



FINANCIAL SERVICES AUDIT OF

CAPITAL ASSETS

NOVEMBER 2004

**Foreign Affairs Canada
International Trade Canada
Office of the Inspector General
Audit Division (SIV)**

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EXECUTIVE SUMMARY

This report presents the findings of the audit of the departmental practices associated with the accounting for Capital Assets. The objective of the audit was to determine whether the Department appropriately and consistently accounts for its capital assets in accordance with prescribed Departmental and Central Agency accounting standards and relevant policies. The scope of the audit focussed on the capital asset practices applied by the Headquarters Administrative Services Division (SRA), Security and Intelligence Bureau (ISD), Information Management and Technology Bureau (SXD) and Physical Resources Bureau (SRD) during the 2002/03 fiscal year. While the scope of the audit did not include a direct examination of the capital asset practices applied by Missions, some of the audit test results provided an indication of the appropriateness of the processes applied abroad.

Overall, the Department is not always accounting for its capital assets in accordance with prescribed accounting standards and relevant policies. Acquisitions, betterments and retirements related to capital assets are not always properly recorded in the Asset Accounting (AA) module of IMS. Based on the audit testing performed, there is a net understatement of \$10.6M¹ in the Department's equity position of \$912M, as at March 31, 2003.

In our opinion, the understatement is not due to an "ownership" issue. The key departmental capital asset stakeholders are cognisant of the type of assets that fall within their sphere of accountability. They also recognize, albeit to varying degrees, their leadership role with respect to maintaining accurate and complete capital asset data within IMS. Rather, weaknesses in asset stakeholder business processes, financial policy, central coordination and training practices and IMS configuration have collectively contributed to the understatement.

Further, in our view, IMS' configuration adds complexity to the asset capitalization process, increases the risk of poor data integrity and results in more labour intensive monitoring practices. The SAP asset capitalization configuration recommended by the Integrated Financial Management System (IFMS) Program Office, if adopted by the Department, would streamline stakeholders' asset capitalization business processes, improve the accuracy and completeness of IMS capital asset data and promote more efficient monitoring practices.

If left unattended, the weaknesses identified by the audit will continue to result in an understatement of the capital asset information reported in the Department's financial statements and Public Accounts annual submissions. The understatement

¹ It is likely that this understatement would have been substantially larger had the scope of our audit testing included all Departmental Application Development Projects completed or underway post April 1, 2001.

would, over time, reach a dollar materiality threshold that could result in a qualification of an audit opinion issued on the Department's financial statements, in the event that the Government of Canada decided to proceed in this regard.

Recommendation Status

A total of 28 audit recommendations are raised in the report; ISD (4), SMF (2), SMP (1), SMS (10), SRA (2), SRD (4) and SXD (5). Management has responded to each recommendation indicating action already taken or decisions made, as well as future action. Of the 28 recommendations, management has stated that 12 recommendations have been implemented. For the remaining 16 recommendations, management has indicated the initiatives in progress or the intended future course of action.

1.0 BACKGROUND

1.1.1 The Government's Financial Information Strategy (FIS) came into effect on April 1, 2001. FIS changed the Government's method of accounting from a modified accrual basis to full accrual accounting. A key aspect of this change required departments to capitalize the initial acquisition cost of an asset, amortize and expense its value over its useful life and report any gain or loss upon its retirement. Prior to FIS, an asset's acquisition cost was expensed during the year of acquisition.

1.1.2 The Department's capital assets policy (herein referred to as the Policy) states that all assets with a total acquisition cost equal to, or greater than, \$10,000 shall be capitalized. The value of the Department's capital assets as of March 31, 2003 is reflected in the following table.

DFAIT's CAPITAL ASSETS VALUE @ MARCH 31, 2003 (000's)			
Asset Category	Carrying Cost	Accumulated Depreciation	Net Book Value
Land	\$ 192,436	\$ 0	\$ 192,436
Buildings	\$ 836,582	\$ (320,967)	\$ 515,615
Machinery & Equipment	\$ 118,741	\$ (86,583)	\$ 32,158
Vehicles	\$ 33,080	\$ (19,338)	\$ 13,742
Leasehold Improvements	\$ 35,843	\$ (4,221)	\$ 31,622
Assets Under Construction	\$ 126,883	\$ 0	\$ 126,883
Total	\$ 1,343,565	\$ (431,109)	\$ 912,456

2.0 AUDIT OBJECTIVE, SCOPE, APPROACH AND TIMING

2.1 Audit Objective

2.1.1 Our audit objective is to determine whether the Department appropriately and consistently accounts for its capital assets in accordance with prescribed Departmental and Central Agency accounting standards and relevant policies.

2.2 Audit Scope

2.2.1 The Department's capital reference level for the past three fiscal years is reflected in the following table.

DFAIT's CAPITAL REFERENCE LEVEL 2000/01 TO 2002/03 (000's)						
Authority Type	2000/01 (Note 1)		2001/02 (Note 1)		2002/03 (Note 1)	
	Available Authority	Authority Used	Available Authority	Authority Used	Available Authority	Authority Used
Capital	\$ 104,728	\$ 104,559	\$ 177,141	\$ 176,523	\$ 121,633	\$ 121,553

Note

1. Amounts per Public Accounts Form A - "Summary of Source and Disposition of Authorities".

2.2.2 The sum of the 2002/03 capital reference level for SRA, ISD, SXD and SRD amounts to \$93.2M. This figure represents 77% of the Department's capital reference level of \$121M. Accordingly, the scope of our audit focussed on the capital asset practices applied by these organizational units.

2.2.3 The audit did not include a review of the April 1, 2001 opening balance of departmental capital assets as the Office of the Auditor General had previously examined this area and reached positive conclusions.

2.2.4 While the scope of the audit did not include a direct examination of the capital asset practices applied by Missions, some of the audit test results provided an indication of the appropriateness of the processes applied abroad.

2.3 Audit Approach and Timing

2.3.1 The internal audit was conducted in accordance with the Treasury Board Policy on Internal Audit and the Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing. The examination took place during the period December 2002 to July 2003.

