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Audit and Ethics Branch
Direction générale de la vérification et de l'éthique

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Final Audit Survey Report

Audit of Financial Commitments and Forecasting

2005-09-27

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Executive Summary

The Audit objectives were to assess the compliance and capability of Responsibility Centre (RC) Managers to policies and procedures for financial commitments and forecasts, and to determine the impact of budget management on information for decision making.

Commitments are an intrinsic part of the expenditure planning and the budgetary control processes. It is essential that commitment controls are in place to: ensure compliance to Section 32 of the Financial Administration Act, which confirms the availability of funds before a contractual arrangement is entered into; record the commitments or obligations into Common Departmental Financial System (CDFS); and, to ensure that the funds allocated to an organization are spent only within the limit of its budget.

The Audit's conclusion on the compliance and capability of RC Managers, within Headquarters, was that: financial management is well structured; individuals strive to be compliant with policies and procedures for financial commitments and forecasts; and, they have the skills, experience, and sufficient training to accurately forecast and report revenues and expenditures.

The Audit observed several issues of budget management that impact on the use of information for decision making and concluded that:

- Management will continue to develop internal stand-alone spreadsheets to monitor funds and projects because there is no strong Departmental forecasting tool. The impact of this is: higher dependence on Financial Management Advisors and less accountability of financial management by RC managers; increased consumption of resources to reconcile CDFS with various Branch feeder systems; increased risk of reconciliation errors; and, limited reliance or integrity of CDFS financial data for reporting and decision making.
- Changes in financial tombstone data, as a result of many organizational changes, limit the effectiveness of CDFS as a reporting tool to produce relevant information for decision making, or qualitative information of budget management for performance analysis.
- The new Departmental policy on commitment control is reasonable and the exception reporting provides a beneficial method of controlling and verifying compliance to the policy, however there is the potential for future non-compliance and increased financial workarounds by Managers frustrated with CDFS's restrictive system checks and constraints. Such limitations of budget management issues, as observed in the audit, could limit the effectiveness and benefit of CDFS financial information to decision makers.

The Audit recommended that:

1. *The Audit should be concluded at the Survey Phase since a detailed examination is unlikely to provide additional assurance on commitments and forecasts; and,*
2. *The Chief Financial Officer of Finance Branch should ensure that the Common Departmental Financial System is sufficiently robust and flexible in its programming and controls, to support Managers, accountable for sound financial management, in actions that are compliant to departmental financial policies, and in reporting of financial information that is accurate, relevant and timely for decision making.*

1 Introduction

1.1 Authority for the Project

This audit was approved by the departmental Audit and Ethics Committee (AEC) as part of the 2004-05 Audit Plan. The Audit's priority was confirmed by the AEC at its November 25, 2004 meeting.

1.2 Objectives

The audit objectives were to:

1. Assess the application of and compliance to the policies and procedures governing financial commitments and forecasts;
2. Assess the capability of applicable Responsibility Centre (RC) Managers to accurately forecast and report revenues and expenditures; and,
3. Determine the impact or consequences of inadequate budget management (i.e. recording, reporting, utilization of information for forecasting) on decision making.

1.3 Scope

The Audit's preliminary survey scope included an examination of the records of commitments and forecasts for the fiscal year 2003/04 and the first six to seven months of fiscal year 2004/05; identification of key accountabilities, controls, and processes used for commitments and forecasting; and review of a sample of commitments within Common Departmental Financial System (CDFS) to examine, in detail, the procedures or process for recording financial commitments.

Additional work in the detailed Audit examination phase was to include an independent review of Section 32 signatures, and samples in the Region.

1.4 Background

It is important that Public Works and Government Services Canada (PWGSC) have the appropriate mechanisms in place to monitor financial performance and to provide timely and reliable financial information to Management. The indicators, as described in the Treasury Board Secretariat's Management Accountability Framework (MAF), that are relevant to such mechanisms include: Results and Performance - integrated financial and non-financial performance information used in corporate decision making; Stewardship - compliance with policies, regulations, and legislations; and, Accountability - clear accountabilities and responsibilities for due process and results.

RC Managers should effectively manage their budgets and should understand their spending authority, which may include: expenditure initiation authority; commitment authority; authority to contract; and, confirmation of contract performance and price.

