



Western Economic  
Diversification Canada

Diversification de l'économie  
de l'Ouest Canada

## **Audit of Community Futures Program**

**WESTERN ECONOMIC DIVERSIFICATION CANADA**

**Audit, Evaluation & Disclosure Branch**

**April 2009**

## Table of Contents

<b>1.0 EXECUTIVE SUMMARY</b>	<b>1</b>
<b>2.0 STATEMENT OF ASSURANCE</b>	<b>2</b>
<b>3.0 INTRODUCTION</b>	<b>3</b>
<b>Background</b>	<b>3</b>
<b>Audit Objectives</b>	<b>3</b>
<b>Audit Criteria</b>	<b>4</b>
<b>Key Risks</b>	<b>4</b>
<b>Scope and Methodology</b>	<b>4</b>
<b>Acknowledgements</b>	<b>4</b>
<b>4.0 FINDINGS AND RECOMMENDATIONS</b>	<b>5</b>
<b>4.1 Program Administration</b>	<b>5</b>
<b>4.2 CF Program Financial Management (Operating and Investment Funds)</b>	<b>5</b>
<b>4.3 CF Program Investment Fund Management</b>	<b>6</b>
<b>4.4 Management Controls to Ensure Compliance</b>	<b>7</b>
<b>5.0 CONCLUSION</b>	<b>9</b>
<b>6.0 AUDIT STRATEGIES AND APPROACH</b>	<b>11</b>

## 1.0 Executive Summary

- 1.1 The Community Futures Program Audit was identified in Western Economic Diversification Canada's (WD) approved 2009-12 Risk Based Audit Plan. WD has funded Community Futures organizations (CFs) since 1995 to provide three core services: local strategic economic planning services, business counselling, and loans to small and medium business in rural communities. The Community Futures (CF) Program:
- supports local rural communities and small and medium-sized enterprises (SMEs) in meeting their economic needs;
  - helps rural communities to develop and implement long-term community strategic plans leading to the sustainable development of their local economies; and
  - provides resources to local Community Futures organizations (CFs) to build community capacity to adapt to and manage change.
- 1.2 The objective of the audit was to provide assurance that:
- program authorities were adhered to;
  - program funds were spent for the purposes intended;
  - an effective process was in place to manage the distribution of pooled investment funds for CFs across Western Canada; and
  - effective management control processes and practices were in place at WD and at the CFs.
- 1.3 The audit covered the period from April 1, 2006 to December 31, 2008. The audit methodology integrated review and analysis of relevant program and policy documents, interviews with key personnel at WD and at the CFs, and testing of transactions. Documents were reviewed as part of the audit process including, but not limited to: CF Program authority, Contribution Agreements, Treasury Board Policy on Transfer Payments, Financial Administration Act, Result Based Management Accountability Framework, CF Program Audit (2003), CF Program Evaluation (2008) and WD CF Program Risk-Based Audit Framework.

## Findings and Conclusions

- 1.4 WD has made significant improvements in its management practices in implementing the recommendations made in the 2003 Audit of Community Futures Program. WD has developed standard templates to be used throughout the regions, standardized monitoring and review tools, a project risk assessment document, and a dashboard template to assess CF performance at a glance. However, the regions have not fully implemented these tools and processes. This report contains recommendations that address the most significant areas for improvement.
- 1.5 For the most part, the CFs adhered to the contribution agreements. WD has established a management control framework to further compliance to the program authorities and to

monitor the CF operations and performance. However, WD's monitoring practices were inconsistent across regions and tended to rely heavily on externally audited financial statements of the CFs rather than a balance of active monitoring. All ten CFs visited had established sound internal controls and procedures to manage the CF investment funds. Two of the ten CF's visited had some weaknesses in their controls over their operating funds.

- 1.6 WD recently developed a few new investment policies to provide additional guidance to CFs on issues that have emerged over time. In addition, WD should consider whether some of the inactive investment funds could be better utilized to achieve overall program objectives.
- 1.7 Although WD has standard risk assessment templates to guide the annual risk assessment process, the overall risk assessment process should be enhanced. Three main findings support this conclusion: there were cases where the risk was assessed at low despite evidence that a higher risk ranking would have been more appropriate; the auditors could not find documented evidence to support that WD intervention was commensurate with the level of risk; and, there was no current mechanism to roll up significant regional risk issues to track trends or issues at a departmental level.
- 1.8 From time to time, WD has contracted special review work to deal with significant issues at selected CFs. In a couple of isolated cases in one region, the contractors found that the audits/reviews indicated that certain expenditures were ineligible. WD is aware of the situation and has initiated action to ensure compliance going forward. In addition, WD needs to initiate steps to either recover or write-off those ineligible funds.

