



1999-713 Report

AUDIT OF ACCOUNT VERIFICATION

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Executive Summary

Authority for the Project

Project 99-713, Audit of Account Verification in PWGSC - Government Operation Services (GOS), was authorized as part of the 1999/2000 Audit and Review Plan approved by the departmental Audit and Review Committee.

Background

Responsibility for the system of account verification and related financial controls rests with those officers who are delegated payment authority pursuant to Section 33 of the Financial Administration Act. Financial officers with payment authority (FAA Section 33) must provide assurance of the adequacy of the FAA Section 34 account verification and be in a position to state that the process is in place and is being properly and conscientiously followed.

In accordance with Treasury Board policy on account verification, Financial Sector, Financial Operations Directorate (FOD), National Capital Area developed a quality assurance function to ensure that the process by which payment requisitions are verified is consistent and reliable. This quality assurance function includes a pre-payment sampling model which was implemented at FOD in July 1992 by the former Supply and Services Canada. In order to improve the efficiency of the account verification process, it has been proposed that a post-payment audit model be implemented at FOD as part of the administrative realignment of Finance and Real Property Services (RPS) within the National Capital Area (NCA).

The proposed post-payment audit model and sampling plan will be phased in at FOD, NCA over the next few years. It should be noted that the post-payment audit model has only recently been introduced and that our audit was conducted during the implementation of the pilot phase at RPS.

Objectives and Scope

The objectives of the audit, as stated in the Terms of Reference, were to assess the effectiveness of the account verification process and practices in PWGSC - Financial Operations Directorate and their compliance to Treasury Board policy, including an assessment of the management framework as it relates to account verification activities.

Account verification activities in PWGSC pursuant to FAA Section 33 are executed throughout the National Capital Area, the regions and for Special Operating Agencies. The audit was limited to the account verification process and practices at FOD, NCA. According to FOD, this represents approximately 56% of the total payments authorized by PWGSC.

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The audit examined payment requisitions authorized by Financial Services, NCA, and focused on two issues identified in the Preliminary Survey for further assessment in the Detailed Examination phase. These included:

- the effectiveness of the pre-payment sampling model; and,
- the effectiveness of the post-payment audit model.

The audit covered pre-payment transactions processed between April 1 and October 31, 1999. Post-payment transactions were reviewed from payment requisitions selected by the Quality Assurance Unit (QAU) for verification during the 4th Quarter FY 1998/1999 and the 1st Quarter FY 1999/2000. The audit was carried out in accordance with generally accepted auditing standards.

The quality assurance function performed by FOD for transactions forwarded through the Feeder systems and Acquisition Card transactions (MasterCard and American Express) were not covered within the Detailed Examination phase.

Key Findings and Conclusions

1.1 Pre-payment Sampling Model

The pre-payment sampling model is adequate for controlling the account verification under FAA Section 34. Pre-payment account verification clerks were found to be experienced in quality assurance of FAA Section 34 functions. This was evident in that reference documentation was maintained in a manner which enhanced verification activities, and file documentation which generally provided a clear audit trail.

While the post-payment audit model will increasingly replace the pre-payment audit model, FOD will continue conducting pre-payment verification for travel and relocation expenditures. We therefore consider bringing improvements to the pre-payment sampling model as a worthwhile investment.

Audit findings, presented below, are based upon an examination of 84 transaction files and a review of documentation. Other observations noted during the audit which represent opportunities to enhance the effectiveness of the pre-payment sampling model were communicated to FOD in a management letter for their consideration and proper action.

- ♦ Reporting practices related to pre-payment quality assurance verification activities would benefit from enhanced accuracy. Performance reports contained inaccurate information, such as error rate ratios, and the audit team was unable to reconcile some of the quality assurance control reports to source documents.

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- ♦ The pre-payment sampling plan in place at the time of the audit did not fully meet Treasury Board requirements regarding the approval and documentation of sampling methodologies and procedures in the departmental financial manual.

1.2 Post-Payment Audit Model

The post-payment quality assurance process provides an adequate level of confidence in the consistency and reliability of FAA Section 34. Our review revealed evidence of good management practices in the preparation for the transition to a post-payment quality assurance audit model. Also, numerous initiatives have been undertaken by the Quality Assurance Unit (QAU) to enhance the account verification process by providing quality support services to Real Property Services' (RPS) staff.