The departmental Policy on Commitment Control, effective April 01, 2004, prepared by the Financial Policy and Procedures Directorate, included a monitoring role for Audit & Ethics Branch (AEB) within its policy: *'To ensure the Policy has been fully implemented in PWGSC, Audit & Ethics Branch will perform an audit of the commitment controls in place and assess their efficiency'*. The main focus of this audit was commitment authority. Commitments are an intrinsic part of the expenditure planning and the budgetary control processes. It is essential that commitment controls are in place to: ensure compliance to Section 32 of the *Financial Administration Act (FAA)*, which confirms the availability of funds before a contractual arrangement is entered into; record the commitments or obligations into CDFS; and, to ensure that the funds allocated to an organization are spent only within the limit of its budget.

Once the fiscal-years budget is established, Senior Management should regularly monitor the availability of funds (free balance) that could be used to address changing priorities and forecast changes to their expenditures, within their authority or reference level.

1.5 Work Performed

The standard audit methodology includes a Survey Phase to gain an understanding of procedures, policies, and infrastructure surrounding commitments and forecasts in the Department, and to identify potential issues of significance.

Work performed during this Audit's Survey Phase included the following:

- Review of Departmental information on Financial Management Strategy and Financial Delivery.
- Review of Government and Departmental policies and procedures on commitments.
- Analysis of financial data by Responsibility Centres for fiscal year 2003/04 and the first nine months of fiscal year 2004/05.
- Development of Audit programs and questionnaires for the areas to be pursued in the Survey Phase, as well as the Detailed Examination Phase.
- Random selection of six RCs based on an initial review of the financial data.
- Interviews with over twenty-seven Financial Management Advisors/Financial Advisors; CDFS clerical input staff; and, RC Management.
- Review of RC financial and operational documentation related to reporting on commitments and forecasts.
- Review of relevant audit reports and presentations by the Office of the Auditor General.

At the point of validation of the draft Survey Audit report, the former Assistant Deputy Minister, Finance, Accounting, Banking and Compensation Branch asked that the Audit team undertake further analytical work on forecasts. The team was to select a sample from the RCs reviewed and consider the factors that may impact changes to forecasts, and whether RC Managers' awareness and decisions to declare surplus of funds could be projected.

2. Observations

The Audit Survey Phase was conducted during the period November 8, 2004 to January 25, 2005. The observations addressed the three objectives of this Audit.

2.1 Objective 1

To assess the application of and compliance to the policies and procedures governing financial commitments and forecasts.

All the persons interviewed indicated an awareness of their obligations under the new departmental Commitment Policy. Each RC ensured appropriate signing authorities under FAA Section 32 to commit funds through a control process and the timely decommiting of funds through regular monthly monitoring.

Interviews with Management and RC clerical staff, as well as the Financial Management Advisors (FMAs)/Financial Advisors, who support Operational Management with regards to commitments, indicated that Departmental staff were well aware of the policy/procedures and some have received training either in the Department or through their FMA/Financial Advisor. Many indicated that their Branch Senior Management had given clear instruction on the necessity for RCs to effectively manage their finances.

The Audit sample of financial data disclosed no evidence of large, outstanding commitments which had been committed early in the fiscal year and had not been monitored or adjusted throughout the year. Interviewees also indicated that blanket and multi-year commitments are rarely used.

For business lines, such as IT and Real Property Services, which undertake large contractual arrangements there have been situations that resulted in a deviation from the commitment policy due to financial timing delays. Such delays result when a contract to deliver a program/good/service has been committed against the RC's finances, but the funding from Treasury Board Submissions, Supplementary funding, or client Departments has not been obtained. This problem does not exist within the financial arrangements of Revolving Funds. In one example, the RC Management was forced to decommit an existing contractual arrangement because of a constraint in cash flow in order to process other transactions. Although blanket commitments for future expenditures can be recorded, there are limited protocols or provisions in the FAA to create a blanket commitment for future uncertain revenues.

> The Audit conclusion is that financial management of commitments, forecasting and reporting are well structured and individuals strive to be compliant with policies and procedures.

2.2 Objective 2

To assess the capability of applicable RC Managers to accurately forecast and report revenues and expenditures.

