Appendix 7.1

Background Paper on General Control Environment

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Review Commission on Constituency Allowances and Related Matters 2007

General Control Environment

A general control environment is fundamental to the accurate recording of transactions and the preparation of reliable financial reports. Without an adequate control environment to ensure the proper recording of transactions, the resulting financial data may become unreliable and undermine management's ability to make decisions, as well as the confidence of its stakeholders.[1]

An effective internal control structure is comprised of several components which include:

Entity Level
Process/Transactional Level
Operating System (Financial Management System)
Other Related

As each organization's level of transactions differ, so too does the organization's control needs. Although the components of an effective internal control environment are consistent from organization to organization, the optimal balance or mix of these internal control components must be assessed by each entity's leadership.[2]

The components of an effective, general control environment are discussed below.

Entity-Level Controls

In order to assess the effectiveness of the internal controls in any organization, it is necessary to review, and to have an understanding of, the controls that are in place at the top of the organization - the entity-level controls.

Organizations have long understood the necessity for strong entity-level controls. However, in light of recent corporate scandals those involving such as Enron and WorldCom, it became apparent that many organizations did not have effective entity-level controls in place. From these failures came the requirement for organizations to document and evaluate the effectiveness of internal controls and procedures over financial reporting, also known in the United States as the *Sarbanes Oxley 404 Act*.[3]

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[1] Ernst & Young LLP, *Preparing for Internal Control Reporting: A Guide to Management's Assessment Under Section 404 of the* Sarbanes-Oxley Act, (2002).

[2] James L. Goodfellow and Alan D. Willis, *Internal Control 2006: The Next Wave of Certification, Guidance for Directors* (The Canadian Institute of Chartered Accountants, 2006).

[3] Ernst & Young LLP, "Canada's Internal Control Reporting Environment: What Do Canadian Corporations Do Now?" (2006), online: Ernst & Young <http://www.ey.com/Global/download.nsf/Canada/Internal_Controls_2006/$file/16105_Internal_Controls_2006>.

In the early stages of *Sarbanes Oxley 404*, managements of some of the world's largest organizations searched for a framework to be used for evaluating their company's internal controls that would satisfy the requirements of the *Act*. Through this exhaustive search, The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) report, "Internal Control - Integrated Framework"[4] was adopted by most large entities.

The COSO framework defines Internal Control as a process - affected by an entity's board of directors, management, and other personnel - designed to provide reasonable assurance regarding the achievement of objectives in the following three categories: effectiveness and efficiency of operations, reliability of financial reports, and compliance with laws and regulations. It also identifies five interrelated components of effective internal control:

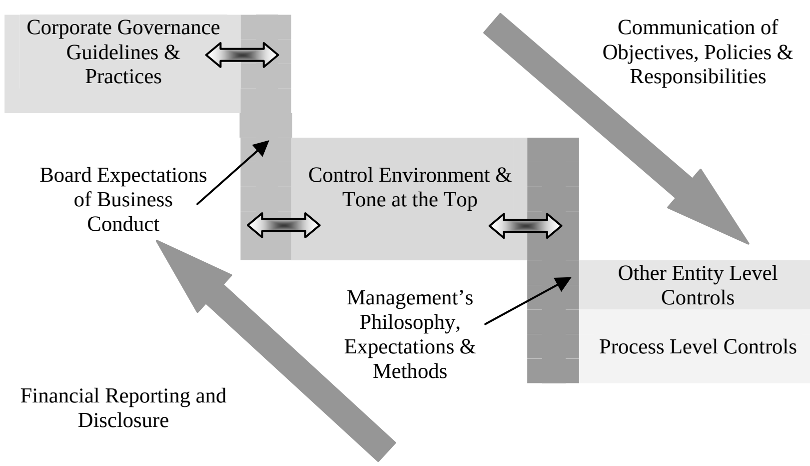
- Control Environment
- Risk Assessment
- Control Activities
- Information and Communications
- Monitoring.[5]

This section will discuss the entity-level controls in terms of the five components of internal control as discussed by COSO.

Exhibit 1 displays the component and their interactions:

Exhibit 1

Linking Governance & Control



Source: Goodfellow and Willis, p. 11.

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[4] See Committee of Sponsoring Organizations of the Treadway Commissions, "Internal Control - Integrated Framework Volume," (1992), online: Wiley Publishers. <http://www.wiley.com/legacy/products/subject/accounting/accounting>.

[5] "Preparing for Internal Control Reporting."

