



Western Economic
Diversification Canada

Diversification de l'économie
de l'Ouest Canada

Audit of Financial Reporting Controls

WESTERN ECONOMIC DIVERSIFICATION CANADA

Audit & Evaluation Branch

February 2012

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1.0 Executive Summary

- 1.1 The Audit of Financial Reporting Controls was identified in the department's approved 2011-12 Risk Based Audit Plan. This audit is a follow up to management's financial readiness assessment completed by an external consultant. The purpose of the audit was to provide assurance that the department has designed and maintained a system of internal control over financial reporting that is adequate and effective.

Findings

- 1.2 Management has designed and maintained effective key controls to ensure integrity and objectivity in periodic financial reporting in accordance with Treasury Board directives. The controls have operated effectively to ensure the periodic financial reports produced satisfy the format and contents required by Treasury Board. Management has exercised its responsibility appropriately to provide adequate and reliable financial information in all material respects in accordance with *Treasury Board Accounting Standards*.
- 1.3 Opportunities for improvement identified pose low risk and the audit recommends that the department develop concise capital asset procedures to provide greater clarity on required conditions of assets capitalization.

No material issues were identified in this audit that would impair the integrity and objectivity in the financial reports produced in the audit period.

2.0 Statement of Assurance

- 2.1 In my professional judgment as Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusion provided and contained in this report on the effectiveness of controls for financial reporting.
- 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

- 3.1 Treasury Board Accounting Standards and related policies and directives assign certain responsibility requirements internally to the Deputy Minister, the Chief Financial Officer and the Departmental Audit Committee. Effective April 2011, the Deputy Minister and Chief Financial Officer are required to attest to the integrity and objectivity of periodic financial reporting that includes a complete set of annual financial statements and a quarterly financial report for each of the first three quarters of each fiscal year.
- 3.2 The department falls within the category of departments that do not need to have their annual financial statements audited by an external auditor. However, the Deputy Minister has to ensure that measures are taken so that the department can sustain a control-based audit of its annual financial statements in whole and in part.

Audit Objective

- 3.3 The audit was to provide assurance that the department has designed and maintained a system of internal control over financial reporting that is adequate and effective.

Key Risks

- 3.4 This audit focused on testing the financial reporting controls that management has developed to mitigate the following key risks:
- That the contents and disclosures are insufficient or not meeting Treasury Board standards;
 - That unaddressed financial reporting control weaknesses exist;
 - That financial statements and associated management information is inaccurate or misleading; and
 - That required financial reports are not published in a timely manner.

Audit Scope

- 3.5 This audit followed-up and built upon the financial statement readiness assessment consulting work done by a consultant for the Chief Financial Officer. We performed additional work to obtain assurance on the maintenance of effective controls for financial reporting during the period of January to December 2011.
- 3.6 In April 2011, the department implemented a framework for monitoring internal controls over financial reporting. This audit did not test the framework due to its early stages of implementation.

Acknowledgements

- 3.7 We thank management and staff involved with financial reporting for their timely cooperation and assistance provided to the audit team throughout the engagement.

4.0 Observations and Recommendations

4.1 Management responsibility and controls

Criteria: It was expected that management has put in place measures of internal controls over financial reporting; and that internal controls were working effectively to ensure the integrity of periodic financial reporting.

- 4.1.1 To fulfill its accounting and reporting responsibilities, management has adopted the financial system called GX Financials, a shared software package used by about a dozen small departments in the federal government.
- 4.1.2 Management maintained an effective system of internal control that was designed to provide reasonable assurance that periodic financial reporting met the requirements of *Treasury Board Accounting Standards 1.2 and 1.3*. This was achieved mainly through documented processes, guidelines, and the training and development of staff. Transactions were properly authorized and recorded in accordance with the *Financial Administration Act* and other applicable legislation and policies.
- 4.1.3 The internal controls have been designed to mitigate the key risks in financial reporting to a reasonable level. The department has designed appropriate segregation of duties, oversight, reviews, proper delegation of authorities, adequate safeguarding of assets and reliable financial reporting of departmental programs.
- 4.1.4 We have conducted a number of prior internal audits to examine the effectiveness and adequacy of the department's system of controls that impact the integrity of financial reporting. Results of those related audits were assessed and considered for the purposes of this audit.

