



# **COMPLIANCE AUDIT REPORT**

## **Asia Pacific Foundation of Canada**

**February 2008**

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**Foreign Affairs and International Trade Canada**  
**[Office of the Inspector General](#)**  
**Audit Division (ZIV)**



## TABLE OF CONTENTS

<b>Executive Summary.....</b>	<b>1</b>
<b>Table of Compliance.....</b>	<b>4</b>
<b>1.0 Background.....</b>	<b>5</b>
<b>2.0 Objectives.....</b>	<b>6</b>
<b>3.0 Scope and Approach.....</b>	<b>6</b>
<b>4.0 Observations.....</b>	<b>6</b>
<b>4.1 Prudent Person Principle.....</b>	<b>7</b>
<b>4.2 Investment of the Fund.....</b>	<b>8</b>
<b>4.3 Changes to the Fund.....</b>	<b>9</b>

## Executive Summary

### Introduction

Parliament established the Asia Pacific Foundation of Canada (Foundation) in 1984 whose purpose is to build networks and develop closer ties between the people and institutions of Canada and the Asia Pacific region. The Foundation operates the Canadian Secretariats for a number of Asia Pacific organizations, produces studies, reports and news releases on a range of Asia Pacific related topics, and hosts an annual Asia Pacific Summit.

On March 31, 2005, the Minister of Foreign Affairs agreed to make a conditional grant agreement (Agreement) to the Foundation in the amount of \$50 million dollars for the establishment of an Endowment Fund (Fund). The Fund is to be prudently invested and the principal is not to be drawn down. The returns shall be used to support the activities of the Foundation.

The Agreement states that the Minister of Foreign Affairs has the right to conduct an audit of the Foundation's activities and financial records in year three of the Agreement to assess the Foundation's compliance with the terms and conditions of the Agreement. The Agreement further states that the Minister of Foreign Affairs may undertake, at the expense of the Department, by auditor(s) of their choosing, an audit and/or financial risk analysis to ensure compliance with the Agreement, as well as its financial viability. Based on this clause and discussions with the Foundation, it was decided that a compliance audit of the management of the Fund (limited to compliance with Section 4.0 of the Agreement) would be undertaken. For fiscal years ended March 31, 2006 and March 31, 2007, DFAIT's Internal Audit Division (ZIV) undertook this compliance audit (Audit) and contracted an external auditor, KPMG LLP, to assist. KPMG LLP's mandate was to conduct specified audit procedures on behalf of ZIV. Annex 1 of this report contains the objectives, procedures and findings of these specified audit procedures.

### Key Findings

The Audit included a review of 11 sub-clauses of Section 4.0 of the Agreement. A summary of Audit findings on a clause-by-clause basis is provided in the Summary of Compliance section at the end of the Executive Summary.

The Audit found the Foundation to be in compliance with all of the sub-clauses. More specifically, the Audit found that the Foundation has:

- managed the investment of the Endowment Fund in a prudent manner with the objective of preserving the principal amount over the long term;
- established an Investment Committee that oversees matters related to the investment management of the Fund;

- established a Statement of Investment Policy which serves as its investment strategy as well;
- appointed an independent, external investment firm to provide investment advice and manage the Fund;
- established conflict of interest policies covering matters related to voting, prohibited transactions, continuing disclosure and avoidance standards;
- not borrowed money, issued any debt obligation, or given any guarantees to secure debt or other obligations of another entity;
- ensured that investments in the equities of any one issuer be limited to no more than 10% of the outstanding stock of the issuer;
- maintained a minimum of 2% of the investment portfolio in cash or cash equivalent instruments to meet liquidity needs;
- ensured that the Fund's holdings of foreign property as a percentage of the investment portfolio's total assets did not exceed the limits applicable for pension funds as described under subsection 206(2) of the Income Tax Act;
- not engaged in or invested in prohibited investments and trading activities as outlined in subsection 4.10 of the Agreement; and
- not made any material changes in the objectives of the Fund, the use of the Fund or the Fund's investment policy.