It should be noted that the post-payment audit model has only recently been introduced at FOD and is still considered to be in its pilot phase. It is reasonable to expect that changes from its current set-up will be made to reflect initial learning. A number of areas which offer opportunities to improve the consistency and reliability of the post-payment account verification process were communicated to FOD in a management letter. The management letter listed observations and recommendations dealing with:

- ♦ improving sampling parameters;
- ♦ capturing high risk transactions;
- ♦ classifying and reporting of non-critical errors; and,
- ♦ tightening of audit timelines.

The findings reported in this section are based upon an examination of 100 post-payment quality assurance files and a review of documentation.

- ♦ Inconsistencies in the application of error recognition criteria were noted during our review of the first two quarters for which the post-payment audit model was implemented. This was due, in part, to a lack of employees' experience with the new process and a lack of clarity of error recognition criteria. Increased clarity of error criteria and definitions would help to ensure greater conformity in post-payment audit results and compliance with Treasury Board regulations by reducing reliance on judgement.
- ♦ Our audit revealed that a number of transactions selected for post-payment verification were excluded from the sample populations without proper explanation or without having been formally approved. The implementation of formal procedures for excluding selected transactions from post-payment verification would enhance inherent controls.
- ♦ The financial subsystem, MIPS, in place at the time of the audit did not provide adequate control to ensure that all commitments of funds were transferred to the central financial system at FOD as per Treasury Board directives. We were advised that verification of

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FAA Section 32, a non-critical error, was no longer included in the post-payment verification criteria due to ongoing subsystem failures.

Recommendations

It is recommended, the ADM, GOSB ensure that :

1. *Revisions to reporting practices related to the pre-payment sampling model be implemented, as planned by FOD, in order to ensure the accuracy of reported results of the quality assurance verification activities.*
2. *The pre-payment sampling plan be updated, approved and documented in the departmental financial manual in order to ensure compliance with Treasury Board Account Verification policy.*
3. *Relevant post-payment sampling parameters and error criteria be evaluated and revised, as required, in accordance with results obtained and lessons learned during the pilot phase, in order to enhance the statistical validity of post-payment audit results by ensuring that:*
 - ♦ *error recognition criteria is applied uniformly; and*
 - ♦ *selected transactions excluded from audit are documented and approved in accordance with a formal procedure.*
4. *Measures are taken to ensure that financial subsystems transmit all financial information to central systems.*

1 Introduction

1.1 Authority for the Project

Project 99-713, Audit of Account Verification in PWGSC - Government Operation Services (GOS), was authorized as part of the 1999/2000 Audit and Review Plan approved by the Audit and Review Committee.

1.2 Background

Responsibility for the system of account verification and related financial controls rests with those officers who are delegated payment authority pursuant to Section 33 of the Financial Administration Act. Financial officers with payment authority (FAA Section 33) must provide assurance of the adequacy of the FAA Section 34 account verification and be in a position to state that the process is in place and is being properly and conscientiously followed. Account verification activities pursuant to FAA Section 33 are executed throughout the various regions and for Special Operating Agencies.

In accordance with Treasury Board policy on account verification, FOD developed a quality assurance function to ensure that the process by which payment requisitions are verified is consistent and reliable. This quality assurance function includes a pre-payment sampling model which is applied to transactions processed through the Common Departmental Financial System (CDFS) and a post-payment audit model which is currently being introduced as a method to monitor account verification practices of payment requisitions processed through the Financial Management System (FMS 28).

The pre-payment sampling model was implemented at FOD in July 1992 by the former Supply and Services Canada in order to ensure the probity of account verification practices pursuant to FAA Section 34. The pre-payment sampling plan has remained in place without major modification since this time. In order to improve the efficiency of the account verification process, it has been proposed that a post-payment audit model be implemented at FOD as part of the administrative realignment of Finance and Real Property Services within the National Capital Area.