2.3.2 The audit work included reviewing documentation and conducting interviews with the Department's key capital asset stakeholders (i.e. SMD, SRA, SRD, SXD and ISD) to develop an understanding of their roles, responsibilities, authorities and associated business processes. Flowcharts were prepared depicting the various modules of the Information Management System (IMS) used to capitalize an asset's initial acquisition cost and record all subsequent changes in value over its useful life. Random samples of capital and operational and maintenance expenses recorded in IMS during the 2001/02 and 2002/03 fiscal-years were drawn.

3.0 SUMMARY OBSERVATIONS AND RECOMMENDATIONS

3.1 Compliance with Accounting Standards and Policies

3.1.1 The Department is not always accounting for its capital assets in accordance with prescribed accounting standards and relevant policies. This has resulted in a net understatement of \$10.6M in the Department's equity position as at March 31, 2003 as detailed in the following table.

Sample Results by Asset Stage Summary of Financial Impact				
Asset Stage	Impact	# of Sample Items	# of Sample Items in Error	Dollar Value
Acquisitions	Understatement of Dept'l Assets (Note 1)	562	375	\$ (7,591,000)
Betterments	Understatement of Dept'l Assets (Note 2 & 3)	130	64	\$ (3,285,000)
Retirements	Overstatement of gain upon retirement of asset	25	15	\$ 500,000
	Overstatement of loss upon retirement of asset	31	31	\$ (233,000)
Net Understatement of DFAIT's Equity Position		748	485	\$ (10,609,000)

Notes

1. DFAIT's Policy on Accounting for Capital Assets is silent on whether costs associated with Departmental Application Development projects need to be capitalized. However, a Treasury Board Bulletin issued in October 2000 specifies that the capitalization of software will be mandatory on a prospective basis starting on April 1, 2001. It also stipulates that "departments must capitalize allowable costs incurred after March 31, 2001 for acquired and in-house developed software, regardless of the start date of the project". The audit team selected a sample of 23 Departmental Application Development Projects and determined that \$1.8M of costs had not been capitalized in accordance with TB direction. It is likely that the net understatement in DFAIT's equity position would have been substantially larger than the reported \$10.6M had the scope of our audit tests included all Departmental Application Development Projects completed or underway post April 1, 2001.
2. The betterments sample items relate strictly to real property assets. The amount of the understatement, and whether the sample items represent in fact errors, is in dispute with SRD due to a divergence in views as to how to interpret the applicable Policy requirements. In addition, the amount includes approximately \$1.0M of real property expenditures (26 transactions) which were incurred directly by the Missions (i.e. outside of SRD's direct control).
3. Some sample items represented a single expense associated with a betterment or maintenance project. The reported understatement is based on the dollar value of the sample item and does not reflect all expenses related to the project.

3.1.2 We conclude, that the net understatement of the Department's equity position is attributed to weaknesses in financial policy, central coordination and training, IMS configuration and asset stakeholder business processes. The required improvements in each of these areas are described below.

3.2 DFAIT's Capital Asset Policy

3.2.1 The DFAIT Accounting Manual outlines the Capital Asset Policy's scope, objective, requirements, key definitions and associated roles and responsibilities. It provides useful information and a baseline upon which the key departmental capital asset stakeholders can develop their internal business processes. However, we noted the following areas where there are no stated policy requirements:

- Departmental Application Development Projects;
- Upgrades made to software acquired prior to April 1, 2001 that was excluded from the initial upload of the capital asset data into IMS based on direction received from the Treasury Board Secretariat;
- Upgrades made to software acquired and capitalized after April 1, 2001;
- Leasehold improvements made to properties leased pre and post April 1, 2001; and,
- Accounting for the costs of disposals when calculating the gain or loss upon the retirement of an asset.

3.2.2 While the Policy includes a section dealing with "Roles and Responsibilities", the content is general and lacks detail. The section states that SRD, SXD and ISD have "specific responsibilities"; however, these responsibilities are not clearly articulated, nor are those of SRA, SMD and Missions.

3.2.3 The Policy also provides a description of concepts typically associated with capitalizing assets. For example, the "whole versus component" approach to asset capitalization is described, as well as the importance of distinguishing between "betterment and maintenance" expenses. While a description of these concepts and others is provided, it is general and is not clearly articulated on how they are to be interpreted from a policy perspective by the key departmental capital asset stakeholders.

3.2.4 In absence of an explicit policy, there is a stronger likelihood that the departmental capital asset stakeholders will continue to inconsistently account for, record and report their capital asset holdings. In consequence, this impacts adversely the integrity of IMS data and the accuracy of the Department's Financial Statements and Public Accounts submissions.

Recommendations for SMS

3.2.5 In consultation with SRA, SRD, SXD, SMF and ISD, revise the Capital Assets Policy by defining its requirements with respect to the following areas:

- a. Departmental Application Development Projects;**

- b. Upgrades made to software acquired pre April 1, 2001 that was excluded from the initial upload of the capital asset data into IMS;
 - c. Upgrades made to software acquired and capitalized post April 1, 2001;
 - d. Leasehold improvements made to properties leased pre and post April 1, 2001; and,
 - e. Accounting for the costs of disposals when calculating the gain or loss upon retirement of an asset.
- 3.2.6 Obtain and review from SRA, SRD, SXD, SMF and ISD a description of their:
- a. assigned capital asset roles, responsibilities and authorities and those attributed to HQ Bureaux and Mission staff, where applicable; and,
 - b. interpretation of the key asset capitalization concepts that are applicable to their business operations.
- 3.2.7 Create an annex to the Capital Assets Policy for each of the key departmental capital asset stakeholders (i.e. SRA, SRD, SXD, SMF and ISD) and insert the information received per 3.2.6 into the applicable annex.
- 3.2.8 Include the revised Capital Asset Policy in the DFAIT Accounting Manual and inform Headquarters and Mission stakeholders of the existence of the updated document.