## 2.0 Statement of Assurance

- 2.1 In my professional judgement as Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusions provided and contained in this report on the effectiveness of management controls for the efficient delivery of Community Futures Program.
- 2.2 The assurance is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria that were agreed upon with management. The assurance is applicable to the policies and processes examined. The evidence was gathered in compliance with Treasury Board policy, directives, and standards on internal audit for the Government of Canada. The evidence has been gathered to be sufficient to provide senior management with the proof of the conclusions derived from the audit.

### 3.0 Introduction

#### Background

3.1 WD has funded Community Futures organizations (CFs) since 1995 to provide three core services: local strategic economic planning services, business counselling, and loans to small and medium business in rural communities. In 2006, WD signed new four-year agreements to enable the CFs to continue operations. There are 90 non-profit CFs in Western Canada (27 in Alberta, 34 in British Columbia, 16 in Manitoba, and 13 in Saskatchewan). There are also four CF Associations, one in each western province, that provide support and coordination for CFs in their region. The approved four-year funding for the CFs and CF Associations was \$110.5 million and summarized below:

<b>Millions of Dollars</b>					
<b>Region</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>	<b>Total</b>
AB	\$8.2	\$8.4	\$8.5	\$8.7	\$33.8
BC	\$9.9	\$10.1	\$10.3	\$10.5	\$40.8
SK	\$3.9	\$4.0	\$4.1	\$4.1	\$16.1
MB	\$4.8	\$4.9	\$5.0	\$5.1	\$19.9
<b>Total</b>	<b>\$26.8</b>	<b>\$27.4</b>	<b>\$27.9</b>	<b>\$28.4</b>	<b>\$110.5</b>

- 3.2 WD key responsibilities under the Community Futures program authorities are:
- to maintain adequate program and financial controls, systems, procedures and resources to ensure strict adherence to government policies and regulations, due diligence in approving transfer payments, verifying entitlement, eligibility and results achieved, and for management and administration and follow-up of the program;
  - to develop and implement policies and procedures for adequate monitoring of results achieved for program activities governed by contribution agreements and for obtaining suitable information from CFs on their Operating and Investment Fund policies and procedures to ensure adequate departmental accountability; and
  - to be responsible for determining whether recipients have complied with the contribution agreement terms and conditions. This responsibility includes audit of CFs and their client files when deemed necessary.
- 3.3 In support of a request for funding, each CF prepares an annual plan, or a multi-year plan with annual updates. In this plan, the CF reports on all planned activities for the upcoming year, including Investment Fund activities. The plan includes a statement of the measurable objectives and targeted results of the program activities for the upcoming year, the strategy the CF intends to employ to achieve those results, and a budget plan for the upcoming year.

#### Audit Objectives

3.4 The objective of the audit was to provide assurance that:

- program authorities were adhered to;
- program funds were spent for the purposes intended;
- an effective process was in place to manage the distribution of pooled investment funds for CFs across Western Canada; and
- effective management control processes and practices were in place at WD and at the CFs.

## **Audit Criteria**

- 3.5 The audit criteria have been drawn from the program authorities, contribution agreements, program audit and evaluation frameworks, Treasury Board Policy on Transfer Payments, and Treasury Board standards for internal audit. Detailed audit criteria are included in the Findings and Recommendations section of this report.

## **Key Risks**

- 3.6 The audit program was designed to test the existence and effectiveness of WD's controls to mitigate the following key risks:
- management capacity at CFs may be insufficient to ensure compliance and achievement of program results;
  - ineligible costs may be claimed and paid;
  - inadequate due diligence exercised by CFs to manage the Investment Funds;
  - Operating and Loan Investment Funds may not be used for intended purposes;
  - program objectives and intended results may not be achieved; and
  - non-compliance with Treasury Board requirements and terms and conditions of contribution agreements.

## **Scope and Methodology**

- 3.7 The audit covered the period from April 1, 2006 to December 31, 2008. The audit methodology included review and analysis of the program and management practices and control processes, and interviews with key personnel at WD and at the CFs. A judgemental sample of five CF project files including 15 advance payments was examined in each region. The total number and dollar value of samples were 60 and \$4.5M, these represent 5% and 6% of the population respectively. Ten of 90 CFs (11%) across western Canada were visited to obtain information on management controls and practices, and to review sample files.
- 3.8 In this audit, the auditors followed up on the findings and recommendations in the 2003 audit of the Community Futures Program.