The proposed post-payment audit model and sampling plan will be phased in at FOD, NCA over the next few years. Phase one consisted of implementation of the post audit approach at Real Property Services (RPS), effective February 1, 1999. In phase two, the post audit model and the approved sampling plan will be extended to the electronic Feeder systems which forward payment requisitions from various responsibility centres to the Common Departmental Financial System. Finally, at phase three, the post audit approach will be extended to the remaining payment requisitioning processes. The only exception will be travel and relocation expenditures which will continue to be subjected to a review at FOD prior to payment authorization.

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1.3 Objectives

The objectives of the audit, as stated in the Terms of Reference, were to assess the effectiveness of the account verification process and practices in PWGSC - Financial Operations Directorate (FOD), National Capital Area and their compliance to Treasury Board policy, including an assessment of the management framework as it relates to account verification activities.

1.4 Scope

Account verification activities in PWGSC pursuant to FAA Section 33 are executed throughout the National Capital Area, the regions and for Special Operating Agencies. The audit was limited to the account verification process and practices at FOD, NCA. According to FOD, this represents approximately 56% of the total payments authorized by PWGSC.

The audit examined payment requisitions authorized by Financial Services, NCA, and focused on two issues identified in the Preliminary Survey for further assessment in the Detailed Examination phase. These included:

- the effectiveness of the pre-payment sampling model; and,
- the effectiveness of the post-payment audit model.

The audit covered pre-payment transactions processed between April 1 and October 31, 1999. Post-payment transactions were reviewed from payment requisitions selected by the Quality Assurance Unit (QAU) for verification during the 4th Quarter FY 1998/1999 and the 1st Quarter FY 1999/2000.

The quality assurance function performed by FOD for transactions forwarded through the Feeder systems was excluded from the scope of the Detailed Examination phase. A review of the Feeder systems has been authorized as part of the 2000/2001 Audit and Review Plan approved by the Audit and Review Committee.

In addition, Acquisition Card transactions (MasterCard and American Express) were excluded from the Detailed Examination phase as the Audit and Review Branch has conducted recent audit work in this area.

1.5 Audit Approach and Methodology

In the Preliminary Survey phase, the Audit and Review Branch (ARB) examined the account verification process within FOD and its application to specific payments in order to gain an understanding of the account verification structure, processes, policies and directives at FOD, and to identify key issues and potential risk areas. Determination of the issues, payments and

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expenditures pursued in the Detailed Examination phase was based on an assessment of risk as well as management concerns expressed in the Preliminary Survey.

Our conclusions and audit findings are based upon an assessment of the following elements using the audit criteria detailed in the Preliminary Survey Report. These elements include:

- ◆ Sampling methodology;
- ◆ Administration of quality assurance account verification;
- ◆ Reporting, monitoring and corrective actions; and,
- ◆ Data integrity.

The audit was conducted at Financial Operations Services, NCA. The audit was carried out in accordance with generally accepted auditing standards and included interviews, a review of files and other documentation, and transaction testing on a stratified sample of transactions in FY 1998/1999 and FY 1999/2000. Key audit findings, conclusions and recommendations are presented in this report.

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2 Pre-Payment Sampling Model

The integrity of the account verification process under FAA Section 34 is monitored on an ongoing basis within the pre-payment sampling model. Within the pre-payment quality assurance framework, all high risk transactions and a random selection of 25% of non-sensitive payments are subjected to a maximum review of 14 criteria prior to payment authorization. The remaining three-quarters of non-sensitive payments are subjected to a minimum verification based on the following four payment criteria: vendor number; amount; coding; and statutory set off.

Monthly management reports are prepared for each Departmental Accounting Office (DAO). An error analysis is distributed to client responsibility centres under which the respective DAOs are grouped. Responsibility centres are asked to undertake measures to ensure their monthly error rate is equal to or less than the maximum error rate of 4%.

Pre-payment account verification clerks were found to be experienced in quality assurance of FAA Section 34 functions. We were especially impressed by the level of professionalism observed in the Travel and Relocation unit. This was evident in that reference documentation was maintained in a manner which enhanced verification activities, and file documentation which generally provided a clear audit trail.

The conclusions and audit findings reported below are based upon an examination of 84 pre-payment quality assurance files, a review of documentation, as well as interviews with relevant stakeholders.