4.2 Accounting policies, format and contents

Criteria: It was expected that the Chief Financial Officer has provided the Deputy Minister periodic departmental financial reporting information that met the form and content requirements of the Treasury Board.

- 4.2.1 For the period under audit, the system of internal controls enabled the Chief Financial Officer to prepare periodic financial reports using accounting principles and standards required by *Treasury Board Accounting Standards 1.2 and 1.3*. Corporate Finance maintains an ongoing dialogue with Treasury Board Secretariat officials to ensure the financial reports meet expected requirements.
- 4.2.2 The department produced the 2010-11 financial statements for the year ended March 31, 2011 and the quarterly financial reports starting in 2011-12. The statement and reports contained the financial position, financial results, risks and the significant changes with relevant information on departmental operations which met the format and content

required by Treasury Board. Where necessary, management has followed Treasury Board guidelines to provide best estimates.

- 4.2.3 In one case tested, we examined an accounting estimate for the amount collectible from an outstanding account. In our professional judgement, the allowance for doubtful account was understated which resulted in an overstatement of receivables based upon the information that was available at the time of establishing the accounting estimate.
- 4.2.4 At March 31, 2011, capital assets were reported at a cost of \$4.7 million, accumulated amortization at \$2.3 million and net book value of \$2.4 million. Compared to the total balance sheet assets of \$271 million, this amount is relatively small in dollar terms. The nature of departmental business required very few operational items that met the asset capitalization criteria threshold of \$10,000 or more.
- 4.2.5 *Treasury Board Accounting Standard 3.1* directs that departments establish procedures that should be reviewed regularly to reflect required conditions for asset capitalization. There were no departmental capital asset guidelines in place. We found that some offices capitalized certain equipment while others did not even though the nature of asset was similar. For example, three video conference equipment units totalling over \$17,000 were expensed even though each individual asset was considerably less than \$10,000; software licenses under \$400 were capitalized because they totaled \$22,641; and leasehold improvements of \$9,899 were capitalized despite being below the \$10,000 threshold. Lack of the procedures advocated by *Treasury Board Accounting Standards 3.1 and 3.1.1* could lead to inconsistencies in the treatment of identical assets.
- 4.2.6 The development of concise departmental capital asset procedures would help improve consistency in the accounting for capital assets. Periodic valuation, amortization of fixed assets, disposals, write-offs, and leases would be treated in a consistent manner appropriate to the nature of the capital asset and its use by the department.
- 4.2.7 We also noted that amortization rates adopted by the department were at the high end of the range provided by Treasury Board based on the nature of one particular asset. For example, video-conferencing equipment is being amortized over ten years, even though similar older equipment has been replaced in the past before they reached 5 years of age.
- 4.2.8 The cumulative total of all the above noted situations was not material enough to cause significant misstatement of the financial reports produced in the audit period.

Recommendation #1: The department should develop concise asset procedures in order to provide greater clarity and consistency to asset capitalization and amortization practices.

4.3 Attestation and Communication

Criteria: It was expected that a complete set of periodic financial reports were signed by the Deputy Minister and Chief Financial Officer after reviews and comments from Departmental Audit Committee; that the publication of reports was timely; and that the key elements of responsibility for the attestation were clear and understood.