SMS Action and Time Frame

- 3.2.5-8 **Agreed. SMSP will, in consultation with stakeholders, revise the Capital Asset policy as required for each of the items specified. This review will begin in January 2004. Any revisions are dependant on stakeholders providing critical information to include in the policy. Once all the information is received, the policy will be revised and re-issued as Chapter 13 in each of the Headquarters Accounting Manual and the Mission Accounting Manual. Both Headquarters and Mission stakeholders will then be made aware of the existence of the updated document.**

SMS Updated Action and Time Frame

3.2.5-8 Since our initial response to this recommendation, SMS has placed the Capital Asset Policy on its web site with the caveat “under review.” As of October 2004, not all stakeholders have provided SMS with the required information. As such, SMS will convene a working group of all stakeholders this coming December/January that will address the recommendations. We anticipate that the revised Capital Asset Policy will be completed by March 31, 2005.

3.3 Central Coordination and Training

3.3.1 The period immediately preceding the introduction of FIS was a busy and hectic time for key capital asset stakeholders. Efforts were focussed, in part, on verifying the integrity of the initial upload of capital asset data into IMS, defining asset capitalization business processes and learning how to use IMS for purposes of achieving policy objectives.

3.3.2 The key capital asset stakeholders have commented that training provided prior to the introduction of FIS was limited to a one day information session provided by SMSF. While the one day session was a positive step, it did not constitute a formal capital asset training program. Participants did not develop a comprehensive understanding of the Policy’s requirements and how to use IMS’s functionality to properly record the various transactions that could occur over a capital asset’s useful life. Neither formal capital asset training nor information sessions have been provided to stakeholders, both at Headquarters and Missions, since the introduction of FIS on April 1, 2001. It is evident from our interviews and test results that a formal capital asset training program is required.

3.3.3 SMSF prepared several documents describing how to use the Asset Accounting (AA) Module of IMS to record particular capital asset transactions (i.e. post-capitalization, write-downs and write-ups). These well prepared documents, however, have only been distributed to SRD. Therefore, the realization of the expected benefits, in terms of improved knowledge and greater consistency, has been limited.

3.3.4 The key capital asset stakeholders commented that they do not have a contact to provide guidance on how to properly account for the various capital asset transactions or use IMS’s functionality. They have essentially been left on their own since April 1, 2001 and forced to deal with the challenges of introducing asset capitalization in a manner they think is most appropriate. It should be noted that the Department’s draft Policy on Accounting for Capital Assets does identify SMSP and SMSC as the organizational units to contact for enquiries that deal with the Policy and IMS respectively. Phone numbers are also provided to assist the stakeholders in

appropriately directing their enquiries. Two of the four key capital asset stakeholders informed the audit team that they have not received a copy of the draft Policy.

3.3.5 In summary, the understanding of the Policy's requirements and how to use IMS to properly record capital asset transactions, varies considerably amongst the stakeholders. This is due, in part, to the absence of both a formal capital asset training program and an officially promulgated Departmental Policy on Accounting for Capital Assets. These gaps increase the risk of stakeholders inappropriately accounting for capital asset transactions which adversely impacts the integrity of IMS data and the accuracy of the Department's Financial Statements and Public Accounts submissions.

Recommendations for SMS

3.3.6 **Contact CFSI and inform them of a requirement for a capital assets training program to be offered and tailored to the needs of both Headquarters and Mission stakeholders; and,**

3.3.7 **Ensure that its documents describing how to process various type of transactions in the AA Module are made available to capital asset stakeholders.**

(Note - recommendations dealing with the finalization and promulgation of the Department's Policy on Accounting for Capital Assets are provided in section 3.2 of the report)

SMS Action and Time Frame

3.3.6 **SMSF has met twice with CFSI to review the existing asset accounting training material available and to discuss the need for a refresher course on IMS asset accounting functionality. The training needs to cover the full asset life cycle from acquisition to retirement and disposal, incorporating the policy requirements and instructions related to IMS asset accounting functionality.**

3.3.7 **SMSF created user documentation for SRD to address questions raised by SRD. SMSF subsequently (during the audit) distributed this documentation to the other key stakeholders responsible for departmental assets.**

3.4 IMS Configuration

3.4.1 IMS is the corporate tool available to stakeholders for purposes of capitalizing their assets. However, its current configuration does not facilitate the maintenance of complete and accurate capital asset information. In particular, IMS:

- does not allow the referencing of multiple order numbers on Purchase Order (PO), Commitment (CO) and Invoice Receipt (KR) document types. As a result, stakeholders cannot refer to both an internal order and a statistical order on these documents to ensure that their asset capitalization and budget tracking and reporting objectives are simultaneously met. Faced with this dilemma, asset stakeholders have assigned a higher priority to their budget tracking and reporting objectives and decided, therefore, to refer to a statistical order on the PO, CO and KR documents. By doing so, a manual intervention is introduced into the asset capitalization process as the stakeholders must create a journal entry (SA document type) when the expense is incurred to record their capital asset in the asset sub-ledger (AA Module) and the Department's financial records (GL Module). Our audit tests indicate that this manual intervention is not regularly occurring, thereby adversely impacting the integrity of IMS's capital asset data.

The SAP asset capitalization configuration recommended by the IFMS Program Office² allows stakeholders to refer to both the Asset Master Record (AMR) and a Statistical Order on the PO, CO and KR document types. This configuration, therefore, can accommodate the stakeholders' asset capitalization and budget tracking and reporting objectives simultaneously, without any manual intervention.

IFMS Program Office representatives report that their recommended asset capitalization configuration is currently being used by 12 of the 15 federal departments with SAP, including the Passport Office. None of the individuals interviewed (within both the IFMS Program Office and DFAIT) could give a clear explanation of why the Department decided not to adopt the recommended configuration when accrual accounting was first introduced on April 1, 2001.

IFMS Program Office representatives also report that migrating from DFAIT's current asset capitalization configuration to the one they recommend could occur within a one week period. SMSF officials report that a month would be a more realistic estimate of the amount of time required to make the migration;

- does not separately identify and report on the betterment(s) made to a capital asset;
- does not account for the costs of disposal when calculating the gain or loss upon the retirement of an asset; and,
- inappropriately calculates a loss when removing duplicate AMRs from the AA module when the applicable asset has not reached the end of its useful life.

² Group housed in Treasury Board responsible for providing central coordination and support to departments using SAP software.