Exhibit 2 is a summary of the impact on style of adopting these types of control mechanisms:

Exhibit 2

Management's philosophy and operating style

The "tone at the top" has a major impact on the CEO's and senior executives' management philosophy and operating style, including their:

- Approach to accepting, managing and monitoring business risks, including those related to disclosure and financial reporting
- Attitudes and actions concerning financial reporting and disclosures, including accounting policies and estimates
- Emphasis on meeting shorter term budget, profit, and other financial and operating goals, and
- Focus on longer term business development and value creation.

The degree to which these factors are aligned with board-approved corporate goals, objectives and strategy influences management's philosophy and operating style. That operating style is the interface between the board's expectations and the control environment, and the expectations communicated to employees about control and the conduct of business. It, therefore, has a significant influence over the effectiveness of Internal Control Over Financial Reporting ("ICFR").

In summary, the control environment has an overarching, pervasive impact on other entity-level and process-level controls, including those relevant to ICFR.

Source: Goodfellow and Willis, p. 13.

Control Environment

The control environment sets the tone of an organization and influences the control consciousness of its people. The control environment reflects the overall attitude and actions by the overseeing body, its members and management concerning the importance of controls and the emphasis placed on controls over the policies and procedures.

The Treadway Commission stated that the tone set by the top management - the corporate environment or culture within which financial reporting occurs - is the most important factor contributing to the integrity of the financial reporting process. In other words, if the tone set at the top is lax, an impressive set of written rules and procedures will accomplish little.[6]

The numerous factors that comprise the control environment are discussed below:

Integrity, ethical values, and behaviour of key executives

[6] "Preparing for Internal Control Reporting."

Integrity and ethical behaviours are the products of an entity's ethical and behavioural standards. These include management's actions to remove items that could cause members to engage in dishonest, illegal, or unethical acts. An entity's values are often communicated through a code of conduct or through management leading by example.

Management's control consciousness and operating style

All parts of a control environment are influenced by the actions and decisions of management. In a positive control environment, management's commitment to control consciousness creates a positive atmosphere favourable to the effective operation of the processes and controls.[7] In this environment, the likelihood of an error is reduced.

The concept of control consciousness refers to the importance management places on internal controls, and thus to the environment in which the controls function.

Commitment to competence

Commitment to competence includes management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge. Management considers whether employees have the appropriate knowledge and skills to perform the requirements of the job.

Organizational structure and assignment of authority and responsibility

A good organizational structure provides for the assignment of responsibility. The effective communication of an entity's organizational structure allows employees to have an understanding of their roles and responsibilities. Effective management review of the organizational structure will permit the identification of segregation-of-duties issues and their correction before conflicts can arise.[8]

Human resource policies and practices

Human resource policies and practices relate to an entity's policies and practices for hiring, orienting, training, evaluating, counselling, and compensating personnel. The competence and integrity of employees is essential to an entity's control environment. An entity's ability to recruit and retain qualified, competent individuals is highly dependent upon human resource policies and practices in place in the organization.

Risk Assessment

No matter how large or small an organization, all entities encounter various levels of risk. Risks affect an entity's ability to survive, compete, and maintain its financial strength and public image. Since risk is always present, management must determine how much risk

[7] Goodfellow and Willis.
[8] "Preparing for Internal Control Reporting."

is acceptable and strive to maintain risks at that level.[9] The process of identifying, analyzing and managing risk is a critical component of an effective internal control system.

Information and Communication

The process of gathering the information required to manage the operations of an entity is referred to as "information and communication." The ability for management to make informed business decisions is directly related to the quality of an entity's information and communication system, and the financial information that comes from this system.

As part of this process, it is also necessary to ensure that management communicates employees' duties and control responsibilities in an effective manner, and that communication channels are in place to allow people to report suspected improprieties.

Control Activities

Control activities are policies and practices that help ensure the management directives are carried out and that necessary actions are taken to address the risks to achievement of the company's objectives.

Examples of effective control activities include:

- Management has clear objectives in terms of budget and other financial and operating goals; these objectives are clearly written and communicated throughout the entity and monitored regularly;
- Appropriate levels of management investigates variances and takes appropriate and timely corrective actions;
- Duties are divided or segregated among different people to reduce the risk of fraud or inappropriate actions;[10]
- Access security software, operating system software, and/or application software is used to control access to data and programs.

Monitoring Activities

An important responsibility of management is to establish and maintain internal control. Management must monitor controls to ensure that they are operating effectively and to determine whether they need to be modified for changes occurring with the entity's environment. Monitoring is a process of assessing the quality of internal control performance over time, considering whether controls are operating as intended, and assuring that they are modified as appropriate for changes in conditions.

Examples of effective monitoring activities include:

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[9] Ibid.
[10] Ibid.