## **Acknowledgements**

- 3.9 The auditors would like to thank WD and CF staff for the timely cooperation and assistance provided to the audit team throughout this engagement.

## 4.0 Findings and Recommendations

### 4.1 Program Administration

*Criteria: WD's overall management of the CF Program is effectively administered.*

- 4.1.1 A proper organizational structure existed at WD to effectively manage the program. Roles and responsibilities of the management and staff were clearly defined and understood. Assistant Deputy Ministers (ADMs) were accountable for the program management in the regions. They were supported by the program staff, and Monitoring and Payment Officers. The Senior Program Advisor at headquarters provided guidance in developing program policies and guidelines, and coordination to the regions. WD has established policies, procedures, guidelines and forms to guide WD and CF management and staff in the effective administration of the program. Proper controls were in place to ensure compliance to Community Futures program authorities and contribution agreements.
- 4.1.2 Proper organizational structure existed at the CFs. The Board of Directors provided decision-making and policy development to the organization while the General Manager executed the daily operations of the CFs. Staff of a typical CF consisted of a general manager, business analyst, loans officer, community economic development officer, and administrative staff.
- 4.1.3 WD and CFs had signed contribution agreements, which set out their responsibilities for the program. The contribution agreements correspond with the program authorities. WD has complied with the program authorities. The CFs have generally complied with the contribution agreements. The exceptions were noted in this report.
- 4.1.4 The auditors' review identified two issues concerning WD policies and guidelines:
- No formal guidelines exist to outline the circumstances under which CFs can transfer interest from the Investment Fund to the Operating Fund. WD is developing a document on the principles for approving the use/transfer of interest; and
  - At the time of the audit, WD had drafted but not approved two policies that will clarify some issues around investment fund usage: a policy for loans over \$150K and a policy for interest transfers – building purchases. The issue on loans over \$150K was raised in the 2008 Evaluation of Community Futures Program.

### 4.2 CF Program Financial Management (Operating and Investment Funds)

*Criteria: CF Program Funds (Operating and Investment) are accessible to all CFs and being used as intended. CF Program advance and claim payments, including any interest on advances, are made according to the contribution agreement schedule. Proper information is gathered, reviewed and approved in support of the payments of advances and claimed costs.*

- 4.2.1 Operating funds were provided to CFs by quarterly payment of advances based on the CF's cash flow requirements specified in the CF's operating plan and contribution agreement. The advances were generally paid on the first day of the quarter. CFs received investment funds (repayable and non-repayable) to provide loans to entrepreneurs.
- 4.2.2 WD established effective financial controls to review and approve advances, review semi-annual and annual audited financial statements, and review interest transfers. The review process in place examined for incorrect and unauthorized payment of advances, ineligible expenditures paid out of the Operating Fund, inappropriate and unauthorized transfers from the Investment Fund to Operating Fund or non-compliance to the CF Program Financial Statement Guide. The reviews of annual audited financial statements were adequately documented.
- 4.2.3 WD reviewed and approved the operational plans prior to payment of the first quarter advance. CFs usually prepared semi-annual financial statements. CFs prepared annual financial statements followed the Generally Accepted Accounting Principles and the Program Financial Statement Guide provided by WD. During the course of WD's review of all of these documents, the issues or concerns arising from the review were resolved with the CFs and were generally documented.
- 4.2.4 The auditors' site visits at CFs identified one case of a minor ineligible expenditure paid out of the Operating Fund. In another case, one CF's policy, related to the payment of honorariums to the Board Chair and members, was contrary to the contribution agreement. Contribution agreements state that honorariums are ineligible expenditures and must not be expensed against the program operational funds. One CF did not comply with WD's policy whereby recipients are expected to use competitive processes to get the best value for money. In this case, an organization provided management services to the CF through a non-competitive process without any documented evidence of proper justification.

Recommendations related to strengthening WD's monitoring and review process are included in section 4.4 of this report.

### **4.3 CF Program Investment Fund Management**

*Criteria: CF Program investment funds are accessible to all CFs and repayments are made in accordance with the contribution agreement and CF Program policies and guidelines. Investment funds are able to lever funds from other CFs which hold excess investment funds*

- 4.3.1 WD's investment contributions to CFs included the non-repayable Investment Fund (inherited from Human Resources Development Canada), the conditionally repayable General Investment Fund, and the conditionally repayable Entrepreneur with Disability (EDP) Fund. CFs used the investment funds to provide repayable financial assistance in the form of loans, loan guarantees, or equity investments to local entrepreneurs in order to create new small or medium enterprises. Individual CFs also had access to the regional

Investment Fund Pool and the pooled funds were accessible to the entrepreneurs within their respective regions.