2.1 Findings, Conclusions and Opportunities for Improvement

The pre-payment sampling model provides adequate control of account verification under FAA Section 34. While the post-payment audit model will increasingly replace the pre-payment audit model, FOD will continue conducting pre-payment verification for travel and relocation expenditures. We therefore consider bringing improvements to the pre-payment sampling model as a worthwhile investment.

Other observations noted during the audit which represent opportunities to enhance the effectiveness of the pre-payment sampling model were communicated to FOD in a management letter for their consideration and proper action. Audit findings, presented below, are based upon an examination of 84 transaction files and a review of documentation.

- ◆ Reporting practices did not fully ensure the accurate reporting of pre-payment quality assurance verification activities. Overall, 8 of the 27 performance reports prepared for responsibility centre clients reviewed by ARB contained inaccurate information, such as reported error rates. Also, the audit team was unable to reconcile some of the quality assurance control reports for the period of August to October 1999 to source documents. We were informed that a review of reporting practices is being undertaken.

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- ♦ An approved copy of the pre-payment sampling plan was not documented in the departmental financial manual as required by Treasury Board policy. Also, the pre-payment sampling plan in place at the time of the audit, did not meet a number of Treasury Board requirements regarding the documentation of sampling methodologies and procedures, such as information on the sampling populations and transaction streams, critical errors, the maximum tolerable error rate, methodological assumptions, evaluation and reporting practices or approaches to corrective actions.

2.2 Recommendations

It is recommended, the ADM, GOSB ensure that :

1. *Revisions to reporting practices related to the pre-payment sampling model be implemented, as planned by FOD, in order to ensure the accuracy of reported results of the quality assurance verification activities.*
2. *The pre-payment sampling plan be updated, approved and documented in the departmental financial manual in order to ensure compliance with Treasury Board Account Verification policy.*

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3 Post-Payment Audit Model

The post-payment audit model and sampling plan has recently been introduced and will be phased in at FOD, NCA over the next few years. Our audit was conducted during the implementation of the pilot phase at Real Property Services (RPS).

Within the post-payment audit framework, the integrity of financial controls is monitored on a quarterly basis by taking a stratified sample of non-sensitive and 100% of high risk transactions after they have been completed and subjecting them to an in-house audit. The post-payment audit findings are then used to assess the quality of departmental account verification processes. The results are evaluated against an approved critical error-rate threshold as indicated in the sampling plan. If the rate exceeds the threshold then Finance recommends corrective actions which the responsibility centre managers are responsible for implementing.

The post-payment audit sampling plan as documented by FOD in its *Framework for the Implementation of the Post-Payment Audit in PWGSC* sets out data gathering and reporting procedures, and defines quality assurance processes and key terms used in the framework and sampling plan as per Treasury Board guidelines.

Our review revealed evidence of good management practices in the preparation for the transition to a post-payment quality assurance audit model. The sampling framework developed by FOD was based upon an analysis of post-payment audit practices in four other government departments (OGD). This analysis included a review of responsibilities, sample selection tools, reporting processes, sampling parameters, error types and definitions, error tolerance and problems encountered in the implementation phase.

Numerous initiatives have been undertaken by the Quality Assurance Unit (QAU) to enhance the account verification process by providing quality support services to RPS staff. The "best practices" indicated below demonstrate the proactivity of QAU in helping its clients manage this function more effectively. These initiatives should, in turn, increase confidence levels as to the consistency and reliability of the account verification process.

- ◆ QAU has developed an Operational Services Unit (OSU) to provide ongoing support to RPS account verification staff and managers. OSU provides services through its telephone Hotline and SOS Finance e-mail site. Besides responding to specific queries from RPS staff, OSU also delivers, as required, communiqués on departmental and central agency directives.
- ◆ FAA Section 34 account verification training seminars were provided by QAU during February 2000 to a total of 179 RPS employees, notably: 107 account verification clerks, 10 CSU business managers and 62 project managers. Training sessions will be provided to RPS staff, upon request, on an ongoing basis.
- ◆ A training/business manual has been developed by QAU to provide both RPS verification clerks and managers with a reference of departmental account verification procedures.