- Performing periodic evaluations of internal controls;
- Implementing internal control recommendations made by external or internal parties;
- Correcting known reportable conditions on a timely basis;
- Establishing an independent internal audit function to assist with monitoring activities.[11]

[11] Ibid.

Appendix 7.2

MHA Constituency Allowance Monitoring Form

Appendix 7.2 Constituency Allowance Monitoring Form

Form developed by the Speaker of the House

MHA NAME

	Total $
Maximum Constituency Allowance	A
Actual Expenditure to Date	B
Funds Available	C=A-B

Claim #	Claim Date	Description	Line Object	Accounting Distribution	Claim total (excluding HST)

Form developed by the Speaker of the House with suggested modifications

MHA NAME

	Total $	%
Maximum Constituency Allowance	A	D= 100
Actual Expenditure to Date	B	E =(B/A)*100%
Funds Available	C=A-B	F =100-E

Claim #	Claim Date	Description	Line Object	Accounting Distribution	Claim total (excluding HST)
					B

Appendix 7.2

Appendix 7.3

Summary of Budget Responses from Interjurisdictional Survey

Appendix 7.3 Summary of Budget Responses from Interjurisdictional Survey

A complete listing of responses by province and territory is included in Appendix 8.1 of this report. To date, responses have not been obtained from the provinces of Quebec and New Brunswick.

Discussion of Survey Results

1. *Does the Commission have full autonomy to review and formally approve the final budget of the House?*

The majority of the respondents to this question answered yes. Three respondents' budgets are reviewed and approved using the policies of the Treasury Board.

2. *Does the Commission receive detailed budgetary submissions from the staff supported by clear analysis to explain proposed expenditures for the coming year, as well as an explanation of budgetary variances for the current year?*

Detailed budgetary submissions are received by the majority of respondents. For one respondent, Nova Scotia, the details are received by the Speaker only and not the full Commission.

3. *Is there any involvement of the Treasury Board, the Management Board, Cabinet &/or Cabinet Secretariat (or any arm of the executive branch of government) in the budget analysis/approval process for the House? Is there any analysis of the budget by staff outside of the legislature? If there is any interaction, please explain. (Interaction/dialogue vs. "hands off")*

The majority of the respondents answered that there is no involvement outside of the Commission. Three respondents follow normal process for approval by the House, once approved by the Commission (or equivalent group).

4. *Does the Commission establish the required staffing levels (complement) for the administrative support for the House? Does it set the salaries? Are other departments/agencies involved?*

The Commission or the Speaker and Clerk set the salaries without involvement outside of the Commission for the majority of the respondents. Salaries are set using the government process in two jurisdictions.

5. *Does the Commission have the authority to transfer funds between subheads of expenditure during the course of a fiscal year? What is the process for seeking Special Warrants?*

Commissions of all but two of the respondents have this authority. Most delegate the authority to the Clerk or a specific finance person.

6. *Are there policies which limit the scope of the Commission to transfer funds? Do certain types of funds require prior Treasury Board/Management Board or Cabinet approval? Specify.*

All but two of the respondents did not identify any restrictions to their authority to transfer funds. In one province, the restriction applies only to amounts greater than $250,000. In cases where there are restrictions, the legislature must approve such transfers.

7. *Does the Commission itself deal with funds transfers or is this delegated to the Permanent Head (DM or Clerk and staff)? Is there supporting documentation reviewed by the Commission?*

The majority of respondents delegate the authority to others within the House of Assembly. Five of the respondents delegate this to the Clerk and three delegates to the Director of Financial Services.

Appendix 7.4

Treasury Board Directive

GOVERNMENT OF
NEWFOUNDLAND AND LABRADOR

EXECUTIVE COUNCIL
Treasury Board

OFFICE OF THE SECRETARY

1997 08 14

TO: ALL DEPUTY MINISTERS, AUDITOR GENERAL AND COMPTROLLER GENERAL

RE: Transfer of Funds Policy

A revised Transfer of Funds Policy was approved by MC 97-0410. Details are attached.

The Transfer of Funds Policy was amended to provide a new accountability framework for departments. This framework provides more flexibility in the day to day management of departmental operations. The major amendments are as follows:

- The Professional Services Expenditure Main Object is now included under the General Operating Category enabling departments to transfer funds either within or across specified Current Account Activities without reference to Treasury Board.

- Departments may now transfer funds from Salaries within or across specified Current Account Activities into any of the main objects included in the General Operating Category.

- Departments may now transfer funds into the Information Technology Main Object from the Salaries Main Object or any of the Main Objects included in the General Operating Category within or across specified Current Account Activities.