- 4.3.2 The auditors found copies of the loan policies and procedures at the CFs visited. CF loan policies and procedures manuals included loan application forms. The CFs provided WD with quarterly performance reports included the amounts of leveraged funds from non-CF sources.
- 4.3.3 WD needs to review the investment fund portfolios (e.g., Entrepreneurs with Disability) for all CFs as these funds have been inactive for some time. The audit identified very limited use of these funds. There is a risk that these monies are sitting idle and that they could potentially generate greater overall program results if made available through the General Investment Fund. Under the current contribution agreements, WD does allow temporary transfers between portfolios if preauthorized by WD.

**Recommendation #1:** WD should review its current management practices around the CF investment fund portfolios to determine if the current segregated investment fund approach is achieving the greatest program results.

#### 4.4 Management Controls to Ensure Compliance

*Criteria: Controls and processes are in place to ensure that recipients are in compliance with the requirements of contribution agreements and program authorities. Management practices are effective to monitor and review the program performance reporting and requirements.*

- 4.4.1 Standard contribution agreements were used in all regions and they reflected program authorities. Types of eligible and non-eligible expenditures were also specified in the program authorities and contribution agreements.
- 4.4.2 Individual CF funding levels were determined through regional funding formulas that had been developed in consultation with CFs through their provincial CF Associations. These funding formulas included factors such as size and population served. WD staff completed CF operational plan reviews, risk assessment and Due Diligence Reports for individual CFs prior to project approval. Regional ADMs approved the Due Diligence Reports, the Deputy Minister and Minister approved program funding, and WD and the CFs signed the contribution agreements. WD exercised adequate due diligence in approving the projects and developing contribution agreements with CFs.
- 4.4.3 Adequate controls exist to monitor and manage compliance to program authorities and contribution agreements. Key controls included submission and review of annual operating plans, internally certified semi-annual financial statements, annual audited financial statements, and quarterly performance reports that were in accordance with the departmental standards. A standard information system, accessible to CFs and WD staff,

was used to track and report on the program performance. WD reviewed and monitored documents that the CFs submitted to ensure compliance and measure performance that was complemented by randomly selected project reviews. WD provided sufficient guidance to support CFs and issues were identified and resolved in a timely manner.

4.4.4 This audit identified some weakness in management controls related to program monitoring and oversight that can be strengthened by the recommendations made in the report. These areas are:

- CFs were not consistently following approved timelines for submitting operational plans, semi-annual and annual audited financial statements, and quarterly performance reports. This practice had an impact on WD having to hold back payments, therefore, causing cash flow challenges for CFs. The audit sample of 60 CF files for period 2006-08 noted that CFs submitted 48% of operating plans, 20% of semi-annual financial statements, and 8% of annual audited financial statements late.
- The Alberta and Manitoba Regions did not have documentation to support that staff reviewed semi-annual financial statements. In the Alberta region, the auditors found that semi-annual statements for 2 out of the 5 CFs sampled, were not certified by the CFs prior to submission to WD.
- Follow-ups and discussions on outstanding issues, concerns or missing requirements made during WD's review of the operating plans were not always documented and the reviews were not always signed off. This exception was noted on 3 of 20 CF files reviewed.
- The Alberta Region did not have documentation to confirm the review of quarterly performance reports for 2006-07 and 2007-08. However, in 2008-09, the region initiated a new process to manage CF performance on a semi-annual basis. The region has prepared a report comparing five key indicators of CF's actual performance against established minimum performance standards. A formal notification was sent to each CF Board Chair advising them of the status of their CF's performance. In addition, at the end of fiscal year, CFs which have not met their performance standards and targets on key performance indicators will be invited to meet with WD management to discuss their CF performance for the past year and develop a remedial plan for the coming year.
- In the British Columbia Region, discussion with officers and management indicated that quarterly performance reports were regularly reviewed, although this review was not always documented. In each of the 5 files examined, auditors found only an annual variance report for each of the three fiscal years covered.
- WD's annual project risk assessment process was not working effectively. In BC, all 5 CFs sampled were ranked low risk, even though one CF had some serious issues stemming from the external audit of their financial statements. In Alberta, 3 out of 15 files examined did not have evidence of an annual project risk assessment. In Saskatchewan, one project risk assessment showed "no audit observation" but the related auditor's compliance letter indicated some compliance issues. Strong and

effective risk management is a key principle of the new Treasury Board Policy on Transfer Payments.

