



AUDIT OF FINANCIAL INTEGRITY

PHASES I AND II INTERIM RESULTS

Project No. 443/98

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1.0 INTRODUCTION

The Financial Integrity audit deals with non-salary Operation and Maintenance (O&M) funds within HRDC. Grants and contributions will be covered in a separate audit in the last two quarters of 1998-99.

The objective of the audit is to:

- a) Identify major risk areas for errors, misappropriation, misuse and abuse of non-salary funds within HRDC;
- b) Identify major risk areas that are not covered by existing internal controls, if any;
- c) Assess the effectiveness of existing controls over major risk areas designed to prevent, detect and deter errors, misappropriation, misuse and abuse; and,
- d) Provide recommendations to improve, create or replace internal controls over major risk areas.

Small as they are compared to Program funds, O&M expenses are often very visible.

This audit has three phases. Phase I, conducted in September 1998, led to the identification of risk areas. Phase II, conducted in October, was a review of existing financial internal controls associated with identified risk areas. The third Phase, planned for the first quarter of 1999/00 will test actual financial and administrative decisions, actions and transactions in the areas where risk is high and/or controls were absent or inadequate at the time of the review.

The non-salary budget for HRDC during fiscal year 1998/99 is relatively small when compared to salary and grants & contributions budgets. One manager went so far as to compare it to “peanuts” not justifying elaborate internal controls. If HRDC is perceived as being indifferent with respect to O&M expenditures, this could result in a public notion that we are not prudent with the rest of the public funds which are entrusted to us.

Small as they are compared to other payments and expenses, non-salary O&M expenses are often very visible, both internally and to the public. While materiality is important in assessing the impact of financial or administrative

wrongdoing, there are other factors such as the Department's public image and credibility and the protection of our employees who are entrusted with or exposed to valuable assets. A \$50 hospitality expense perceived as an abuse, or the theft of \$20 by an employee from an unprotected petty cash may have serious consequences on the morale or the career of our staff and managers.

No organization, public or private, is immune against financial abuse on the part of its employees. Extensive studies in the United States by the Certified Fraud Examiners estimates that \$9 per day per employee is lost in private business through fraud. In HRDC, there are examples of misappropriation, misuse and abuse of non-salary funds, O&M. Although knowledge of these incidents tend to remain within a small circle of auditors and security specialists, it was quite obvious during the risk assessment sessions and the following interviews that many employees, supervisors and managers have a suspicion that fraud exists around them.

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Financial transaction audits have been conducted several times in the past ten years. Most of them focused on compliance to Treasury Board and Departmental rules and policies. This audit includes some elements of compliance but its ultimate objective is to provide managers with useful information to help them reduce, control and manage the risks of financial errors, fraud, misappropriation, misuse and abuse within their responsibility centres. It is not the intent of the auditors to question the decentralization of offices or the empowerment of managers. Risk can be best reduced by ensuring that the right controls are at the right place, rather than putting more controls everywhere.

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The purpose of this interim report is to provide National Headquarters and Regional Executive Heads with a tool to evaluate the level of non-salary financial risk in their own area of responsibility and take corrective action as appropriate. The third phase will determine how successful we are in protecting the assets entrusted to us.

2.0 SCOPE AND METHODOLOGY

Phase I of the audit consisted of 12 risk assessment sessions and interviews, in 5 regions (NHQ, Ontario, Quebec, Manitoba and New Brunswick). The sessions were held with Clerks, Chiefs of Administrative Services (CAS) or equivalents and Managers. The interviews were held with post audit and internal control representatives as well as HRCC directors. Following the sessions, audit teams visited 7 regions and interviewed CASs, Clerks and Managers on existing internal controls (or absence thereof). There was no testing of actual transactions, which will be conducted during Phase III.

3.0 REPORTING RESULTS

Phases I and II identified eleven areas where the risk of financial errors, misappropriation, misuse and abuse exists. These areas have been grouped into two sections: Protection of Financial and Movable Assets, and Protection Against Abuses of Equipment, Facilities or Authority.

Each area is associated with a list of factors which increase the possibility of errors, misappropriation, misuse and abuse.

Many of the factors described in this document have been directly witnessed during Phase II of the this audit. The others were reported to the auditors during field interviews or at one of the risk assessment sessions.

The findings of Phases I and II are presented in the following table. We encourage the managers concerned with the issues raised in this document to review their own area of responsibility and check how many of the factors identified in this report are present, and take appropriate measures to reduce the level of risk.

PROTECTION OF FINANCIAL AND MOVEABLE ASSETS

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
<p>Suspense accounts</p>			
<p>Passwords and user identification</p>		<p>18 (d) + 21 (1) (a) (b)</p>	

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
Passwords and user identification (continued)			
Purchasing		18 (d) + 21 (1) (a) (b)	

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
Purchasing (continued)			
		18 (d) + 21 (1) (a) (b)	

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
Purchasing (continued)			
Receipt and deposit			
		18 (d) + 21 (1) (a) (b)	
Petty cash			
Payment on Due Date policy (PODD)			

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
Moveable assets			
		18 (d) + 21 (1) (a) (b)	

PROTECTION AGAINST ABUSES OF EQUIPMENT, FACILITIES OR AUTHORITY

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
Contracting			
		<p>18 (d) + 21 (1) (a) (b)</p>	

RISK AREA	NATURE OF THREAT	INCREASING FACTORS	COMMENTS
Travel			
		18 (d) + 21 (1) (a) (b)	

Tele-Communications	
Hospitality	18 (d) + 21 (1) (a) (b)