2010–11 Annex to the Statement of Management Responsibility, Including Internal Control over Financial Reporting

Office of the Auditor General of Canada

Note to the reader

The new Treasury Board Policy on Internal Control, effective 1 April 2009, requires that organizations demonstrate the measures they are taking to maintain an effective system of internal control over financial reporting (ICFR).

As part of this policy, organizations are expected to conduct annual assessments of their system of ICFR, establish action plans to address any necessary adjustments, and attach a summary of their assessment results and action plan to their Statement of Management Responsibility.

Effective systems of ICFR aim to produce reliable financial statements and to provide assurances that

- transactions are appropriately authorized;
- financial records are properly maintained;
- assets are safeguarded from risks such as waste, abuse, loss, fraud, and mismanagement;
- applicable laws, regulations, and policies are complied with.

It is important to note that the system of ICFR is not designed to eliminate risks, rather to mitigate risks to a reasonable level, with controls that are balanced with and proportionate to the risks they aim to mitigate.

The maintenance of an effective system of ICFR is an ongoing process designed to identify and prioritize risks and the controls to mitigate these risks, as well as to monitor its performance in support of continuous improvement. As a result, the scope, pace, and status of departmental assessments of the effectiveness of their systems of ICFR will vary from one organization to the other based on risks. They will also take into account their unique circumstances.

Table of Contents

2010–11 Annex to the Statement of Management Responsibility, Including Internal Control over Financial Reporting

1 Introduction

This document is attached to the Office of the Auditor General's (OAG's) Statement of Management Responsibility, Including Internal Control over Financial Reporting, for the fiscal year 2010–11. As required by the new Treasury Board Policy on Internal Control, effective 1 April 2009, this document provides summary information on the measures taken by the OAG to maintain an effective system of internal control over financial reporting (ICFR). In particular, it provides summary information on the assessment conducted by the OAG as at 31 March 2011, including progress, results, and related action plans along with some financial highlights pertinent to understanding the control environment unique to the OAG.

1.1 Authority, mandate, and program activities

Detailed information on the OAG's authority, mandate, and program activities can be found in the Departmental Performance Report and Report on Plans and Priorities.

1.2 Financial highlights

The OAG's annual audited financial statements for the fiscal year ended 31 March 2011 can be found within the Departmental Performance Report. Financial information can also be found in the Public Accounts of Canada.

- The OAG is financially dependent on Parliament for its funding. The appropriations provided by Parliament represent approximately 87 percent of total costs, or $88.3 million. An additional 14 percent of total costs, or $14.2 million, are services that are provided without charge by Public Works Government Services Canada (PWGSC).

- Salaries and employee benefits, excluding employee insurance plan costs, account for the majority (71 percent or $72.3 million out of $101.7 million) of the OAG's total expenses. The costs of accommodations ($8.9 million) and employee insurance plans ($5.3 million) make up the $14.2 million that are provided without charge by PWGSC. The remaining expenses (15 percent or $15.2 million) are for professional services, travel, communication, and other equipment and supplies.

- Tangible capital assets comprise 91 percent, or $2.9 million, of the OAG's total non-financial assets of $3.2 million. Financial assets are composed mostly of an amount due from the Consolidated Revenue Fund of $7.9 million.

- Post-employment benefits account for the majority (57 percent or $14.2 million) of total liabilities. Accounts payable and accrued liabilities comprise the remaining 43 percent ($10.4 million) of total liabilities. The accrued liabilities include accruals for salary, overtime, and vacation pay.

- The OAG's head office in Ottawa is responsible for centrally administering the salary and other related benefit payouts for all employees, including staff in the four regional offices. The Comptroller's Group is also centralized in Ottawa. While staff in regional offices may initiate

and approve expenses in accordance with a delegated signing authority, the process for the recording of operating expenses is in Ottawa.

- The OAG has information systems that are critical to its operations and financial reporting, such as our financial system, GX Financials.

1.3 Service arrangements relevant to financial statements

The OAG relies on other organizations for the processing of certain transactions that are recorded in its financial statements:

- PWGSC centrally administers the payment of salaries as well as the payment of invoices to suppliers through the Standard Payment System.