3.4.2 The Audit Team observed that the “Asset Transaction - by Transaction Type Code” report produced from the AA Module is not functioning properly. It is not always possible to generate a report for specified Transaction Type Codes. In addition, access profiles assigned to certain asset stakeholders are preventing them from:

- displaying a comprehensive list of assets due to the inability to view all assets assigned to specific “Plants” (i.e. Missions); and,
- performing certain monitoring functions (i.e. gaining access to the “Internal Order actual/plan” reports to determine the costs recorded against the Internal Order and settled to the AMR).

3.4.3 In summary, IMS’s current configuration requires most key departmental capital asset stakeholders to manually prepare an SA document to record the acquisition of an asset in the corporate financial system. This manual intervention is not consistently occurring and is a key cause of the reported understatement in DFAIT’s equity position. The SAP asset capitalization configuration recommended by the IFMS Program Office is an attractive solution as it removes the manual intervention, thereby improving the operational efficiency and effectiveness of stakeholders. There is also a need to work with the IFMS Program Office to identify solutions to improve the integrity of IMS data with respect to betterments and the retirement of capital assets.

Recommendations for SMS

- 3.4.4 a. **Adopt the asset capitalization configuration recommended by the IFMS Program Office prior to completing the development work associated with version 4.7 of SAP; and,**
- b. **Provide an information session to the key capital asset stakeholders, highlighting the main differences between DFAIT’s SAP asset capitalization configuration and that which is recommended by the IFMS Program Office, so that they can revise their internal business processes accordingly.**
- 3.4.5 **Review relevant departmental business processes and investigate with IFMS Program Office representatives the possibility of amending SAP’s functionality so that it can:**
- a. **report on the betterment(s) made to a capital asset;**
- b. **account for costs of disposal when reporting the gain or loss upon the retirement of an asset; and,**

- c. **avoid recognizing a loss when removing duplicate AMRs from the AA module when the applicable asset has not reached the end of its useful life.**
- 3.4.6 Provide user documentation to the capital asset stakeholders which describe the departmental business processes required to ensure that the objectives set out in 3.4.5 are achieved.**
- 3.4.7**
 - a. **Test all AA reports to ensure that they are functioning properly; and,**
 - b. **Verify that all capital asset stakeholders have a security profile which enables them to view all Plants (i.e. missions) within the AA module and gain access to all applicable IMS reports that could facilitate the effective monitoring of capital asset transactions.**

SMS Action and Time Frame

3.4.4 The current IMS asset accounting configuration was put in place based on decisions made during the DFAIT FIS implementation by a working group established to determine the business processes to be used. This working group included representatives from the key departmental asset stakeholders including SRD, ISDF, SXD, and SRAM. The current IMS asset capitalization configuration is supported by the IFMS Program Office. The IFMS Program Office supports asset capitalization where costs are posted directly to an asset master record. They also support the posting of costs to real internal orders that are subsequently settled to asset master records - this process was designed by the Program Office to be used for assets under construction.

As part of the upcoming IMS upgrade to version 4.7, working groups with key stakeholders, including those using asset accounting functionality, will be established to review business processes that have changed due to changes in the software or that require changes for various reasons. Asset accounting stakeholders will be consulted via an upgrade working group to review the issues raised as part of this audit and determine whether DFAIT should change the current business processes and the related IMS configuration. Once decisions have been made by the working group, the training needs will be assessed.

- 3.4.5 a. SMSF has approached the IFMS Program Office and requested this functionality as it is not currently supported by them. Unfortunately, no other department has requested this functionality. The IFMS**

Program Office requires the support of 5 departments to initiate this type of change. This functionality would only apply to a limited number of other departments with property, for example, DND and RCMP. Consequently, it is difficult to get 5 departments to support this type of change. SMSF will review the business process for betterments with the asset accounting working group that will be set up for the IMS 4.7 upgrade.

- b. SMSF has approached the IFMS Program Office and requested this change. The IFMS Program Office will not make a change to standard SAP functionality. SMSF will review this business process with the asset accounting working group that will be set up for the IMS 4.7 upgrade.**
- c. SMSF will review this business process with the asset accounting working group that will be set up for the IMS 4.7 upgrade.**

3.4.6 As noted above, these business processes will be reviewed during the IMS 4.7 upgrade to determine whether changes are required. End user documentation and training needs will be assessed once decisions have been made on any required changes to the current business processes.

- 3.4.7 a. During the course of the audit all AA reports were tested and are working properly.**
- b. Security access has been reviewed and adjusted as required to ensure that capital asset stakeholders have appropriate access to IMS functionality.**

3.5 Security and Intelligence Bureau (ISD) Business Processes

3.5.1 This section of the report describes the audit findings related to ISD's capital assets business processes. The findings have contributed to the understatement of DFAIT's equity position as reported in section 3.1.

3.5.2 Overall, ISD is not always appropriately and consistently accounting for its capital assets in accordance with prescribed accounting standards and relevant policies. In particular:

- Assets Master Records (AMRs) are not consistently created for acquisitions with a unit cost equal to, or greater than, \$10K;**

- An AMR's value does not always include all costs associated with the initial acquisition (i.e. purchase, fit-up, shipping, installation);
- An AMR's value reflects, at times, an estimate of the initial acquisition cost as opposed to the actual expenditure;
- Occasionally, operational and maintenance costs are capitalized instead of being expensed;
- Armoured vehicles are depreciated based upon the date the vehicle was purchased, rather than at the date on which it is put into service as required by the policy; and,
- Betterment costs related to an asset are not reflected in its value.

3.5.3 The above findings are due to the absence of a documented business process describing its key activities and the roles, responsibilities and authorities of ISD, HQ Bureaux and Missions with respect to the entire life-cycle of a security asset. The findings are also attributable to weaknesses in the Policy, corporate coordination and training practices and IMS as described in the previous sections of the report.