RC Managers demonstrated sound financial management through monthly reviews of expenditures, commitments and free balance as reported in CDFS financial statements. As well, they undertake a regular comparison of project or program spreadsheets to the forecasts of financial requirements. Interviewees were aware of the new Departmental policy on commitments, and there was evidence that financial training had been provided to them in a number of venues. Management in their monthly review made adjustments to forecasts and commitments, as applicable.

In addition, the Departmental financial sector has established an effective time schedule for adjusting budgets and forecasts, which provides sufficient time for RC Managers to review financial reports and identify revisions.

> The Audit conclusion is that RC Managers have the skills, experience, and sufficient training to accurately forecast and report revenues and expenditures.

2.3 Objective 3

To determine the impact or consequences of inadequate budget management (i.e. recording, reporting, utilization of information for forecasting) on decision making, as appropriate.

The Audit identified several budgetary management issues which could impact on the use of information for decision making.

- Stand-alone Spreadsheets RC Management and FMAs/Financial Advisors create and maintain internally-developed spreadsheets to monitor their forecasts and projects. Most spreadsheets are created in Excel or Lotus 123. These had no upload or download connection to Departmental financial systems such as CDFS or Financial Management System (FMS) and limited connection to other spreadsheets created for other RCs. As a result, verification and comparison of these spreadsheets to the Departmental financial systems requires extensive manual manipulation. Interviewees stated that CDFS was developed as the Departmental reporting tool, but does not provide a strong forecasting tool. To provide effective budget management they had to create and maintain other tools to manage forecasting and their budgets on a daily basis.

- CDFS System Issues System issues with CDFS, which have been outlined in the December 2004 Financial Management Framework report were confirmed in Audit interviews and through review of documents.

- Restrictive System Checks CDFS has certain system checks to prevent payments; however some of these checks have resulted in financial workarounds. One example was the decommitment of large contractual commitments which constrained the free cash balance for other payments when the funding for that contract had not been received. Another example was the system requirement for a commitment to be in place for expenditures greater than $50,000. Expenditures for Payment in Lieu of Taxes (PILT) or Seized Property distribution of revenues are often in excess of $50,000 as the single expenditure is a consolidation of several RCs or activities. The centralized, requisition RC creates a commitment, which is an encumbrance against several responsible RCs, and inputs it into CDFS prior to making the payment.

- CDFS Management Reporting Module (MRM) The MRM was developed, for Managers, as a reporting and monitoring module of CDFS. Interviewees indicate that it is not being used, as there has been difficulty in interpreting and validating the information. Managers dealing with such problems found limited benefit in using MRM when there is a qualified FMA/Financial Advisor who can easily provide the information. As the Government is exploring the benefits of a centralized financial system, it will not likely benefit the Department to undertake a major overhaul or upgrade to MRM at this time.

- Commitment Monitoring As a beneficial method of controlling and verifying compliance with the Commitment Policy, Finance has created new Commitment Monitoring - Exception Reports. These reports are for: Non-Budgetary, Uncommitted Accounts Payable, Uncommitted Periodic Payments, Accounts Payable and Blanket Commitments. One of these exception reports is a monthly selection of expenditures that are greater than $5,000 but that do not have a commitment. This provides an opportunity for FMAs to speak with RC Management and determine why a commitment had not been prepared. In some cases, these Commitment Monitoring Exception Reports do not work. For example, the system creates an exception report, after a contract amendment, that notes the contract expenditures made prior to that amendment as errors. In another case, it was observed that the RC responsible for telecommunications has received multi-pages of errors. The system reported errors for cellular phone expenditures greater than $5,000; however, individually, each expense per cellular phone is less than approximately $30.00.

- Internal Payments There are constraints in managing commitments caused by system programming for intradepartmental charges. As example, payments for certain expenditures, such as utilities and PILT are collected through lease holdings and represent the expenses of a specific building or portfolio within a Real Property Branch RC. Payment is however centralized and undertaken by Accommodation and Portfolio (Finance Group) within RPB. The Finance Group makes the payment and charges the expense to the RC through an Intradepartmental charge, which is expensed to the RC's financial IS code. If the RC sets up a commitment, the Finance Group cannot charge against it. This would mean that the Finance Group would expense the payment against the cash balance and the RC would have to decommit when it receives notice of the internal payment. This increases the level of manual verification and adjustment. To mitigate this effort, most RCs choose not to create a commitment. As a result, the financial reports show a large Free Balance, even though the balance should be lower to reflect future payments, like utilities or PILT, known but not yet paid. (Accounts Payable) This overstatement of Free Balance is compounded by the time lag between collection and payment. PILT is normally paid twice a year and some utilities may lag by several months.