- 4.3.1 During the audit period, the department produced a set of annual financial statements and several quarterly financial reports. All reports produced in the audit period were certified by the Deputy Minister and Chief Financial Officer and submitted as required by *Treasury Board Accounting Standards 1.2 and 1.3*. Executive Committee and Departmental Audit Committee presentations indicate that the reports were discussed and reviewed.
- 4.3.2 In coordinating financial information for departmental financial reporting, Corporate Finance developed an attestation template clarifying key elements in the financial reports that regions and branches were to submit to headquarters for financial reporting. There was an attestation checklist for Assistant Deputy Ministers and Financial Managers that explained what the officers were attesting to. Periodic budget forecast reports and financial statements were certified as reviewed against year to date expenditures and related financial information by appropriate responsible managers including all of the Assistant Deputy Ministers.
- 4.3.3 There was evidence that document reviews and reconciliations of documentation to support the integrity of financial reports were performed in all significant financial accounting reporting areas by the appropriate delegated authorities and officers. Adequate segregation of duties, organizational structures and assigned responsibilities were in place. Results of the audit confirmed key financial, operational and oversight controls were working; and accountability frameworks existed to safeguard the assets.
- 4.3.4 Certain attractive items that were below the \$10,000 threshold were held in large quantities therefore representing significant expenditures overall. Not all of the regions had complete, reliable, and integrated information on asset management items for under \$10,000, or were able to provide documentary evidence that periodic physical counts and tagging was reconciled to the financial accounting records. To enhance the existing internal controls over the safeguarding of assets, it would be prudent to perform such reconciliations for items that are at a higher risk of loss.
- 4.3.5 The documented internal control system requires that at year end the Chief Financial Officer present departmental financial statements and notes for significant management estimates and judgments to the Departmental Audit Committee for review and discussion prior to recommendation to the Deputy Minister for approval and submission to the Treasury Board. Corporate Finance had to distribute the draft financial statements to the Departmental Audit Committee members electronically as the deadline for submission of

the statements to the Treasury Board Secretariat fell in between the dates for the committee’s quarterly face to face meetings. For the same reason, the committee was only able to review the quarterly financial reports after the Deputy Minister had already approved them.

Recommendation #2: The department should develop an appropriate asset management system to manage and reconcile attractive items below the \$10,000 capitalization threshold.

5.0 Conclusion

5.1 The financial reporting controls in place were sound and working as intended. The exceptions noted were immaterial in total and possessed minimal residual risk. Opportunities for improvement are provided in this report.

5.2 Summary Conclusions by Criteria and Audit Element

Audit Element Area	Audit Assessed Result
Management responsibility and controls	Criteria Met
Accounting policies, format and contents	Criteria Mostly Met
Attestation and Communication	Criteria Mostly Met

6.0 Audit Strategies and Approach

Planning

- 6.1 Audit planning started in October 2011 and fieldwork was completed in January 2012. Departmental employees were engaged as necessary throughout the audit process to facilitate identification of key risks, audit criteria, control elements and audit strategies. The audit also looked to identify opportunities to assist the department's implementation of the *Treasury Board Accounting Standards 1.2 and 1.3* and related directives.

Standards and Methodology

- 6.2 Government of Canada internal auditing standards were used for the audit. It was evidence-based and provides audit assurance that is fully supported. The audit examined evidence against criteria that were established based on the *Treasury Board Accounting Standards 1.2 and 1.3* and other federal government sources including: departmental performance report, Receiver General Manual, management discussions, *Financial Administration Act*, and *Audit Criteria related to the Management Accountability Framework: A Tool for Internal Auditors*. The basis for the audit examination and expectations was communicated and agreed to by management in the terms of reference. The sources of evidence gathered and used included: risk analysis, interviews, regional visits, verification, confirmations as necessary, audit analysis, analytical reviews, and cause and effect assessment.

Sampling

- 6.3 Based on the 275 controls documented during the financial statement audit readiness assessment project, internal audit judgementally selected 50 key controls relating to financial reporting and tested them for effectiveness. Internal Audit examined 8 completed recommendations from the financial statement readiness assessment project that have direct and significant impact on financial reporting. Internal Audit then performed additional tests necessary to satisfy that requirements of *Treasury Board Accounting Standards 1.2 and 1.3* for the annual financial statements and quarterly financial reporting for March 2011, June 2011 and September 2011 were met.

Audit Team

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