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CHAPTER 1, FINANCIAL MANAGEMENT AND CONTROL AND RISK MANAGEMENT, OF THE 2011 STATUS REPORT OF THE AUDITOR GENERAL OF CANADA

Report of the Standing Committee on Public Accounts

David Christopherson, MP
Chair

APRIL 2012

41st PARLIAMENT, 1st SESSION

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THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

has the honour to present its

FIFTH REPORT

Pursuant to its mandate under Standing Order 108(3)(*g*), the Committee has studied Chapter 1, Financial Management and Control and Risk Management, of the 2011 Status Report of the Auditor General of Canada and has agreed to report the following:

INTRODUCTION

The *Financial Administration Act* and its regulations require the federal government to exercise sound financial management and control as well as risk management. It must also follow relevant Treasury Board policies, directives and standards, and be guided by principles of value for money, accountability, transparency and risk management. Accordingly, systems, practices and resources need to be in place to ensure that:

- public funds are managed prudently and honestly;
- assets are safeguarded;
- resources are used effectively, efficiently and economically to achieve government objectives;
- accountabilities for financial management are clearly established;
- financial risks are mitigated by effective internal controls; and
- the Canadian public and parliamentarians are provided with pertinent and reliable information on the use of public funds.

The Office of the Auditor General (OAG) conducted audits related to financial management and risk management in 2003 and 2006. Chapter 1 of the *April 2003 Report* of the Auditor General of Canada, entitled “Integrated Risk Management,” identified shortcomings in risk management, while Chapter 1 of the *2006 May Status Report*, entitled “Managing Government: Financial Information,” suggested that federal departments had not made satisfactory progress in resolving financial control weaknesses and in improving management competencies. The OAG also found that financial controls needed improvement and that the quality of financial information used for making key decisions was at risk. The OAG produced a follow-up audit report in Spring 2011 to assess progress that departments had made in implementing the recommendations made in these two reports.[1]

[1] Auditor General of Canada, *2011 Status Report,* Chapter 1, “Financial Management and Control and Risk Management” (Ottawa, 2011).

Regarding Chapter 1 of the *2011 Status Report*, the House of Commons Standing Committee on Public Accounts (the Committee) heard from witnesses on November 28, 2011. From the OAG, the Committee heard from Nancy Cheng, Assistant Auditor General, and Michael Pickup, Principal. From the Treasury Board of Canada Secretariat (TBS), the witnesses were Jim Ralston, Comptroller General of Canada, Paule Labbé, Executive Director of the Management Accountability Framework and Risk Management Directorate, and Gonzague Guéranger, Executive Director of the Office of the Comptroller General, Financial Management Sector, Financial Management Policy.

AUDIT FINDINGS

In this follow-up audit report, the OAG examined four main areas: financial controls, risk management, human resource capacity in financial management, and government progress on accrual-based budgeting and accrual-based appropriations. Overall, the OAG concluded that the Office of the Comptroller General (OCG) and audited departments had made satisfactory progress in implementing the recommendations made in the 2003 and 2006 reports. The Assistant Auditor General, Nancy Cheng, stated, "Overall, we found that the Treasury Board of Canada Secretariat and the departments have made satisfactory progress in acting on their previous commitments, in particular, in developing policies, frameworks, and relevan[t] guidance on internal controls, and in implementing risk management measures."[2] However, despite the noted progress, the OAG identified some areas requiring further attention.

A. Financial Controls

The OAG recognized that the OCG had provided leadership by developing a new and strengthened financial management policy framework that clarified roles and responsibilities, and had supported deputy heads in their role as accounting officers as set out in the *Financial Administration Act*. This policy framework included the development of the 2009 Policy on Internal Control. An important element of the Policy

[2] House of Commons, Standing Committee on Public Accounts, *Evidence*, 1st Session, 41st Parliament, November 28, 2011, Meeting 17, 1530.

is that deputy heads are given clearly defined responsibilities for establishing, maintaining, communicating and monitoring internal controls for managing public resources, and are made accountable for departmental financial management. The Assistant Auditor General noted, "Accountability is germane to public administration. In the Financial Administration Act, designating the deputy head as the accounting officer, it also means that the accounting officer is accountable for the various results and performance of the organization he or she leads."[3]

The Policy on Internal Control also outlines monitoring and reporting responsibilities for the Comptroller General of Canada. The OAG indicated how the Comptroller General has been providing ongoing support to departments, including:

- developing policy centres that provide guidance and support to the financial community;
- creating guidelines and tools to assist in implementing policy requirements, such as the Guideline for Chief Financial Officer Qualifications;
- implementing the Management Accountability Framework; and
- conducting audits to support the information received from departments and agencies.