- The Treasury Board of Canada Secretariat provides the OAG with information to validate calculations for various accruals and allowances, such as the accrued severance liability.

1.4 Material changes in fiscal year 2010–11

The OAG's financial statements have been prepared in accordance with Canadian generally accepted accounting principles for the public sector (PSAS), instead of Treasury Board Accounting Standard 1.2 (TBAS). While there are differences, the Office and the Treasury Board of Canada Secretariat have committed to reviewing the current TBAS by 31 December 2011. This will allow time for the Office and the Secretariat to find a permanent solution to resolve the differences between PSAS and TBAS.

The financial statement presentation has changed in 2010–11, and now includes a net debt indicator on the Statement of Financial Position and a Statement of Changes in Net Debt. No other significant changes that are relevant to the financial statements occurred in 2010–11.

2 The Control Environment Relevant to ICFR

The OAG recognizes the importance of setting the tone, starting with senior management, to help ensure that staff at all levels understand their role in maintaining effective systems of ICFR and are well equipped to exercise these responsibilities effectively. The Executive Committee provides overall direction and oversight for the OAG and is supported by the Finance and Corporate Services committees, which conduct due diligence and provide advice on the development and implementation of OAG policies and controls, as well as other matters. An independent audit committee oversees key aspects of values and ethics, risk management, internal controls, an external audit of our financial statements, quality management, our internal audit and practice review function, and accountability reporting.

The OAG's organizational structure is clearly defined, and the lines of authority and responsibility are well established. Staff members are qualified and trained, and formal job descriptions are in place. An OAG code of values, ethics, and professional conduct sets out (in detail) the values and the ethical, professional, and other standards that guide staff in their work.

An integrated risk management framework is in place based on the Committee of Sponsoring Organizations of the Treadway Commission enterprise risk management model. The framework is monitored and updated regularly, and it provides the basis for an annual risk management report to the Executive Committee, which is reviewed by the Audit Committee.

The OAG's Practice Review and Internal Audit function, which reports directly to the Auditor General, prepares an internal audit plan. The plan is based on a systematic assessment of business risk, which is developed using the risk management framework and other inputs. Internal audits assess significant administrative systems on a rotational basis. Annual practice reviews, of all three major product lines, assess the implementation of our quality management system for audit operations, and makes recommendations to improve the system's design and function.

2.1 Key positions, roles, and responsibilities

The following are the key positions and committees with responsibilities for maintaining and reviewing the effectiveness of the OAG's system of ICFR:

Auditor General (AG)—As the OAG's Accounting Officer, the AG assumes overall responsibility and leadership for the measures taken to maintain an effective system of internal control. The AG chairs the Executive Committee.

Deputy Auditor General (DAG)—The DAG is a member of the Audit Committee and has the responsibility for the management of the OAG's corporate risk profile.

Chief Financial Officer (CFO)—The CFO reports directly to the Auditor General and provides leadership for the coordination, coherence and focus on the design and maintenance of an effective and integrated system of ICFR, including its annual assessment.

Chief Information Officer (CIO)—The CIO is responsible for leading our Information Technology and Security, and Knowledge Management groups, as well as special IT projects.

OAG senior managers—Senior managers are responsible for maintaining and reviewing the effectiveness of their system of ICFR that falls within their mandate.

Chief Audit Executive (CAE)—The CAE reports directly to the Auditor General and provides assurance through periodic practice reviews and internal audits, which are instrumental to the maintenance of an effective system of ICFR.

OAG Audit Committee—The Audit Committee is an advisory committee that provides the Auditor General with objective views on the OAG risk management, control, and governance frameworks. The Audit Committee also recommends for approval the annual Report on Plans and Priorities and Departmental Performance Report (including audited financial statements) to the Executive Committee. The Chair of the Audit Committee meets with the Auditor General at least once each year.

Executive Committee—The Executive Committee is the central decision-making body; it approves and monitors the OAG Risk Management Framework and the system of internal control, including the assessment and action plans relating to ICFR. The committee—which comprises the Auditor General, Deputy Auditor General, Commissioner of the Environment and Sustainable Development, and assistant auditors general—sets policy and provides overall professional administrative direction for the OAG.