## **Key Recommendations**

The Audit identified the following recommendations with respect to the key Audit findings:

1. It is recommend that the maximum investment in bonds should be less than or equal to 88% (100% - 12%).
2. It is recommended that the Statement of Investment Policies and Procedures be revised to ensure the preservation of the principal amount of the Fund.

## **Summary of Compliance**

The Audit found the Foundation to be in compliance with all of the sub-clauses of Section 4.0, Management of the Fund, of the Agreement for the fiscal years 2005/2006 and 2006/2007. The table on the following page lists each of the Agreement sub-clauses that were subject to Audit. For each sub-clause, the table identifies whether the Foundation was in compliance with the clause and where the Audit observations can be

found. For the majority of the sub-clauses, KPMG LLP's report dated August 30, 2007 found at Annex 1, provides greater detail on the audit procedures performed and the results obtained. The Audit observations in this report, Section 4.0, describe the remaining sub-clauses for which KPMG LLP did not perform any audit procedures and other applicable recommendations.

## Table of Compliance

Grant Agreement Clause Subject to Audit	Foundation Found to be Compliant	Relevant Subsection of Audit Report
4. Management of the Fund		
4.1 Prudent Person Principle	Yes	4.1
4.2 Investment Committee	Yes	Annex 1*
4.3 Investment of the Fund		
4.3.1	Yes	4.2, Annex 1*
4.3.2	Yes	Annex 1*
4.4 Statement of Investment Policy		
4.4.1	Yes	Annex 1*
4.4.2	Yes	Annex 1*
4.5 Investment Advisor & Portfolio Manager	Yes	Annex 1*
4.6 Conflict of Interest Concerning Investment Management		
4.6.1	Yes	Annex 1*
4.6.2	Yes	Annex 1*
4.7 Borrowing		
4.7.1	Yes	Annex 1*
4.7.2	Yes	Annex 1*
4.8 Quantitative Limits on Investment Holdings		
4.8.1	Yes	Annex 1*
4.8.2	Yes	Annex 1*
4.8.3	Yes	Annex 1*
4.8.4	Yes	Annex 1*
4.8.5	Yes	Annex 1*
4.9 Investment Holdings in Foreign Properties	Yes	Annex 1*
4.10 Prohibited Investments and Trading Activities	Yes	Annex 1*
4.11 Changes to the Fund	Yes	4.3

\*KPMG LLP's report dated August 30, 2007 can be found at Annex 1.

## 1.0 BACKGROUND

Parliament established the Asia Pacific Foundation of Canada (Foundation) in 1984. The purpose of the Foundation, as per the Act, is to build networks and develop closer ties between the peoples and institutions of Canada and the Asia Pacific region. Over the years, the Foundation has taken on many roles; it has developed teaching materials, provided “Asia 101” to businesses and managed a Media Fellowship program. The Foundation created and administered the GLOBE Series conferences for ten years and undertook the administration of the Canadian Education Centres Network (CECN), a network of education information centres in Asia, from 1994 to 2002. In 2002, GLOBE and CECN became independent of the Foundation. The Foundation currently operates the Canadian Secretariats for a number of Asia Pacific organizations, produces studies, reports and news releases on a range of Asia Pacific related topics, and hosts an annual Asia Pacific Summit.

On March 31, 2005, the Minister of Foreign Affairs agreed to make a conditional grant agreement (Agreement) to the Foundation in the amount of \$50 million dollars for the establishment of an Endowment Fund (Fund). This amount was paid to the Foundation in December 2005. The Fund is to be prudently invested and the principal is not to be drawn down. The returns shall be used to support the activities of the Foundation.

The conditional grant will enhance the capacity of the Foundation to achieve the following results:

- Canadian businesses, scholars and citizens have a good understanding of, and strong relations with people and institutions of the Asia Pacific Region; and
- Organizations, institutions and associations in private and public sectors in Canada and the Asia Pacific region collaborate, forming strong networks and relationships.