Recommendations for ISD

- 3.5.4 Post appropriate entries in the AA module to correct errors noted and raised during the audit debriefings.**
- 3.5.5 Document its business processes associated with each phase (i.e. acquisition, operation and maintenance and retirement) of the capital asset life-cycle with particular emphasis placed on:**
- a. Describing their key activities and the roles, responsibilities and authorities of Headquarters and Mission staff;**
 - b. Implementing the use of an ISD Asset Procurement Checklist to ensure that capital assets are recorded in IMS in an accurate and timely manner; (See note below)**
 - c. For security assets procured by Missions, ensuring that the SA journal voucher referencing an Internal Order is prepared only after the expense has been incurred; (See note below)**
 - d. Ensuring that consultation occurs between ISRA, ISDF, SRD and Missions when ISD funds local procurement of goods and services which could be defined as a betterment to a real property asset;**

- e. **Initiating the Asset Shutdown process for any new asset whereby partial costs are incurred prior to it being put into service; and**
 - f. **Undertaking periodic monitoring utilizing the various reports in the AA and MM Modules.**
- 3.5.6 Provide to SMSP, for inclusion in the Capital Assets Policy, a description of:**
- a. **its interpretation of those policy requirements which require a significant amount of judgment; and,**
 - b. **the roles, responsibilities and authorities of Headquarters and Mission staff with regard to assets under its accountability;**
- 3.5.7 Seek direction from SMSP and SMSF in order to implement measures to ensure that all applicable costs related to the retirement of an asset are considered when determining any applicable gain or loss;**

Note: Recommendations 3.5.5b and c will be applicable only for an interim period if SMS decides to adopt the SAP asset capitalization configuration supported by the IFMS Program Office as recommended under Section 3.4.4 of the report.

ISD Action and Time Frame

- 3.5.4 We concur with the observations and recommendations identified in the audit. ISDF completed the posting of the appropriate entries in the AA module, corrected all errors noted and raised during the audit briefing and created new AMR's as required. Transaction code and new AMR numbers are all documented for each AMR reflecting the action taken.**
- 3.5.5 a. Our internal business process is in first draft identifying roles, responsibilities and specific instructions to ensure that the capital assets are properly recorded and monitored. This document will also include security specifics such as IDACS and why it is considered a capital asset even though it is made up on many smaller components. ISDF will provide final business process to be incorporated into the Departmental Capital Asset Policy when finalized. The final business process should be completed end of December, 2004.**

- b. **During the audit, ISDF created a checklist which was reviewed by the auditors and implemented by ISDF during the course of the audit. This checklist is kept on the inside cover of each procurement file for capital assets where all information can be recorded when the asset is created.**
- c. **In the case where Missions procure capital assets using their own funds, we rely on the Mission and/or ISR to advise us of the purchase. ISD believes that procedures should be identified in the Mission's section of the Capital Asset Policy but will wait for SMS's decision on the asset capitalization configuration, as noted in the report.**
- d. **Consultations are on-going with ISRA, SRD and the missions when local procurement of goods and/or services could be defined as a betterment to a real property asset.**
- e. **This recommendation has been addressed and implemented with new capital purchases and is part of our internal business process.**
- f. **Monitoring of capital assets through the various reports in the AA Module commenced in January 2004 and will be conducted quarterly. This procedure has been incorporated into our internal business process.**

3.5.6 See 3.5.5a above.

3.5.7 This recommendation would be implemented in conjunction with SMS 3.2.5 and 3.3.6 recommendations. ISDF would also welcome any further training that may be available related to the retirement of an asset.

3.6 Headquarters Administrative Services Division (SRA) Business Processes

3.6.1 This section of the report describes the audit finding related to SRA's capital assets business processes. The finding had no impact on the understatement of DFAIT's equity position as reported in section 3.1.

3.6.2 SRA is consistently recording its capital assets in the AA module. It is not always, however, done in accordance with prescribed accounting standards and relevant policies. Our review indicated that four of the seven capital assets acquired during 2001/02 and 2002/03 were not recorded in the AA module in a timely manner.

3.6.3 The above finding is largely due to SRA's infrequent procurement of capital assets (i.e. low business volume) and a significant time lapse between the creation of the purchase order and the establishment of the internal order settlement rule. It is also attributable to weaknesses in the Policy, corporate coordination and training practices and IMS as described in the previous sections of the report.

Recommendations for SRA

3.6.4 Document business processes associated with each phase of the capital asset life-cycle (i.e. acquisition, operation and maintenance and retirement), with particular emphasis placed on describing key activities, roles, responsibilities and authorities of staff. The following are items which should be incorporated into the business processes.

- a. Establish the Internal Order settlement rule and AMR at the same time of creating the purchase order; *(See note below)**
- b. Undertake periodic monitoring utilizing various reports in the AA and MM Modules.**

3.6.5 Provide, to SMSP for inclusion in the Capital Assets Policy, a description of:

- a. SRA's interpretation of those Policy requirements which require a significant amount of judgement; and,**
- b. the roles, responsibilities and authorities of Headquarters staff with regards to assets under its accountability;**

Note: Recommendation 3.6.4a will be applicable only for an interim period if SMS decides to adopt the SAP asset capitalization configuration supported by the IFMS Program Office as recommended under Section 3.4.4 of the report.

SRA Action and Time Frame

3.6.4-5 We concur with findings and recommendations outlined above. As training was limited to one day, SRAM was unaware additional steps had to be taken to ensure that an internal order settlement rule was established. SRAM staff have since been informed, an internal business process has been drafted, complete with roles, responsibilities, specific instructions and menu paths to ensure capital assets are properly recorded in a timely manner and

monitored. The document also includes SRAM's interpretation of certain items such as systems furniture and why they are not being tracked as a capital asset. A copy of the business processes has been forwarded to SMSP for inclusion in the Departmental Capital Asset Policy (Completed).

We would welcome the opportunity to have additional training once a year to ensure consistency, understanding of the Policy and incorporate changes if needed.

3.7 Information Management and Technology Bureau (SXD) Business Processes

3.7.1 This section of the report describes the audit findings related to SXD's capital assets business processes. The findings have contributed to the understatement of DFAIT's equity position as reported in section 3.1.