2.2 Key measures taken

The OAG's control environment equips its staff to manage risks well by raising awareness, providing appropriate knowledge and tools, and developing skills. Key measures include the following:

- All OAG staff formally acknowledge compliance with the OAG code of values, ethics, and professional conduct annually; they are required to disclose any potential conflict of interest or holdings of certain assets, liabilities, or other interests.

- Staff in key financial management positions hold accounting designations.

- All OAG policies and procedures are available to staff on the OAG's INTRAnet site, and references are provided to Treasury Board policies. Awareness programs include group awareness sessions, bulletins, emails, and orientation sessions for new employees and reminders on the INTRAnet homepage.

- The regularly updated detailed financial signing authority is available on the INTRAnet.

- Main business processes and related key control points are documented to support the management and oversight of ICFR.

- Secure financial processing systems, with access limited to appropriate staff, are in place to ensure the integrity of financial data and processing of transactions.

3 Assessment of OAG's System of ICFR

3.1 Assessment baseline

The OAG maintains an effective system of ICFR with the objectives to provide reasonable assurance that

- transactions are appropriately authorized;

- financial records are properly maintained;

- assets are safeguarded from risks such as waste, abuse, loss, fraud, and mismanagement; and

- applicable laws, regulations and policies are complied with.

The external auditors conduct an annual controls-based audit and are actively engaged (at least twice per year). As part of the requirements of the Treasury Board's Policy on Internal Control, the OAG is to annually assess both the **design** and **operating effectiveness** of key controls over financial reporting in support of continuous improvement.

Design effectiveness is the assurance that key control points are in place and that they are identified, documented, and aligned with the risks (i.e. controls are balanced with and proportionate to the risks they aim to mitigate). This includes the mapping of key processes to the main accounts.

Operating effectiveness means that key controls have been tested over a defined period and that any remediation is addressed. Such testing covers all OAG control levels that include entity, general computer, and business process controls.

3.2 Assessment method

The OAG has taken measures to assess its system of ICFR starting from its financial statements, with a focus on the following main processes:

- Payroll (National Capital Region)

- Operating Expenditures

    - Contracting and procurement (professional services, goods and other services) (National Capital Region and four regional offices)

    - Travel (National Capital Region and four regional offices)

    - Capital Assets (National Capital Region)

- Revenues (National Capital Region)

- Year-end reporting (National Capital Region)

The OAG gathered all information related to its business processes, risks, and controls relevant to ICFR and documented all relevant key controls—taking into consideration the risk, materiality, volumes, complexity, past history, susceptibility to losses and fraud, and public perception.

The OAG also documented and assessed its entity level controls and IT general system controls at a summary level. Finally, the OAG took into account information available from recent audits or evaluations, including a recent internal audit of the internal controls of GX Financials (November 2009).

Once the documentation was compiled, the design effectiveness of the identified internal controls was assessed, that is, samples of transactions in each of the main areas were reviewed to confirm that the controls were appropriately documented and were designed to effectively mitigate risk. The final phase involved testing larger sample sizes to ensure that the controls were operating effectively throughout the fiscal year.

4 Assessment Results

In assessing its key controls, the OAG's initial focus was on design effectiveness, which is a prerequisite for testing operating effectiveness. As of 31 March 2011, the OAG has completed all testing and remediation of design effectiveness. The testing of operating effectiveness has also been carried out and covers the main business areas.

4.1 Design effectiveness

When performing design effectiveness testing, the OAG completed all documentation (including validation by process owners), and verified whether the corporate, general computer and business process controls were in place and corresponded to actual practices. This was accomplished by selecting transactions on which to perform walkthroughs of key controls. When actual processes did not meet the description of the key controls, actions were taken to correct the differences and update the process descriptions, as well as to inform process owners about any areas of improvement to be addressed.

Follow-up actions have been taken to address the following areas to ensure that

- there is more consistency in the documentation and evidencing of the key controls performed;

- delegation of authority instruments are better controlled and change access is limited to key personnel only; and

- standing data master files are controlled and reviewed on a more timely basis, and that access to make changes is limited to key personnel only.

4.2   Operating effectiveness

In 2010–11, the OAG tested the operating effectiveness of the identified key controls related to the four key business process areas. This testing ensures that key controls are functioning over a 12-month period or a specified period of time during the fiscal year based on risks.

