Legislative
Assembly
of Ontario

Assemblée
législative
de l'Ontario

STANDING COMMITTEE ON PUBLIC ACCOUNTS

UNSPENT GRANTS

(Chapter 2, 2009 Annual Report of the Auditor General of Ontario)

2nd Session, 39th Parliament
59 Elizabeth II

Library and Archives Canada Cataloguing in Publication Data

Ontario. Legislative Assembly. Standing Committee on Public Accounts
Unspent Grants (Chapter 2, 2009 Annual report of the Auditor General of Ontario) [electronic resource]

Issued also in French under title: Subventions non dépensées (Rapport annuel 2009 du vérificateur général de l'Ontario, chapitre 2)
Electronic monograph in PDF format.
Mode of access: World Wide Web.
Issued also in printed form.
ISBN 978-1-4435-4824-3

1. Grants-in-aid – Ontario. 2. Intergovernmental fiscal relations – Ontario. I. Title.

HJ200 O5 2010 328.713'07653 C2010-964046-2

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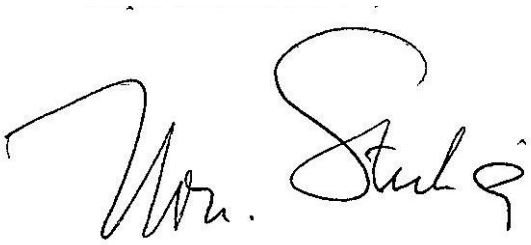
The Honourable Steve Peters, MPP
Speaker of the Legislative Assembly

Sir,

Your Standing Committee on Public Accounts has the honour to present its Report and commends it to the House.



Norman W. Sterling, MPP
Chair

Queen's Park
October 2010

STANDING COMMITTEE ON PUBLIC ACCOUNTS*

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2nd Session, 39th Parliament

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*Peter Tabuns served as an ongoing substitution.

STANDING COMMITTEE ON PUBLIC ACCOUNTS

LIST OF CHANGES TO COMMITTEE MEMBERSHIP

MARIA VAN BOMMEL was replaced by WAYNE ARTHURS on September 22, 2010.

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PREAMBLE

The Auditor General noted that the issue of multi-year grants and unspent grants has been discussed in the Auditor's annual reports since 2005. In his *2009 Annual Report*, the Auditor stated that over the years he has expressed the following two concerns with respect to government year-end spending practices:

- the government flowing hundreds of millions, and even billions, of dollars at year-end to fund activities of future periods while expensing such grants as current-year expenses; and
- the weakening of normal accountability controls over transfers that occurred with these year-end grants.

With respect to the second concern, the Auditor said that he was pleased to report in 2008 that after working with the Ministry of Finance, that the two were able to agree on a number of accountability and control provisions that could be included in these year-end transfers, addressing many of the Auditor's concerns in this area. These were key points raised in the *Unspent Grants* section, Chapter 2 of the Auditor's *2009 Annual Report*.

In April 2010 the Standing Committee on Public Accounts held public hearings on this section of Chapter 2. Senior officials from the Ministry of Finance and the Ministry of Energy and Infrastructure (now the Ministry of Energy and the Ministry of Infrastructure) participated in the hearings.[1] (For a transcript of the Committee proceedings please see Committee *Hansard*, April 28, 2010.) The Committee endorses the Auditor's findings. These are summarized in this Committee report which presents the Committee's findings, views, and recommendations. The Committee requests that the Ministry of Finance and the Ministry of Infrastructure provide the Committee Clerk with their written responses to the Committee's recommendations within 120 calendar days of the tabling of the report with the Speaker of the Legislative Assembly, unless otherwise specified in a recommendation.

Acknowledgments

The Standing Committee on Public Accounts extends its appreciation to officials from the Ministry of Finance and the Ministry of Energy and Infrastructure for their attendance at the hearings. The Committee also acknowledges the assistance provided during the hearings and report writing deliberations by the Office of the Auditor General, the Clerk of the Committee, and staff in the Legislative Research Service.

[1] Since the hearings, the Ministry of Energy and Infrastructure has been separated into two separate ministries, the Ministry of Energy and the Ministry of Infrastructure. Recommendations in this report will be directed to the Ministry of Infrastructure.