3.7.2 Overall, SXD is not always appropriately and consistently accounting for its capital assets in accordance with prescribed accounting standards and relevant policies. In particular:

- AMRs are not consistently created for SXD and Mission acquisitions with a unit cost equal to, or greater than, \$10K;
- AMRs are not consistently created in a timely manner (i.e. AMR created, at times, some 10 months after the purchase order);
- The appropriate asset class is not consistently selected when creating AMRs;
- AMRs have been created but no values have been settled to the AA Module (i.e. Internal Order [IO] not created or IO created but with no cost attributed to it via an SA); and,
- The value of an AMR does not always accurately reflect the overall acquisition cost of the asset (i.e. IO created but cost attributed twice via an SA);

3.7.3 SXD has recently developed the Information Technology Asset Management System (ITAMS) as its primary tool for tracking and managing all of its assets, regardless of value. However, it is not integrated with IMS's asset sub-ledger as there is no direct link between the ITAMS record and the AMR in the AA Module. As a result, the Bureau is forced to manually identify which ITAMS record corresponds to which AMR when the asset's value needs to be adjusted (i.e. write-down, retirement, etc.) in the AA Module. This reduces operational efficiency and increases the likelihood that the AA Module will not be updated in a timely manner, thereby, adversely affecting the integrity of IMS's capital asset data. The audit observed that the manual

identification is not occurring. The impact of this weakness, if it continues, will be substantial as the Department is planning to invest \$13.5M into new servers during the 2003/04 fiscal year as part of the Infrastructure Renewal Program.

3.7.4 The above findings are due to the absence of a documented business process describing its key activities and the roles, responsibilities and authorities of SxD, HQ Bureaux and Missions with respect to the entire life-cycle of an IT capital asset. The findings are also attributable to weaknesses in the Policy, corporate coordination and training practices and IMS as described in the previous sections of the report.

Recommendations for SxD

3.7.5 Post appropriate entries in the AA module to correct errors noted and raised during the audit debriefings.

3.7.6 In light of the acquisition and retirement of capital assets associated with the Infrastructure Renewal Program (IRP), document its capital assets business processes as soon as possible with emphasis placed on:

- a. describing the roles, responsibilities and authorities of SxD divisions, HQ Bureaux and Missions stakeholders for each phase (i.e. acquisition, operation and maintenance and retirement) of the capital asset life-cycle;**
- b. assigning the responsibility for creating a PO, IO and AMR to SXMP;**
- c. ensuring that the information recorded in ITAMS is used to maintain and verify the integrity of the data contained in the AA module; and,**
- d. periodic monitoring utilizing the various reports in the AA and MM Modules.**

3.7.7 Provide to SMSP, for inclusion in the Capital Assets Policy, a description of:

- a. its interpretation of those Policy requirements which require a significant amount of judgment; and,**
- b. the roles, responsibilities and authorities of the SxD divisions, HQ Bureaux and Mission stakeholders with regard to assets under its accountability.**

3.7.8 Create a reference document describing the type of capital assets included in each of the IT Asset Classes contained in the AA Module.

3.7.9 Assess, in consultation with SMSF, the feasibility and cost-effectiveness of using IMS's Project Systems (PS) Module for purposes of recording its capital assets in the Department's financial system. In the event that a decision is made not to proceed with the PS module: (See note below)

- a. A manual tracking system should be put in place. This system should ensure that the costs of a capital asset are recorded against an Internal Order (IO) at the time of invoice receipt (via an SA) in those instances when a Statistical Order was referenced in the "Order" field of the purchase order; and,**
- b. A Statistical Order (SO) for capital asset settlement should be established and referenced on the credit line of all SA documents created to record costs against an IO to prevent an overstatement of the free balance in SXD Fund Centre budgets.**

Note: In the event that SXD decides not to use the PS Module and SMS decides to adopt the SAP asset capitalization configuration supported by the IFMS Program Office as recommended under Section 3.4.4 of the report, recommendation 3.7.9a and b will be applicable only for an interim period.

SXD Action and Time Frame

3.7.5 Reports are now available to assist us in monitoring errors. While the discrepancies identified during the audit have been corrected, additional errors have been recently discovered and should be addressed prior to the end of September 2004. These additional errors occurred during the year end PAYE exercise because the liability of the PO could not be carried forward into the next fiscal year (Completed).

3.7.6 a. The asset capitalization process is now documented and entrenched into the day-to-day procurement and invoicing procedures. Also, to facilitate deployment and required asset control processes involved with this project (i.e. shipping, installation and retirement/disposal), SXMP have seconded a staff member from the asset and inventory management area to the project for the duration of the implementation. These other processes including roles, responsibilities and authorities will be documented in the new IT

Asset Management Policy currently under development (November 2004).

- b. SXMP and SXMF have, since August 2003, a solid business process in place identifying roles and responsibilities that have been clearly established between the two sections. The responsibility for creating PO's and AMR's are assigned to SXMP and the creation of IO's including the de-capitalization process has been assigned to SXMF. While there have been some minor issues that required adjustments, the process is documented, in place and functioning (Completed).**
 - c. A business process document (checklist) was initiated by SXMP and SXMF and implemented in August 2003. It identifies individual roles and responsibilities as well as detailed procedures to ensure capitalization and de-capitalization of assets. An important factor in the creation of this checklist was to ensure that we had a mechanism in place to capture all our depreciable assets from the time of creation until time of retirement and to leverage our existing systems (i.e. ITAMS) to help achieve this. ITAMS has been modified to include Asset Master Records. While there are automated reporting capabilities at the time of disposal of an asset, the actual initial data input must still be done manually. A monthly report of all current and retired AMR's is provided to SXMF for data verification and de-capitalization, whatever the case (Completed).**
 - d. Agreed. A monthly report of all current and retired AMR's is provided to SXMF from the ITAMS database. We also produce on a monthly basis a report identifying all items procured in IMIT and verification is made to ensure AMR's were created where necessary (Completed).**
- 3.7.7 While there have been brief discussions with SMSP, due to other priorities this recommendation has not been met to date. SXM(P) has begun to draft a new IT Asset Management Policy which will encompass different issues in dealing with IT Assets (i.e. acquisition, certification, etc.) and intends to discuss with SMSC and the new Bureau SPD capitalization requirements (Completion date: November 2004).**
- 3.7.8 We agree that this would be a useful tool, especially for IMIT Procurement Officers. There is a list that already exists and the people that currently use it know it fairly well. A review had started but was discontinued due to other priorities. Since a list exists that**

we are using, we do not see this has a very pressing issue and we intend to resume the review in September 2004. SXMP are also exploring the creation of a new e-catalogue to facilitate the procurement of IT Assets. We will visit the possibility of incorporating these references within this new tool at that time.