The Agreement states that the Minister of Foreign Affairs has the right to conduct an audit of the Foundation’s activities and financial records in year three of the Agreement to assess the Foundation’s compliance with the terms and conditions of the Agreement. The Agreement further states that the Minister of Foreign Affairs may undertake, at the expense of the Department, by auditor(s) of their choosing, an audit and/or financial risk analysis to ensure compliance with the Agreement, as well as its financial viability. Based on this clause and discussions with the Foundation, it was decided that a compliance audit of the management of the Fund (Section 4.0 of the Agreement) would be undertaken. For fiscal years ended March 31, 2006 and March 31, 2007, DFAIT’s Internal Audit Division (ZIV) undertook this compliance audit (Audit) and contracted an external auditor, KPMG LLP, to assist.

## **2.0 AUDIT OBJECTIVE**

The objective of the Audit was to ensure the recipient's compliance to the terms and conditions of section 4.0 of the Agreement, Management of the Fund. The Audit is to report on areas where deficiencies were noted and corrections are required, and to make appropriate recommendations to raise the capacity of operations to the appropriate level.

## **3.0 SCOPE & APPROACH**

The scope of the Audit covered the fiscal years 2005/2006 and 2006/2007. Since the \$50 million conditional grant was given to the recipient in December 2005, the Audit specifically covered the period from December 2005 to March 31, 2007

The Audit was conducted in accordance with generally accepted Canadian audit standards. The Audit activities included, but were not limited to:

- a review of relevant background documentation;
- interviews with key Foundation personnel;
- interview with the Foundation's investment advisor at Phillips, Hager & North Investment Management Ltd.;
- an examination of the Foundation's accounting records and other relevant supporting documentation;
- a review of the minutes of Board of Directors and Investment Committee meetings;
- a review of the Statement of Investment Policies and Procedures for the Endowment Fund and the Reserve Fund;
- a review of the Foundation's conflict of interest policies;
- a review of the Investment Account activities of the Foundation; and
- a review of the Foundation's March 31, 2006 and 2007 audited financial statements.

## **4.0 OBSERVATIONS**

We discuss below only those sections of Section 4.0, Management of the Fund, of the Agreement in which audit procedures were not performed by KPMG LLP. For the majority of the sub-clauses, the detailed procedures performed and the results of the procedures are discussed in more detail in KPMG LLP's report dated August 30, 2007 at Annex 1.

#### 4.1 Prudent Person Principle (Subsection 4.1)

Subsection 4.1 of the Agreement states that the Foundation shall invest and manage the Fund according to investment policies, standards and procedures that a prudent person would exercise in making investment decisions regarding property belonging to others. The Audit found the Foundation to be compliant with this requirement.

The Foundation retains a professional investment firm to manage their portfolio. Investment policies and strategies are in place listing the nature of investments to be held and defining prohibited investments. In addition, the audit noted that the whole amount of the Fund, \$50 million, was invested in pooled funds in order to reduce administrative costs and provide better diversification.

The table below shows the asset mix that was communicated to the Investment Manager (refer to Appendix D in Annex 1) by e-mail by the Foundation shortly after the Statement of Investment Policies and Procedures that were approved in December 2005, showing a different asset mix. The Statement of Investment Policies and Procedures were subsequently not modified to reflect these changes, however ZIV understands that the asset mix below, 50% equities and 50% fixed income, was used as the guideline for investment of the Fund during the period that was audited.

Asset Class	Minimum	Target	Maximum
Canadian equities	5%	45%	50%
Foreign equities	5%	5%	30%
<b>Total equities</b>	<b>10%</b>	<b>50%</b>	<b>60%</b>
Alternative investments	0%	0%	10%
Mortgages	0%	5%	10%
Bonds	20%	40%	100%
Cash & short-term	2%	5%	20%

A review of the Foundation's investment statements from December 1, 2005 to March 31, 2007 indicated that the market value of equities including Canadian, international and U.S., represents approximately 50% of the total portfolio. After extensive discussions with the Foundation's senior management and research done by ZIV regarding Endowment Funds granted to other organizations by the federal government, we have come to the conclusion that the Foundation has invested and managed the Fund according to investment policies, standards and procedures that a prudent person would exercise.