Background

The Auditor said that the government's expensing of year-end grants as current-year expenses is acceptable under Public Sector Accounting Board (PSAB) standards, but added that this type of accounting could convey the message that monies had been spent providing programs and services during that fiscal year, while in reality, few or no services had been provided and few or no benefits had been received by the public.[2] He also said that until quite recently the government often eliminated or significantly reduced the conditions under which such grants were provided to recipients as the government wanted to meet accounting criteria allowing for immediate expense recognition. The "Enhancing Accountability for Grants" section below describes how many of the Auditor's concerns in this area were addressed after working with the Ministry of Finance.

ISSUES RAISED IN THE AUDIT AND BEFORE THE COMMITTEE

Significant issues were raised in the audit and before the Committee. The Committee attaches particular importance to those issues discussed below.

Auditor and Ministry Agree on Accountability and Control Provisions for Year-end Grants

Year-end Grant is a Policy Distinction Not an Accounting Distinction

The Ministry of Finance said that grants are one-time transfers made at the discretion of governments; they can be made at any time of the year. If grants are issued toward the end of the year, they are often referred to as year-end transfers. The Ministry of Finance said, however, that whether a grant is made in the first quarter or the last quarter of the fiscal year, the accounting remains the same. It added that while there may be a policy distinction regarding these year-end transfers, there is no accounting distinction.

Enhancing Accountability for Grants

The Ministry of Finance said that following its period of extensive consultation with the Auditor in 2007, the province put in place a number of revised requirements for one-time transfers to enhance accountabilities for these expenditures. These requirements include:

- specification of the purposes for which funds are to be used and the nature of the eligible expenditures;
- periodic reporting on the use of the transfer funds, the service deliverables and the outcomes achieved;
- the right to an independent verification and audit of the information submitted by the grant recipient; and

[2] See "Private versus Public Sector Accounting" section for further details.

- the right to recover the funds if they are not used, or will not be used, for the intended purposes.

The Ministry of Finance said, in addition, that cost effectiveness must be considered as well as the achievement of an appropriate public policy objective.

The Ministry said that during their 2007 discussions both the Ministry and the Auditor wanted to ensure that accounting rules help achieve government policy objectives and value for money for taxpayers. Both agreed on how to interpret accounting rules (including whether cash had to be distributed before year end or whether it could be accrued forward and transferred to recipients later) and what provisions could be attached to grants that would not conflict with PSAB accounting rules. Prior to this, there had been no specific definition of grant purposes such as how the grant would be used, what types of expenditures were eligible, and output expectations for service delivery. Only the general intent of the purpose of the grant had been expressed.

Reporting Requirements

The Committee wished to know how the Ministry of Finance audits grant recipients to ensure that they adhere to the Ministry's conditions under which the grant was provided. To address this, the Ministry indicated that report-back requirements have also been added for grant recipients. A recipient must report back on a periodic basis in accordance with the recipient's contribution agreement, specifying progress against intent. Reporting is more frequent for some programs. Under the transfer payment accountability directive, the government must monitor and track those reports and is obliged to take appropriate action if reports are not received. Options exist under contracts for Ministry staff to audit the recipient. If the Ministry determines that the money has not been spent, or has not been spent for the intended purpose, the money can be recovered.

The Ministry of Energy and Infrastructure said, speaking about 2007/08 year-end investments, that no grant recipient is in default in terms of reporting and that to the best of its knowledge it has not had to recover any funds. It added that if it were to ask for money back that it would first need to obtain Treasury Board approval.[3]

Unspent Grants 2009

The Auditor noted that the government indicated in its 2009 Budget that it planned to make significant investments over the next two years to stimulate the provincial economy. This included some $32.5 billion to be spent on infrastructure projects by March 31, 2011. He said the potential for some of the stimulus spending funds not to be spent cost-effectively is undoubtedly a program

[3] See "Reporting Requirements" and "Different Programs Have Different Reporting Rules" in the "Stimulus Spending" section for details on how reporting was modified for the allocation of stimulus funds and how it can be difficult to track spending for other programs.

risk. The Auditor also cited concerns from economists and academics that many projects would be slow to start and that actual investments may not be made for several years.

He provided examples relating to the spending of infrastructure money provided to municipalities under the *Investing in Ontario Act, 2008* (Act). His review of funding to 25 of the 445 municipalities (over 70% of funds transferred under the Act) indicated that at the time of his review only 6.2% of the total amounts transferred had been spent by March 31, 2009.[4] The Auditor noted that although $1.1 billion was expensed in the 2007/08 fiscal year, only a fraction of the related infrastructure investments had actually been made.