P.O. Box 8700, St. John's, Newfoundland, Canada, A1B 4J6, Fax (709)729-2156

- Departments may now re-allocate funding among the accounts within the Information Technology Main Object. However, Departments are still required to meet their revenue commitments to NewTel Information Solutions, as determined during the annual budgetary process. If changes to this annual NIS commitment are required, these should be forwarded to the Information Technology Management Division for consideration.

- Departments may now create a Main Object of Current or Capital Account Expenditure in an approved Activity when necessary to properly charge expenditures against an appropriate main object.

Although technically these changes are effective immediately, the Government Accounting Division requires time to make adjustments to the Budget Adjustment/REACT system. Should your officials wish clarification of any parts of this policy, they may contact your assigned Treasury Board Budget Analyst.

Peter Kennedy

PETER KENNEDY
Secretary

:AW

GOVERNMENT OF
NEWFOUNDLAND AND LABRADOR

EXECUTIVE COUNCIL
Treasury Board

Directive Number 97-07

TREASURY BOARD DIRECTIVE

Date 1997 06 16	File No.	Division: Budgeting
T.B.M. No. N/A	M.C. No. 97- 0410	O.C. No. N/A
Issued To: All Deputy Ministers, Auditor General and Comptroller General	Reference:	
Subject: Transfer of Funds Policy	Treasury Board Contact — Name: Budget Analysts; Telephone: 729-2467	

TRANSFER OF FUNDS POLICY FOR DEPARTMENTS

APPROVAL

Under the authority of Section 9 of The Financial Administration Act, the Lieutenant-Governor-In-Council has revised the policy respecting Transfer of Funds and amended previous authorities, as follows:

PURPOSE

To provide a basis on which Departments may transfer funds between specified Main Objects within Activities and between specified Main Objects across specified Activities for the purpose of facilitating day-to-day program management.

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GENERAL

A. Subject to the provisions of this Policy, Deputy Ministers may authorize transfers of funds between specified Main Objects within an Activity or between specified Main Objects across specified Activities of the Department. The Treasury Board Secretariat will specify the eligible Main Objects/Activities. The Office of the Comptroller General will key the exception lists into the Budget Adjustment System.

B. Transfers of Funds from one Activity to another Activity in the following instances will require Treasury Board approval:

(a) transfers between Current and Capital Account Activities;

(b) transfers between Capital Account Activities;

(c) transfers between Cost-Shared Activities;

(d) transfers between Cost-Shared and Non Cost-Shared Activities;

(e) transfers across Activities which involve transfers into Salaries from Non-Salary Main Objects.

C. In considering and approving transfers of funds pursuant to this Policy, Deputy Ministers must ensure that:

(a) the transfer is necessary to enable the efficient delivery of ongoing services and

(b) the savings to be transferred, within the specified category, are intended to be of a permanent nature.

D. Deputy Ministers shall not authorize transfers of funds to finance expenditures on new program initiatives, or expenditures for which no overall Government approval exists. Departments will not be permitted to transfer out of any Main Object for which supplementary funding had been approved by means of a Supplementary Supply, Special Warrant or transfers from the Contingency Reserve. Any such proposed transfers of funds will continue to require Treasury Board approval.

E. Departments shall not transfer funds to or from statutory votes.

F. Departments may transfer funds among all Main Objects within certain specified cost-shared Activities provided that such transfers are in accordance with the applicable cost-shared agreement and the cost-sharing ratio is maintained. On an annual basis, Treasury Board will provide a listing of the applicable Activities to the applicable Department and the Office of the Comptroller General will key these lists into the Budget Adjustment System.

G. Treasury Board approval is required to transfer funds to or from the following Objects of Current Account Expenditure of an Activity:

(a) Loans, Advances and Investments
(b) Allowances and Assistance
(c) Grants and Subsidies
(d) Debt Expenses

In accordance with Section F and G, certain Cost-Shared or Capital Account activities are the exception to this rule.

H. In general, Departments may transfer funds among all Main Objects of Capital Account Expenditure within an Activity provided that such transfers are due to changes within the cost components (objects) of specifically approved capital projects. In specific cases, Departments will be given the flexibility to transfer funding from one project to another or to allocate block funding provided to specific projects subject to overall funding within the specified Activity not being exceeded. The Treasury Board Secretariat will indicate annually which capital account projects are the exception.

AMENDMENTS

OC 93-610 and MC 93-0727 are amended to reflect the revisions approved by MC 97-0410.