It was also noted that the maximum allowable investment percentage in bonds of 100% does not allow for a minimum investment of 12% in the other instruments (Canadian equities-5%, foreign equities-5%, cash and short-term-2%).

**Recommendation for the Foundation:**

It is recommended that the maximum investment in bonds should be less than or equal to 88% (100% - 12%).

**Foundation's Management Response:**

**The Foundation has made this change in its Statement of Investment Policies and Procedures.**

**4.2 Investment of the Fund (Subsection 4.3.1)**

Subsection 4.3.1 of the Agreement states that the Foundation shall ensure that the principal of the Fund be invested in accordance with the Prudent Person Principle and that investment decisions shall be made with the principal objective being the preservation of the principal amount over the long term. The Audit found the Foundation to be compliant with this requirement.

With respect to the preservation of the principal amount over the long term, the Audit identified that the \$50 million principal balance of the investment was drawn down by \$1,000 on November 22, 2006 and remained drawn by this amount until the end of the fiscal year, March 31, 2007. As discussed with the Foundation, a request was made to their bank to transfer \$208,098.72 representing the investment income earned above \$50 million to their operating account. However, \$1,000 more was transferred by error. This error was not noticed and continued throughout the remainder of the 2006/07 fiscal year.

With respect to the preservation of the market value of the investment holdings, the Audit identified that the market value fell below \$50 million to \$49,878,170 on May 31, 2006 and to \$49,221,130 on June 30, 2006.

Although it was found that the principal amount was drawn down by error during one instance and the market value fell below \$50M during two instances, we determined the Foundation to be compliant with this clause since their objective of preserving the principal amount of the Endowment Fund over the long term did not change.

According to the Resolution of the Executive Committee meeting (at which all committee members were in attendance) on March 22 and 23, 2007 held in Toronto, it was decided that funds in excess of \$51 million (market value) would be transferred from the Fund to the Reserve (i.e. Operating) Fund. In addition, it was noted that in order to maintain the goal of preserving the principal amount of the conditional grant, the Investment Committee would closely monitor the market value of the Fund and, if needed, would transfer funds from the Reserve Fund to the Fund to maintain a minimum market value of \$50 million.

**Recommendation for the Foundation:**

It is recommended that the Statement of Investment Policies and Procedures be revised to ensure the preservation of the principal amount of the Fund. This would include ensuring: a) that the original capital amount of the Fund (\$50 million) is not used, and b) that the investment strategy is such that the market value of the Fund is reasonably maintained, that is consistent with the Prudent Person Principle.

**Foundation's Management Response:**

**The Foundation agrees that a) is a reasonable definition of “principal” (preservation of original contributing capital). The Foundation also agrees that the spirit of clause 4.3.1 in the contribution agreement implies a need to also “reasonably maintain” the market value of the Fund over the long term. This does not mean an absolute prohibition on the market value of the fund falling below \$50m but rather the need to have an investment strategy, based on the Prudent Person Principle, which balances the operating needs of the Foundation and the protection of the real value of the endowment over the long term. The Board will consider at its next meeting an amendment to the Statement of Investment Policies and Procedures to clarify the meaning of “principal” along the lines described above.**

**4.3 Changes to the Fund (Subsection 4.11)**

Subsection 4.11 of the Agreement states that no material change in the objectives of the Fund, the use of the Fund, or the Fund's investment policy is to be undertaken without prior written approval of the Minister of Foreign Affairs. The Audit found the Foundation to be in compliance with this requirement. The Audit found no change in the objectives or use of the Fund during fiscal years 2005/06 and 2006/07, nor was there any material change identified in regard to the investment policy.