3.7.9 With the "programming freeze" that was imposed by SMS this past summer, as they are in the process of upgrading the departmental financial system, it was decided that the tracking of capital assets should be done manually. A manual process is now in place and working well. There is a definite concern that using the PS module will create more work; it is very time consuming and is a cumbersome module to use.

SMS has since released a new functionality for the Funds Reservation module that will provide us with the ability to code POs, PRs, COs and SAs against this module. Using this module, we can continue to use Internal Orders for the capitalization process of IT assets. We are planning on exploring this further. To be implemented April 1st, 2005.

3.8 Physical Resources Bureau (SRD) Business Processes

3.8.1 This section of the report describes the audit findings related to SRD's capital assets business processes. The findings have contributed to the understatement of DFAIT's equity position as reported in section 3.1.

3.8.2 SRD has established appropriate business processes to ensure the capitalization of the *acquisition* of departmental real property assets. Overall, our tests of a random sample of expenses associated with the Long-Term Capital Plan (LTCP) and the Chancery and Official Residence Lease Renewal (CHOR) programs indicate that they are being consistently and appropriately recorded in the asset sub-ledger (i.e. AA Module) and capitalized in the Department's financial records (i.e. GL Module) with the exception of:

- Furniture, security, telecom/IT and valued assets costs which are not always settled to the appropriate asset class or expensed, as applicable; and,
- Capital assets acquired through the Interior Design Refurbishment Program.

3.8.3 In our opinion, the accounting for betterment and maintenance expenses is inconsistent and not always applied in accordance with the requirements stipulated in section 5.6 of the Policy promulgated during the summer of 2001. As indicated in

section 3.1 of this report, SRD is not fully in agreement with this conclusion as there is a divergence of views as to how to interpret the Policy requirements.

3.8.4 Our review of the 2002/03 leasehold improvement expenses indicated that they were charged to both the N001 (O&M) and N005 (Capital) funds. In our opinion, the expenses are capital in nature and should, therefore, be charged solely against the N005 fund. This is a corporate budgetary issue outside of SRD's direct control as it has traditionally received N001 and N005 reference level funding for leasehold expenses from SMD.

3.8.5 Since the introduction of FIS, SRD has processed one write-down transaction in the amount of \$18.8K. Our review indicates that the transaction was properly justified, supported and processed in the AA Module.

3.8.6 Retirement of real property and vehicle assets are being properly processed in the AA Module by SRD. The gain or loss upon retirement, however, is not always accurate due to:

- IMS not properly accounting for the cost(s) of disposal; and,
- SRD not being notified in a timely manner when Missions dispose of assets.

3.8.7 The above findings are due, in part, to the absence of a documented business process describing its key activities and the roles, responsibilities and authorities of SRD, HQ Bureaux and Missions with respect to the entire life-cycle of real property, vehicle and other non IT and Security capital assets. The findings are also attributable to weaknesses in the Policy, corporate coordination and training practices and IMS as described in the previous sections of the report.

Recommendations for SRD

3.8.8 Post appropriate entries in the AA module to correct errors noted and raised during the audit debriefings with respect to the Interior Design Refurbishment Program.

3.8.9 Document its business processes associated with each phase of the capital asset life-cycle (i.e. acquisition, operation and maintenance and retirement) with particular emphasis on:

- a. describing their key activities and the roles, responsibilities and authorities of SRD divisions, HQ Bureaux and Missions stakeholders. The following are items which should be incorporated into the business processes.**

- b. **Review, prior to closing out a project, the costs recorded against the Interior Design Services, Materiel Services and Valued Assets work breakdown structure (WBS) elements in order to ensure that they are transferred to the appropriate asset class or expensed, as applicable.**
 - c. **Obtain, at the inception of a real property project, an Asset Master Record number(s) from ISD and SXD representatives for assets which are not a part of the Real Property Asset and create the appropriate settlement rule(s) for the applicable WBS elements.**
 - d. **Use the IMS Purchase Order Line Item report as a means of ensuring that SRPD acquisitions with a unit cost exceeding \$10K are capitalized.**
 - e. **Establish criteria to consistently and appropriately designate betterment and maintenance projects.**
 - f. **Document the use of the criteria per 3.8.9e above and ensure that SRSF Project Approval Form (PAF) scope statements and cost estimates are sufficiently defined in order to support the decision to treat a project as either a betterment or maintenance initiative.**
- 3.8.10 Provide to SMSP, for inclusion in the Capital Assets Policy, a description of:**
- a. **its interpretation of those Policy requirements which require a significant amount of judgment; and,**
 - b. **the roles, responsibilities and authorities of the SRD divisions, HQ Bureaux and Mission stakeholders with regard to assets under its accountability.**
- 3.8.11 Communicate the results of the audit to the Geographic AMAs and Missions, highlighting the importance of notifying the Bureau of Mission vehicle, real property betterment and other non IT and Security capital asset decisions in a timely manner, so that IMS data can be updated as appropriate.**

SRD Action and Time Frame

- 3.8.8 SRD has post capitalized all individual Assets >\$10K acquired through the Refurbishment Program over the 2001/2002 and 2002/2003 Fiscal Years.**

- 3.8.9 a. SRD has acquired SMSF documentation regarding Asset Management and update processes for SRDZ's roles and responsibilities concerning all phases of the Asset's life cycle (Completed).**

SRD is in the process of documenting all other SRD divisions, HQ Bureaux and mission responsibilities and post on SRD web page notifying all parties accordingly (Work in Process).

- b. SRD has reviewed all LTCP and CHOR projects completed in FY's 2001/2002 and 2002/2003 for individual Assets >\$10K acquired under the Interior Design, Material Services and Valued Assets WBS elements. It has also created AMR records for each and moved Asset values from property AMR's to individual AMR's.**
- c. SRD has met with Asset Management counterparts in ISD and SXD and mapped out which WBS elements from the standard template for each area should be capitalized and which can be expensed.**

SRD has also obtained AUC AMR records from each area at the start of a project to be applied to the settlement rules for each applicable WBS element. This is an on-going process.