Peter Kennedy

PETER KENNEDY
Secretary

:AW

Appendix 7.5

Purchases, Payables and Payments Process

Appendix 7.5 Purchases, Payables and Payments Process – Prepared by Ernst & Young

Preparation and Approval of Purchase Order

The purchasing process commences with the necessity for goods and/or services. When this need arises, a purchase order (“PO”) is prepared by the appropriate individual or department and is then sent to the individual with signing authority for approvals. There are a number of controls that can be put in place at this point to prevent and detect any errors that could potentially occur, what are referred to as “What Could Go Wrongs” or “WCGW.”

WCGW
Person forwarding to GPA does not have the appropriate authority.
Control
GPA checks for appropriate authorization. If appropriate authorization is not attained, the requisition is rejected and sent back to the department for approval.

WCGW
The PO is not for legitimate business purposes.
Control
All POs are approved by the appropriate individual in each department.

WCGW
GPA accepts the PO without the appropriate approval.
Control
Entity-Level Controls - high-level review.

WCGW
GL Coding on the PO is not correct.
Control
All POs are approved by the appropriate individual in each department.

WCGW
Procurement policies are not documented or accessible to all employees (*i.e.* purchase authorization limits).
Control
Policies are made available to all employees.

Request for Tenders or Three Competitive Quotes and Purchase of Goods

Once the PO has been prepared and approved by the appropriate individual, the department must send out a request for tender or obtain three competitive quotes. This step in the process ensures the most competitive pricing is obtained and gives all vendors equal opportunity to provide the goods and services.

Once the winning tender is selected, the purchase is made. There are also a number of controls surrounding the tendering and purchasing process that are necessary to protect against the WCGWs.

WCGW

Competitive pricing is not obtained.

Control

Buyers are required to source multiple quotes whenever possible.

WCGW

Tenders are not used where required.

Control

Purchaser checks to ensure product was tendered prior to making the purchase.

Receipt of Goods (Completion of Receiving Report)

The next step in the purchasing process occurs when the goods are received from the supplier. The individual responsible for receiving the goods must ensure that the goods shipped are appropriate and in the correct quantity. They should document this information on a receiving report to maintain as part of the purchasing process. There are also a number of controls surrounding the receiving process that are necessary to protect against the WCGWs.

WCGW

Quantity of goods ordered does not agree with the goods received.

Control

Receiver verifies the quantity of goods received to the PO.

WCGW

Goods received are not recorded.

Control

Purchasing clerk completes a three-way match of the PO, receiving report and invoice.

Receipt of Invoices, Preparation of Purchases Journal and Payment Processing

Once the goods and/or services have been received and are determined to be appropriate, and the invoice has been received from the supplier, the invoice must be reviewed and approved by the individual with the appropriate level of authority. This approval will provide the confirmation that the invoice details are correct and the purchase was authorized. The appropriate accounting staff member is then able to prepare the purchases journal and record the purchase in the accounting system. When the invoices become due for payment, the accounting staff will then ensure all payments are properly made. There are also a number of controls surrounding this step in the purchasing process to protect against the WCGWs.

WCGW

Invoice is not supported by a PO (contract) and receiving report.

Control

Certifier ensures invoice is appropriate and approves documents for payment.

WCGW

Unsupported payments are made.

Invoices are not authentic or approved by the appropriate level.

Control

Before payment is made, the approver must ensure that the invoice represents valid charges against public funds in compliance with the description approved by the legislature per the Estimates document.

Officials ensure direct charge is a legitimate charge against government funds in accordance with appropriate legislation.

For travel claims, a claimant must certify that the expenses claimed were incurred on government business and are in accordance with the rates, amounts, and allowances prescribed by the Treasury Board.

Enterer ensures that the payment documentation has been certified for payment, if applicable, and that all documentation is complete.

WCGW

Invoices are not posted for payment in a timely manner resulting in charges for the incorrect period (incorrect cut-off).

Control

Monthly management review of expenses to budget.

WCGW

Invoices are paid twice, resulting in the overstatement of the payable.

Control

Enterer ensures that the payment documentation has been certified for payment, if applicable, and that all documentation is complete.

WCGW

Fictitious purchases are made.

Control

Invoice must be supported by a PO and receiving report.

Certifier ensures invoice is appropriate and approves payment when the invoice is not supported by a receiving report, does not agree with the terms of the contract, or is for advanced payment specified in the contract.

WCGW

Invoices are posted to the wrong account.

Control

Approver must ensure the accounting distribution charged is appropriate for the type of good or service purchased.

WCGW

Purchases are recorded at incorrect amount and/or quantity.

Control

Enterer reviews all documentation, including invoices, for accuracy.