Stimulus Spending

Infrastructure Investments

The Ministry of Finance said that in recent years, the province invested significantly to build and upgrade infrastructure in communities across Ontario, including expenditures on roads and bridges, public transit, social housing, hospitals and schools. A record level of stimulus occurred in the 2009/10 fiscal year. According to the Ministry stimulus will be even greater in 2010/11.

The Ministry of Energy and Infrastructure said that over 5,400 projects have been approved and are expected to be completed by March 2011. More than 3,100 of these projects are either underway or complete (about 840 are complete). The Ministry of Finance said that consistent with PSAB standards, Ontario's infrastructure investments (to recipients outside of the province's consolidated financial reporting entity) are recorded as expenses in accordance with criteria established under generally accepted accounting principles (GAAP) and PSAB standards.

Infrastructure Funding Actually Spent on Projects

The Committee wished to know how much of the infrastructure funding that has been distributed to recipients has actually been spent. The Ministry of Energy and Infrastructure said that there is a portion of the project money issued in 2009/10 that had yet to be spent. For example, the Ministry gave the City of Hamilton $100 million for its Woodward Avenue sewage treatment plant but that money had not yet been spent. The Ministry also cited an earlier example of $200 million given to universities as a year-end investment in 2007/08. It said that 76% of this money has been spent, but also noted that an additional $200 million had been given to the universities six months prior and that 96% of those funds had been spent. It noted, however, that reporting rules are different for different programs and that under some programs it is difficult to track, in a timely fashion, money spent (see "Reporting Requirements" section below for details).

[4] See "Expenditures and 2007/08 Fiscal Year-end Transfers" section for further information on the *Investing in Ontario Act, 2008.*

Accountability

The Auditor said that public accountability for major year-end transfers and stimulus funding spending would be enhanced if the government publicly reported on the status of the money provided. He said that this reporting could also be presented in the province's annual report to indicate the extent to which funds transferred have actually been spent on infrastructure investments.

The Ministry of Finance said that it continues to work closely with colleagues at the federal Treasury Board and other agencies to ensure that accountability provisions are consistent across government, simple, and reasonable to administer for grant recipients, but that they provide the critical and appropriate support and respect for taxpayer dollars. Accountability mechanisms include public disclosure of program guidelines, periodic reporting by recipients, the right to independent verification, and website postings that allow people to track the progress of individual projects (see "Website" section below for more details).

The Ministry of Energy and Infrastructure said that under the government's former cash based accounting system and before the strengthening of accountability provisions, the Ministry may not have been able to track exactly how money was spent.[5] The Ministry added that this does not mean that money was not spent properly; it just means that the Ministry does not have a record of how it was spent. Now, through periodic reporting by recipients, it can track this and said that former risks have largely been "managed away" (see "Reporting Requirements" section below for more information).

It added that the Ontario government decided to run an open, competitive intake process for all the municipal and non-profit portions of the stimulus programs to promote transparency and accountability in the application process. It said that no other province did this. Other provinces, for example, in some cases referred back to previous competitions for infrastructure programs to select project candidates.

The Ministry of Energy and Infrastructure noted that Ontario negotiated an overarching agreement with the federal government that includes extensive accountability provisions. Ontario took these provisions from the overarching agreement and included them in contribution agreements that exist between the Ontario government and its funding recipients. The Ministry said that while Ontario has a centralized capital planning process, rather than keep delivery of the stimulus program centralized, it divested responsibility to the line ministries closest to the sectors involved, reasoning that these ministries would best be able to monitor project progress.

Management Committees

The Ministry of Energy and Infrastructure explained that management committees exist for all stimulus project programs. These committees comprise representatives from the Ministry of Energy and Infrastructure, the line ministries delivering the program, and the federal government. These committees manage

[5] See "Public Sector Accounting Board Standards" section for more information.

the programs; they do not produce public reports of their decisions. The Ministry of Energy and Infrastructure plays an oversight role in ensuring that the programs are dealt with in an even-handed and consistent manner. It has been audited by an internal audit and is currently being audited by the Auditor General.