- <u>External Factors affecting Budget Management</u> The efficient management of a yearly budget is interdependent on how well the Department handles its forecasts of expenditures and revenue. Of great concern in the past has been the lapses of budgets. It was reported that the largest amount of lapses for 2003/04 were primarily a combination of a Government and Department freeze, as well as the unique nature of Real Property. This year, the Department is supporting the Government's agenda for redistribution and savings by reducing its costs and lapsing funds. Interviewees reported on the limited control over their budget due to many external factors including: Government freezes, Departmental freezes, wage caps, clients demands and constraints, elections, salaries and collective agreements, union strikes, etc. For the most part, controls over their Operations and Maintenance are further limited by infrastructure costs that tend to be fixed, such as information/technology service agreements, telephones, cell phones and photocopies.

- <u>CDFS financial data</u> A delay in the input of CDFS financial adjustments by a RC can result in inaccurate financial information for decision making. As an example, one RC that was sampled had a negative Operations and Maintenance (O&M) Free Balance. In discussion with the RC Manager, who is responsible for the former Department of Communications, the RC's reference level of salary dollars was lapsing as people had left the organization and the reference level for O&M was overspent, as contract dollars were used to hire part-time staff. At the point of time in the Audit Survey, this RC had not transferred the salary dollars to O&M through a Budget Adjustment Request (BAR).

- <u>Financial Analysis</u> The CDFS financial data is difficult to efficiently use to make accurate comparisons from one year to the next as there have been many organizational changes in the Department, which have resulted in changes in financial tombstone data. (e.g. expenditure coding, addition of/removal of RCs) This limited the audit's ability to quantitatively analysis RC's financial management of forecasts and commitments.

- <u>Forecast Analysis</u> An analysis of CDFS 2004/05 forecast data for a primary RC and five delegated roll-up RCs was undertaken to consider if comparisons of changes in forecast, budget and actual expenditures could provide a reasonable statistical projection of the actions of Managers relative to a declaration of surplus funds. The audit was not able to co-relate the changes in forecast with the actions of Managers. A statistician with Consulting and Audit Canada was consulted to consider other approaches. Based on his experience, an analysis of the financial data for correlational analysis or other types of statistical analysis would require multiple years of data. Given this type of analysis would demand extensive resources and result in limited value to the audit no further work was undertaken.

The Audit conclusions are that:

Management will continue to develop internal stand-alone spreadsheets to monitor funds and projects because there is no strong Departmental forecasting tool. The impact of this is: higher dependence on FMAs and less accountability of financial management by RC Management; increased consumption of resources to reconcile CDFS with various Branch feeder systems; increased risk of reconciliation errors; and, limited reliance or integrity of CDFS financial data for reporting and decision making.

Changes in financial tombstone data, as a result of many organizational changes, limit the effectiveness of CDFS as a reporting tool to produce relevant information for decision making, or qualitative information of budget management for performance analysis.

The new Departmental policy on commitment control is reasonable and the exception reporting provides a beneficial method of controlling and verifying compliance to the policy, however there is the potential for future non-compliance and increased financial workarounds by RC Managers frustrated with CDFS's restrictive system checks and constraints. Such limitations of budget management issues, as observed in the audit, could limit the effectiveness and benefit of CDFS financial information to decision makers.

3 Recommendations

It is recommended that the Audit should be concluded at the Survey Phase since a detailed examination is unlikely to provide additional assurance on commitments and forecasts.

It is recommended that the Chief Financial Officer of Finance Branch should ensure that the Common Departmental Financial System is sufficiently robust and flexible in its programming and controls, to support Managers, accountable for sound financial management, in actions that are compliant to departmental financial policies, and in reporting of financial information that is accurate, relevant and timely for decision making.