- d. SRD incorporated a monthly process whereby the Asset Management position in SRDZ runs the Purchase Order report monthly to ensure individual Capital Assets > \$10K acquired in SRPD are properly accounted for. This is an on-going process.**
- e. SRD's interpretation of a maintenance project versus a betterment as per Management Action c above is in the process of being documented.**
- f. SRD will ensure that betterment versus maintenance decisions are made in accordance with documented criteria, ensuring the basis of the decision is well documented (PAF) and updating the criteria with any new situations requiring a significant amount of judgement (Work in Process).**

- 3.8.10 a. SRD is in the process of reviewing DFAIT's Capital Asset Policy and for policy requirements that in SRDZ's opinion requires a significant amount of judgement, it is providing to SMSP its interpretation of those policies as practised in SRD.**

- b. **SRD is in the process of providing SMSP with the link to the SRD web page containing the roles and responsibilities for the rest of the Department, noted in Management Action 3.8.9a above.**

3.8.11 SRD drafted and sent a Signet broadcast message through SRD reminding missions and AMA's of the importance of notifying the bureau of all actions taken regarding non IT and Security capital assets to ensure the proper accounting for each, regardless of who is funding the action, if applicable (Work in Process).

Recommendation for SMP

3.8.12 SMP should, in consultation with applicable stakeholders, carry out a corporate review to determine the extent to which Vote 1 and 5 monies are used to fund expenditures which are not consistent with the ambient of the Votes. In the event that the results of the review indicate that a permanent change in Vote funding is required, SMP should:

- a. **reflect the change(s) in the Department's Annual Reference Level Update (ARLU) submission to the Treasury Board (TB);**
- b. **update the Department's Main Estimates submission to Parliament upon receipt of the TB Ministers' approval of the ARLU submission; and,**
- c. **revise the capital and operation and maintenance reference levels of Fund Centre Managers accordingly.**

SMP Action and Time Frame

3.8.12 SMS will promulgate a new departmental policy, effective April 1, 2005, which will specify a \$10K per item threshold for determining what constitutes a capital expenditure from the Department's Capital Vote 5. Acquisitions of items individually costing \$10K and above will be charged to Vote 5 (Capital); items individually costing less than \$10K will be charged to Vote 1 (Operating). This will clarify the rules around which Vote to charge and will facilitate recording, monitoring and reporting of capital assets.

By August 2004, SMP will have consulted with stakeholders to determine the amounts that must be transferred from Vote 5 (Capital) to Vote 1 (Operating) to properly align branch budgets with the new

O&M / Capital requirements pursuant to the aforementioned SMS policy.

By September 2004 (the earliest opportunity to do so), SMP will reflect the change in the Department's Fall 2004 Annual Reference Level Update (ARLU). This will result in the O&M / Capital allocations within the 2005-06 Main Estimates (which will be based on the approved resources for the first year (i.e. 2005-06) of the Fall 2004 ARLU), being properly aligned with departmental requirements.

By June 2005, SMP will revise bureau reference levels in accordance with the departmental reference levels approved for the Fall 2004 ARLU.

3.9 International and Domestic Financial Management and Contracting Services (SMF) Business Processes

3.9.1 This section of the report describes the audit findings related to SMF's capital assets monitoring business processes.

3.9.2 SMF's interest with respect to capital assets lies primarily with the integrity of the IMS data used for financial reporting. As a result, its role emphasizes ensuring that adequate financial controls are in place to improve the quality of IMS's capital asset data. To this end, SMF performs some monitoring activity. For example, it periodically identifies internal orders and work breakdown structures whose costs have not settled to an AMR. While SMF does carry out some monitoring, its practices can be improved as demonstrated by the following:

- A key financial control consists of ensuring that details in a sub-ledger reconciles to the summary information maintained in the General Ledger (GL). To date, SMF has not reconciled the detailed information found in the AA Module (i.e. asset sub-ledger) to the capital asset control accounts maintained in the GL Module;
- SMF has instituted year-end procedures whereby Missions are required to certify the balances contained in specific GL accounts. This is a positive practice. Missions, however, are not required to certify the accuracy and completeness of the capital asset data contained in the AA Module; and,
- Reports available from the AA Module can be used for monitoring purposes. For example, the Asset Shell Report could be used to identify those AMRs which have not been populated with a value for some time and require action by the appropriate Fund Centre Manager. SMF does not currently use the Asset Shell Report for monitoring purposes.

Recommendations for SMF

- 3.9.3 Document its capital assets monitoring business processes with emphasis placed on describing the roles, responsibilities and authorities assigned to staff. The following are items which should be incorporated into the business processes.**
- a. Reconcile periodically the detailed information contained in the AA Module to the asset control account information maintained in the GL Module.**
 - b. Require Missions and Headquarters asset stakeholders to certify the accuracy and completeness of the data (excluding depreciation and net book value information) contained in the AA Module as part of its year-end procedures. It should also verify that the HQ asset stakeholders have appropriately actioned the Mission Certifications.**
 - c. Monitor the status of the AMRs contained in the Asset Shell Report and follow up with the applicable stakeholder when no costs have settled to the AMR within four months of its creation; and,**
 - d. Ensure that appropriate documentation is maintained of having performed the monitoring procedures as described per 3.9.3a-c above.**
- 3.9.4 Provide to SMSP, for inclusion in the Capital Assets Policy, a description of the roles, responsibilities and authorities assigned to staff.**

SMF Action and Time Frame

- 3.9.3 It is understood that the primary roles and responsibilities for the business processes belong to the stakeholders. SMFH will document its roles and responsibilities with regard to the process.**
- a. SMFQ will perform this reconciliation annually at year-end.**
 - b. SMF will include the requirement for a certification of capital assets on hand in its year-end procedures issued to Missions and Headquarters. SMF will also ensure that HQ asset stakeholders have taken appropriate action in IMS, when warranted.**
 - c. SMFQ will perform the monitoring and follow-up process quarterly.**

- d. **The documentation concerning items 3.9.3a-c above will be maintained in SMFH.**

3.9.4 SMFH will provide the documentation concerning its roles and responsibilities (in the Capital Assets process) to SMSP (Completed).