Reporting Requirements

The Ministry of Energy and Infrastructure noted strict reporting requirements for various stimulus programs. Municipalities and others are responsible for reporting. In some cases line ministries have had to chase municipalities for the required reports but given the thousands of projects underway, the Ministry of Energy and Infrastructure said this is normal. It added that the Ministry of Agriculture, Food and Rural Affairs (OMAFRA) delivers many of programs on its behalf; OMAFRA has program analysts who are able to follow up if individual project recipients do not submit reports. Likewise, the Ministry of Municipal Affairs and Housing looks after social housing programs and is able to follow up with municipal service managers on any reporting issues.

Different Programs Have Different Reporting Rules

The Ministry of Energy and Infrastructure also discussed other programs with different reporting frameworks (than the framework for reporting for stimulus funds) that make it harder to track, in a timely fashion, money spent. One example is the $450-million municipal infrastructure initiative. This program requires that municipalities report progress on infrastructure projects at the end of each fiscal year but does not require the municipalities to report spending within specific time frames. There is no reporting on project spending until the funds are fully (100%) spent.

A second example is the $400-million program for spending on municipal roads and bridges. This is another program which requires no reporting until the project funds are fully spent. The Ministry of Energy and Infrastructure said that 442 municipalities received money under the program. The Ministry has received reports from 78 of these municipalities, all of which have reported that they have fully spent their allocated funds. The Ministry described these two examples as its most difficult cases.

It noted others with annual obligations for reporting on spending. It cited the $100-million social housing program as an example. The Ministry receives annual reports with expenditure information for this program. Approximately 93% of the program funding was spent by the time of the hearing.

Website

As noted earlier, the Ministry of Energy and Infrastructure developed a website with information on stimulus spending, including an interactive map with specific project information. The Ministry said that regardless of who is responsible for a project – a line ministry, a municipality, or a university – the website enables stakeholders, staff, community members, Deputy Ministers of Finance, etc. to scrutinize those projects. If, for example, a grant recipient says that a project is

50% complete yet people can see on the website that there appears to be nothing "coming out of the ground," this will prompt questions. The Ministry of Energy and Infrastructure said this has an impact on people's incentive to report and to report correctly.

Committee Recommendations

The Standing Committee on Public Accounts believes that the Ministry of Energy and Infrastructure website (now the Ministry of Infrastructure website) which enables users to track the progress of specific infrastructure projects funded by stimulus spending is a positive step forward in enhancing accountability. The Committee recommends that:

1. **The Ministry of Infrastructure shall report back to the Standing Committee on Public Accounts on any measures under consideration to expand reporting on its website for tracking infrastructure stimulus program spending and project progress, such as reporting on who received contracts for the projects and the number of jobs created.**

2. **The Ministry of Infrastructure should develop a website for any major capital grant programs exceeding $25 million over the last two years as well as on a go forward basis. The website should be similar to the Ministry of Infrastructure website which tracks the progress of projects funded by recent stimulus spending. The Ministry of Infrastructure shall report back to the Committee on whether it intends to develop such a website, and if so, when the website can be made public.**

No Clawing Back of Funds

The Ministry of Energy and Infrastructure said that the deadline for stimulus program project completion is March 31, 2011. The Ministry pays out money to municipalities based on project progress. It said that municipalities do not simply receive a lump sum for a stimulus project that can be deposited in a bank to earn interest. It added that an interesting point of negotiation with the federal government was whether money would be clawed back if a recipient failed to complete a project by the March 2011 deadline.

Federal and provincial grants end on March 31, 2011. If a municipality had completed 90% of a project by this date, the municipality would be responsible for funding the additional 10% of the project. In other words, while money will not be clawed back, funds will not be distributed once the March 31, 2011 deadline has passed. The Ministry of Energy and Infrastructure believes this will act as an incentive for timely project completion.

The Ministry of Energy and Infrastructure added that it would know, through reporting, far in advance of the deadline date if a particular project was not likely to be completed by the March 31, 2011 deadline. It said that it will need to hold

discussions with the Treasury Board on what remedial action the government would take for such a case.