- WD site visits to CFs resulting from project risk assessments were not always documented in all regions. Evidence to support the site visits was almost non-existent. Of the 20 files examined, WD program staff conducted 4 site visits; however, only one had a site visit report.
- Quality Assurance Reporting File Contents and Best Practices Checklist forms were not consistently used and filed by the regions. In the Saskatchewan Region all 5 CF files reviewed did not have completed forms.
- In the Saskatchewan Region, 2 of the 5 CF files examined did not have policies concerning the Board of Director's appointment or terms of office. In 3 of 10 CFs visited across western Canada, the auditors found payment vouchers or cheque requisitions for the General Manager's or Board Chair's expenses only signed off by him/her. In all of those cases, the final cheque included a second signature that was not the beneficiary of the payment.

**Recommendation #2:** WD should standardize, document and consistently apply its monitoring and review practices related to the CF's operating plans, financial statements, performance reports, project risk assessments, and corresponding site visits.

**Recommendation #3:** WD should establish formal processes to demonstrate adequate active monitoring of the CF's program compliance and performance.

**Recommendation #4:** WD should strengthen and standardize its risk assessment process that incorporates varying degrees of intervention commensurate with the level of risk assessed.

## 5.0 Conclusion

- 5.1 WD and the CFs have adequate management control frameworks and appropriate control measures in place to effectively administer the program as required by the program authorities, and to mitigate the key program risks. However, areas for improvement identified in this report and recommendations made will further enhance the management capacity in administering the Community Futures Program.
- 5.2 The audit examined several audit criteria used to assess the identified key risks, management control framework and practices. The following is the summary of results.

## Results Summary By The Detailed Criteria

<b>Assessed Audit Criteria</b>	<b>Results</b>
<b><i>1. Program Administration</i></b>	
1.1 WD's overall management of the CF Program is effectively administered according to the program authorities.	Criteria mostly met
<b><i>2. CF Program Financial Management</i></b>	
2.1 CF Funds (Operating and Investment) are accessible to all CFs and are being used as intended.	Criteria mostly met
2.2 CFP advance and claim payments including any interests on advances are made according to the contribution agreement schedule.	Criteria met
2.3 Proper information is gathered, reviewed and approved in support of the payments of advances and claimed costs.	Criteria met
<b><i>3. CF Program Investment Funds Management</i></b>	
3.1 CF investment funds are accessible to all CFs and repayments are made in accordance with the contribution agreement, CF policies and guidelines.	Criteria met
3.2 CF Program investment funds are able to lever funds from other CFs, which hold excess investment funds.	Criteria mostly met
<b><i>4. Management Controls to Ensure Compliance</i></b>	
4.1 Controls and processes are in place to ensure that recipients are in compliance with the requirements of contribution agreements and program authorities.	Criteria mostly met
4.2 Management practices are effective to monitor and review the program performance reporting and requirements.	Criteria partially met

## 6.0 Audit Strategies and Approach

### Planning

- 6.1 Audit planning started in January 2009 and fieldwork was completed in March 2009 in all four regions at WD and selected CFs. Pre-engagement meetings and preliminary survey were completed to facilitate identification of key risks, audit criteria, control elements and audit strategies. WD and CF staff were involved as necessary throughout the audit process.

### Standards and Methodology

- 6.2 Government of Canada internal auditing standards were used throughout the planning, conducting and reporting phases of the audit. The audit is evidence-based in order to ensure that the audit assurance is fully supported. All available evidence has been examined and analyzed against the audit criteria in order to recap the results. Sources of evidence included: interviews, review and analysis of available policies and management practices at WD and CFs, review of previous audits/reviews by other assurance providers, site-visits to regions and CFs, analytical reviews, and elaboration on cause and effect of conditions, background literature, and follow-up on previous audits.

### Sampling

- 6.3 The identified key risks were prominently considered in judgmentally selecting project files and CFs for examination. As part of the audit evidence, the auditors judgmentally selected 20 representative project files from all regions and 10 CFs for examination and tested the sample against the respective audit criteria that were finalized in concurrence with the program management.

### Audit Team:

WD internal audit staff conducted this audit.

Donald MacDonald	Chief Audit Executive
John Hagan	Senior Auditor
Amarjit Mundi	Senior Auditor
Wilfredo Dimailig	Internal Auditor
Barry Neil	Internal Auditor