The OAG put together a review team that drew upon the experience of staff that work on the audit operations side of the OAG. The team established a work plan, selected sample transactions (following audit methodology used by the OAG), and tested them to ensure that the controls work effectively. The team also reviewed the sample transactions to ensure coverage of key components of the business processes over the entire fiscal year. The sample transactions covered sub-categories of transactions within each cycle and also included a review of ongoing management and monitoring controls applicable to all cycles. The following summarizes what was done for each of the main business processes:

- Salaries are paid by PWGSC. Testing payroll involved reviewing the various pay actions initiated by compensation staff, including those related to new hires, terminations, promotions and transfers. Detailed reviews of files were performed to ensure appropriate documentation of controls.

- Within operating expenditures, transactions reviewed included travel, hospitality, contracting, and purchase of supplies. The focus of this testing was ensuring that proper approvals for the expenditures took place and that documentation supporting the transactions were on file.

- The revenue cycle consists of external revenues from the OAG's international audit engagements and other sources. The testing involved ensuring that billing was in line with established agreements.

- For the year-end reporting, a review of year-end procedures was performed, covering the working papers, reviews, and sign-offs used in the preparation of the audited financial statements and public accounts submissions.

Finally, a review of key access controls surrounding OAG financial systems was performed to ensure that access is given to appropriate staff and is monitored on a timely basis.

These tests found no significant weaknesses; however, some opportunities for improvement were identified, and follow-up actions have either taken place or are under way.

4.3   Conclusion

The Treasury Board has a new Internal Control Policy, and the OAG has successfully implemented this policy. The OAG completed its first assessment of ICFR, and concluded that the internal control system over financial reporting is well designed and functioning effectively. No significant weaknesses were noted.

5 The Action Plan

5.1 Progress made as of 31 March 2011

During 2010–11, the OAG made important progress in assessing and improving its key controls. The following is a summary of the main accomplishments completed to date, as well as initiatives that are currently under way:

- documenting key business process over expenditures, payroll, revenues, and financial reporting in narrative descriptions and control matrices linked to financial statement assertions, and identifying key controls;

- performing walkthroughs of the identified controls to assess design effectiveness;

- carrying out a sample-based approach to test operating effectiveness of the identified key controls; and

- noting areas of improvement and undertaking follow-up actions to address them:

  - Within payroll, we have made improvements to further strengthen segregation of duties control over the processing of pay actions and to identify higher risk transactions that require more in depth review prior to authorization.

  - Within operating expenditures, we have modified access for staff, to ensure that only the appropriate individuals have the ability to authorize transactions, and have introduced a more formal process to grant access in exceptional circumstances.

  - For all areas, we have stressed to financial staff the importance of providing evidence that the controls have been performed to ensure an audit trail exists.

Initiatives in progress

The testing of revenues found an opportunity to improve the documentation of hourly rates used for billing purposes. The OAG is developing a formal process to approve hourly billing rates and to improve efficiencies in the billing process.

5.2 Action plan for future years

The OAG has taken several important steps to ensure an effective system of internal control over financial reporting is in place. That being said, continuous, on-going efforts to maintain a strong set of controls over the long-term are necessary to build on the work already performed. The following describes the actions that the OAG plans to take over the next two years:

2011–12

- Perform walkthroughs, using a sample of transactions from the main business processes, to confirm that key controls continue to be designed appropriately and operate effectively.

- Review the general IT-related controls, which includes improving the documentation and expanding the coverage of testing of the key controls that relate to the OAG's key systems.

- Formalize the process for establishing hourly billing rates for our cost recoveries.

- Follow up on progress made in areas identified for improvement in 2010–11.

2012–13

- Review of the OAG control environment relevant to ICFR, which includes improving the documentation and testing of identified key controls, such as creating flowcharts that will compliment and simplify the understanding of the narrative descriptions.

- Develop and establish a formal process of continuous monitoring of ICFR. This may include putting cycles on a rotational review, with an in-depth review of one cycle being performed annually and walkthroughs of the other cycles being done during the same year.

- Follow up on progress made in any areas identified for improvement in previous years.