Committee Recommendation

The Standing Committee on Public Accounts recommends that:

3. **By December 31, 2010, the Ministry of Infrastructure shall report back to the Standing Committee on Public Accounts on how much of the $32.5 billion in stimulus spending for infrastructure projects is at risk of not being spent by the March 31, 2011 deadline and how many projects would be affected if federal and provincial funding lapses at the deadline.**

Expenditures and 2007/08 Fiscal Year-end Transfers

Year-End Grants: Investing in Ontario Act, 2008

In his *2008 Annual Report*, the Auditor expressed concerns about the *Investing in Ontario Act, 2008*. He said that through the Act, the government granted itself the power to determine how certain transactions would be accounted for in the province's consolidated financial statements. The Auditor's objection was that generally accepted accounting standards, not government legislation, should determine this. He said that his Office does not support the use of legislative provisions to override those standards.

The Ministry of Finance noted that the *Investing in Ontario Act, 2008* stemmed from the Provincial-Municipal Fiscal and Service Delivery Review and recognition that municipalities need to increase their investment in municipal infrastructure in partnership with other levels of government. The Act was introduced in the March 2008 provincial budget. A total of $1.1 billion was allocated to municipalities (in proportion to their populations) through the Act. The Auditor noted that money transferred to municipalities under the Act was recorded as an expense in the 2007/08 fiscal year but was actually transferred after the tabling of the 2007/08 Public Accounts in late August. The Auditor acknowledged that under public sector accounting standards, since a liability had been established as of March 31, 2008 and had appropriation approval, recording the amounts in fiscal 2007/08 was allowed for.

The Ministry of Finance said that as of March 31, 2010, half of the money had already been spent on municipal capital priorities such as roads and bridges, social housing and firefighting equipment. It noted that recipients may also use funds from the Act to support the municipal contributions required to receive stimulus funding for infrastructure development. The Act allows the government to take a share of unanticipated year-end surpluses and allocate them to provincial priority needs.[6]

[6] In 2008, that priority need was identified as municipal use and investment in infrastructure.

Private versus Public Sector Accounting

Public Sector Accounting Board (PSAB) Standards

The Ministry of Finance explained that in the mid-1990s Ontario, in conjunction with other provinces, switched from a modified cash basis of accounting to accrual accounting consistent with recommendations of the Public Sector Accounting and Auditing Board (now the Public Sector Accounting Board). The result is a series of financial and accounting rules that are consistent with GAAP but recognize the unique role of governments. The Ministry said that there are differences between the way in which governments and the private sector account for their finances, much of which is driven by the different standard-setting bodies. Organizations responsible for overall governance recognize this and have instituted mechanisms that reflect the differences.

The Ministry of Finance added that the rules established by PSAB are intended to prevent the government from making financial commitments that extend over years with no accountability. Otherwise, this would result in a situation of political announcements, policy announcements or a guaranteed flow of funds that was not accounted for in the books, or was accounted for in a misleading way. The Ministry of Finance said that it is important to ensure from a public policy controllership perspective that there is a match between the commitment of funds and the reporting of funds.

The Committee, noting that the rules are better now than they were a few years ago, wished to know whether it would be possible to change the rules to provide an incentive for good management behaviour, in addition to good accounting. The Ministry of Finance noted the importance of tightening management practices associated with procurement. It also noted that the annual budget cycle provides a high level of accountability and discipline for many programs. However, the Ministry said that accountability for multi-year programs with peaks and valleys does pose more of a challenge and that it is important to hold ongoing conversations on how to manage public finance and multi-year budgeting. There are always instances in which accounting or rules impose distortions on behaviour – particularly delays. The Ministry said that it must be vigilant in operating within the rules and intent of PSAB and GAPP.

The Ministry emphasized that accounting is an evolving, not a static process. The Deputy Minister of Finance said that he and the Controller, along with other deputies and controllers from governments across Canada, have an ongoing dialogue with the Canadian Institute of Chartered Accountants and PSAB representatives.

Treatment of Expenses

The Ministry of Finance said that the basic underlying rules for expensing are similar in private and public sector accounting. When the decision-making body has determined that an expenditure is made (or when the expenditure is inevitable, or the cost, incurred), the appropriate accrual is recorded. Once the expenditure decision is taken, the Deputy Minister of Finance and the Controller must ensure

that the expenditure is appropriately expensed during the time period in which it is made. The transaction is recorded on the government's books. There is often a lag between the times the grant is provided, the cash flows to the recipient, and the recipient uses the funds for the intended purpose. Time may be required, for example, to ensure that financing is lined up, project plans and approvals are completed, and construction is appropriately tendered and contracted. If the grant money is not used for the intended purposes, the government may retract it from the recipient.

