program management regimes was introduced to support programs in implementing a risk-based funding approach within their program. To date, two programs, Community Infrastructure and Community Economic Development, have implemented program management regimes. It was observed that the program management regime for Community Economic Development aligns funding approaches to the program budget activity so that it is clear how recipient and program risk determine a funding approach for within each budget activity.

Although support and direction is being provided by TPCOE to the programs on an ongoing basis, limited oversight and monitoring mechanisms have been established to ensure program/regional compliance to the PTP. The current governance structure that exists to support the implementation of PTP does not track the status of each program's development and implementation of a program management regime to support risk-based funding decisions.

Without sufficient monitoring and oversight of program implementation of PTP and program management regimes, the Department is not able to fully assess its status with respect to the implementation of the PTP on an ongoing basis.

Recommendation

4. The Chief Financial Officer (CFO) should leverage the existing G&C governance structure to establish an oversight mechanism and monitoring program to support programs/regions in implementing the Treasury Board *Policy on Transfer Payments* relative to funding approaches. The oversight mechanism should ensure that program management regimes exist or are in development for each budget activity (program) associated with G&C funding.

6. MANAGEMENT ACTION PLAN

Recommendation	Management Response / Actions	Responsible Manager (Title)	Planned Implementation Date
1. The Chief Financial Officer (CFO) should establish a process to better support the work of senior program managers in their development of program management regimes/program MCFs, which should more formally link the recipient and program/project risk to the funding approach selection, fully integrating recipient risk as per the General Assessment, program risk, and the nature and value of funding. All applicable funding approaches should be considered and the applicability of the flexible funding approach should be assessed for both core and non-core programs. The CFO, with the support of senior program/regional managers, should ensure monitoring and transparent reporting to senior management on the consistent application of these program management regimes/MCFs by regions.	The CFO will establish a process to clarify the role of governance and oversight in program management regimes / management control frameworks as it relates to the selection of funding approaches and monitoring. (This will be reflected in the new Case Management Approach currently in development.)	Chief Financial Officer	March 2014
2. The Chief Financial Officer (CFO) should develop a departmental program compliance framework for programs and regions to implement. To support the implementation, the CFO should establish a process to work with each program area, directly linking compliance activities (i.e. nature and frequency) to the funding approach (including block funding) and recipient risk. This framework should include periodic	The CFO, in the context of the senior management team in charge of improving transparency and accountability, will lead the development of a departmental compliance framework.	Chief Financial Officer	December 2013

monitoring by the CFO to ensure its continued relevance and effectiveness.			
3. The Chief Financial Officer (CFO), in collaboration with the Senior Assistant Deputy Minister of Regional Operations and the Assistant Deputy Minister of the Northern Affairs Organization, with the support of senior program managers, should develop and formally communicate to regions the Departmental position on moving eligible recipients to block funding. This should include tools and communication approaches to work with recipients to plan and prepare for block funding, where eligible. In addition, continued monitoring of regional take-up of this funding approach should be conducted by the CFO, with the support of senior program managers.	The CFO, in collaboration with the Senior Assistant Deputy Minister of Regional Operations and the Assistant Deputy Minister of the Northern Affairs Organization, will work with the Director General, Communications Branch to establish the departmental position on block funding eligibility and communicate it.	Chief Financial Officer	December 2013
4. The Chief Financial Officer (CFO) should leverage the existing G&C governance structure to establish an oversight mechanism and monitoring program to support programs/regions in implementing the Treasury Board *Policy on Transfer Payments* relative to funding approaches. The oversight mechanism should ensure that program management regimes exist or are in development for each budget activity (program) associated with G&C funding.	The CFO will review the Terms of Reference for the existing G&C governance structure to ensure that oversight and monitoring of the implementation of Policy on Transfer Payment.	Chief Financial Officer	September 2013

Appendix A: Audit Criteria

To ensure an appropriate level of assurance to meet the audit objectives, the following criteria were developed to address the objectives as follows:

Audit Criteria	
Governance/Roles and Responsibilities: Assessment of the governance framework and roles and responsibilities to ensure consistent application and management of funding approaches across all programs and regions.	
1.1	TPCOE provides oversight/challenge and guidelines to programs in the selection of applicable funding approaches for the program.
1.2	Funding approach decisions at a recipient level are consistently reviewed by senior regional representatives prior to approval.
1.3	Roles, responsibilities and accountabilities related to the selection of funding approaches for recipients are clearly defined and communicated.
Program Development/Selection of Funding Approaches: Assessment of the appropriateness of the funding approach(es) selected by programs, considering the nature of the program objectives and the risks associated with the respective program; assessment of the tools provided to regional offices to aid in the selection of the appropriate funding approach.	
2.1	Funding approaches available for the program are chosen to respect and achieve a balance between principles of accountability, cost/benefit, risk management and treatment of program recipient.
2.2	Program level guidance has been developed and communicated to regional offices to ensure consistent selection of funding approaches based on risk.
Eligibility and Agreement Development: Assessment of the appropriateness of the eligibility criteria (to assess the recipient's ability and capacity to effectively manage themselves towards program objectives considering the risk associated with the program/funding) relative to each funding approach in place and whether there is a consistent application of established eligibility criteria across regions.	
3.1	Funding approach selected is eligible per program T&C.
3.2	The funding approach selected for each recipient by program is determined based on risk (program and overall basis).
3.3	Funding agreements are approved per delegation of authorities as outlined in the program T&C.

Agreement Monitoring and Reporting: Examination of the controls surrounding the monitoring and reporting of recipient activities to ensure alignment with the risk level of the program, compliance with agreement terms and conditions, demonstration of achievement of program objectives and effectiveness of risk based compliance and recipient auditing.	
4.1	Reporting requirements are aligned with recipient and program risk.
4.2	Compliance monitoring activities are aligned with recipient and program risk.

Appendix B: Relevant Policies/Directives

The following authoritative sources (i.e. Policies/Directives) were examined and used as a basis for this audit:

- AANDC *Management Control Framework for Grants and Contributions;*
- AANDC *Directive 101 – Funding Approaches*;
- Treasury Board *Policy on Transfer Payments*; and,
- Treasury Board *Directive on Transfer Payments*.