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Key elements covered include an overview of the account verification process, required documentation as per transaction type, delegations of authority, *Treasury Board directives* concerning Membership Fees, Hospitality and PAYE, and resources available to RPS staff. Business manuals are to be maintained and updated as required.

3.1 Findings, Conclusions and Opportunities for Improvement

The post-payment quality assurance process provides an adequate level of confidence in the consistency and reliability of FAA Section 34. Confidence levels of the probity of the post-payment account verification process could be enhanced by the implementation of more rigorous audit and sampling mechanisms. The post-payment audit process could be rendered more efficient through a minor restructuring of current practices. Improved data management techniques would increase the reliability and quality of account verification information.

Treasury Board guidelines indicate that sampling plans should be reviewed and updated, as required, on a regular basis. It should be noted that the post-payment audit model has only recently been introduced and is still considered to be in its pilot phase. It is reasonable to expect that incremental changes from its current set-up would be made to reflect initial learning. Given the numerous changes implemented during the pilot phase and the lessons learned, it would thus be advantageous if a review of the sampling plan was undertaken prior to it being approved and documented in the departmental financial manual.

A number of areas which offer opportunities to improve the consistency and reliability of the post-payment account verification process were communicated to FOD in a management letter. The management letter listed observations and recommendations dealing with:

- ♦ improving sampling parameters;
- ♦ capturing high risk transactions;
- ♦ classifying and reporting of non-critical errors; and,
- ♦ tightening of audit timelines.

The findings reported below are based upon an examination of 100 post-payment quality assurance files and a review of documentation.

- ♦ Inconsistencies in the application of error recognition criteria were noted during our review of the first two quarters for which the post-payment audit model was implemented. This was due, in part, to a lack of employees' experience with the new process. The lack of clarity of error recognition criteria was identified as another factor regarding the consistent application of QAU audit criteria, such as support documentation, receipt date, amount and vote or appropriation.

For example, documentation was insufficient to substantiate all relevant aspects of the transaction under review for 14 of 31 PAYE, Service and Construction transactions selected for QAU verification and reviewed by ARB. Three of these 14 files were extracted from the sample and a critical error was attributed to one of the remaining

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11 files. It is our opinion that critical errors were not recognized for the other 10 files due, in part, to a lack of precision in the error recognition criteria used.

Increased clarity of error criteria and definitions would help reduce reliance on judgement in error recognition and ensure greater conformity in the application post-payment audit criteria. We were advised of FOD's plans to review and clarify non-critical error definitions, which should help to increase confidence levels of the consistency of post-payment results. However, critical error definitions and audit guidelines should provide sufficient detail as to ensure that the same results will be obtained regardless of the in-house auditor applying the criteria.

- ♦ Post-audit performance summaries revealed that a total of 93 transactions (11%) selected for verification had been excluded from the sample populations. Thirty-seven of these files were subsequently verified by an external consultant. The audit team was informed that as of the Second Quarter FY 1999/2000 (Period III), only high risk transactions with line object error codes would be excluded from verification. No formal procedures concerning the exclusion of selected transactions from verification were documented in the post-payment sampling plan. Formal procedures for excluding selected transactions from verification would enhance inherent controls by ensuring that decisions to exclude selected transactions were documented and approved.
- ♦ The financial subsystem, MIPS, in place at the time of the audit did not provide adequate control to ensure that all commitments of funds were transferred to central financial systems as per Treasury Board directives. We were advised that due to ongoing subsystem failures the verification of FAA Section 32 was no longer included as a non-critical error in the post-payment verification criteria.

3.2 Recommendations

It is recommended, the ADM, GOSB ensure that :

1. *Relevant post-payment sampling parameters and error criteria be evaluated and revised, as required, in accordance with results obtained and lessons learned during the pilot phase, in order to enhance the statistical validity of post-payment audit results by ensuring that:*
 - ♦ *error recognition criteria is applied uniformly; and*
 - ♦ *selected transactions excluded from audit are documented and approved in accordance with a formal procedure.*
2. *Necessary measures are taken to ensure that financial subsystems transmit all financial information to central systems.*