Exchange Transactions

The Controller noted that exchange transactions occur in the private sector. Under an exchange transaction funds are provided for a service delivered or a good, procured. Recognition occurs when the exchange transaction is finalized. In the public sector grants are provided without getting anything in exchange; therefore, no exchange transaction occurs. These transactions are one-sided with the government providing grants to an agency or municipality. Because there is no exchange occurring, specific rules dictate when to recognize the transaction which, as noted above, is the time that the government decision is taken and the government is irrevocably committed to provide the grant.

"Use It or Lose It"

The Ministry of Finance said that under the prior system of cash based accounting resources often remained at year end prompting expenditures, such as perhaps buying furniture, to reduce the cash balance. Governments have been working over the past 15 years to end the "use it or lose it" philosophy, which the Ministry said has often provided the incentive for such behaviour. The Ministry of Finance believes that the adoption of PSAB and accrual accounting has greatly helped and has introduced a more stringent set of accountability measures at the federal and provincial levels and hopes "at the municipal level that would greatly reduce that temptation."

Treatment of Significant Expenditures

The Ministry of Finance believes that there is more complexity in the public sector in that the government provides funds to an agency/municipality which in turn invests with the intent of service delivery to the public over many years in the future. The Committee noted that while the government will write a large cheque before a service is provided, few businesses would operate on this principle. The Ministry of Finance drew attention to two different circumstances. In the first, for transfer recipients such as hospitals, school boards, and colleges, the net effect of the grants has no impact as these entities are included in the consolidated financial statements. In the second, when funds are given to different levels of governments like municipalities or universities which are not consolidated because they have their own governance and accountability structures, grants are expensed in the year they are given. The Ministry of Finance said that Ontario's public sector practice is consistent with that of the federal government and many other jurisdictions.

Budgeting Process versus Accounting Process

The Ministry of Finance said, as noted above, that in the accounting process a transaction is recorded when the significant economic impact of the transaction is felt by the government; that is, it is recorded during the appropriate fiscal year in which the decision was taken and the government is committed to providing the funds. The cash flow and economic impact of this decision could be felt for many years to come. The Ministry said that it could "footnote the daylights out of public accounts" to track the long term impacts but believes that these are best captured in the budgeting process. Successive governments have used the budget and the budgeting process to discuss out-year economic implications of the expenditures contained in a specific fiscal year. Governments across Canada invest with the expectation that there will be sustained economic benefits associated with current year expenses.

Committee Recommendation

4. **The Standing Committee on Public Accounts acknowledges that current accounting rules allow transfer payment grants that are pre-flowed before the funds are actually required and can be spent by the recipient to be recorded as expenses. However, the Committee requests that the Ministry of Finance report back on whether it supports the principle of pre-flowing grants and recording them as a cost of providing services in the current fiscal year when, in fact, the funds will be spent providing services or constructing assets in future years.**

CONSOLIDATED LIST OF RECOMMENDATIONS

The Standing Committee on Public Accounts requests that the Ministry of Finance and the Ministry of Infrastructure provide the Committee Clerk with written responses to the Committee's recommendations within 120 calendar days of the tabling of the report with the Speaker of the Legislative Assembly, unless otherwise specified in a recommendation.

The Standing Committee on Public Accounts recommends that:

1. The Ministry of Infrastructure shall report back to the Standing Committee on Public Accounts on any measures under consideration to expand reporting on its website for tracking infrastructure stimulus program spending and project progress, such as reporting on who received contracts for the projects and the number of jobs created.

2. The Ministry of Infrastructure should develop a website for any major capital grant programs exceeding $25 million over the last two years as well as on a go forward basis. The website should be similar to the Ministry of Infrastructure website which tracks the progress of projects funded by recent stimulus spending. The Ministry of Infrastructure shall report back to the Committee on whether it intends to develop such a website, and if so, when the website can be made public.

3. By December 31, 2010, the Ministry of Infrastructure shall report back to the Standing Committee on Public Accounts on how much of the $32.5 billion in stimulus spending for infrastructure projects is at risk of not being spent by the March 31, 2011 deadline and how many projects would be affected if federal and provincial funding lapses at the deadline.

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