An element of the audit that the OAG identified as needing improvement was departments' progress on assessing the design and effectiveness of their financial reporting control systems.[4] The OAG gave particular attention to the following areas deemed essential for effective internal control in government departments:

- identifying and documenting key businesses and controls;
- testing the design of internal controls; and
- testing the effectiveness of established internal controls.

[3] Meeting 17, 1650.

[4] The Treasury Board Policy on Internal Control (effective April 1, 2009) states that departments must establish and maintain a system of internal control (section 3.6), and are also responsible for periodic audits and other reviews to ensure effective implementation of internal controls (section 6.1.1).

The OAG noted that, as of September 30, 2010, departments still had not fully assessed their internal control systems with a view to identifying and addressing weaknesses. Moreover, according to departmental plans, this work is targeted for completion, depending on department, from 2010–2011 to no earlier than 2014–2015. Gonzague Guéranger, Executive Director of the Office of the Comptroller General, pointed out, “In 2010, about 50% of the departments were in the middle stage. They were not in fact proceeding with … effectiveness testing. This year, based on the second report, we can say that close to 80% of them have commenced this kind of activity.”[5]

The Assistant Auditor General expressed concern that, though departments have started, departments “have still not fully assessed their internal control systems to identify and address weaknesses. According to their action plans, this work will take years to complete.”[6] She also said that, in some cases, target completion dates may be overly ambitious.[7] At present, there are no requirements to adhere to projected completion dates. The Comptroller General noted that the OCG “didn't feel it was appropriate to put in place fixed timelines”[8] for completion due to the different realities and challenges facing different departments and the need to allow flexibility.

The Assistant Auditor General stated, “The committee may wish to ask the Comptroller General for an update, including information on when he expects all large departments to have their internal control systems fully assessed and on how the OCG intends to monitor the government’s actions in doing so.”[9] The Committee is in agreement with this suggestion, as it feels that until this evaluation is complete, and internal control systems are fully implemented and tested, departments are operating without optimal internal controls. The Committee recommends:

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[5] Meeting 17, 1655.

[6] Meeting 17, 1530.

[7] Meeting 17, 1705.

[8] Meeting 17, 1545.

[9] Meeting 17, 1530.

RECOMMENDATION 1

That Agriculture and Agri-Food Canada, Finance Canada, Foreign Affairs and International Trade Canada, Human Resources and Skills Development Canada, Aboriginal Affairs and Northern Development Canada, Transport Canada and Veteran Affairs Canada complete scheduled risk-based assessments of the design and effectiveness of their financial reporting controls by the noted completion dates in the Auditor General of Canada's 2011 Status Report on Financial Management and Control and Risk Management, and deliver related evaluation reports to the Committee immediately upon completion.

B. Risk Management

According to the Treasury Board of Canada Secretariat, risk management is a systematic approach to setting the best course of action under uncertainty by identifying, assessing, understanding, making decisions on and communicating risk issues.[10]

The OAG determined that each of the examined departments had acted on commitments made in response to the 2003 audit chapter and had developed a corporate risk profile that summarizes key risks, with processes in place to update these profiles regularly, and found that integration of risk into planning, reporting and decision making had improved. The Assistant Auditor General stated:

> The observation that was made in the past was that there really wasn't a holistic and integrated risk management approach. While departments might have had some risk elements they managed from a program-to-program basis, there really wasn't something at the corporate-wide level. Since that time, we reported that all departments we've audited have a corporate risk profile. They're able to bring their various risks together so they can see and prioritize at a departmental level.[11]

Ms. Labbé, Executive Director, MAF and Risk Management Directorate at TBS, expanded on the actions taken by the OCG to provide support to departments:

> The Centre of Excellence on Risk Management was created. We provided guidance and tools for departments. We spent a lot of effort sharing best

[10] Treasury Board of Canada, Framework for the Management of Risk, Ottawa, August 2010.

[11] Meeting 17, 1625.

> practices with departments. We're finding that essentially they pretty well all have good corporate risk profiles that are used as part of strategic and operational planning.[12]

While risk management has shown progress since 2003, there is still some work to be done. The Assistant Auditor General stated:

> The departments we've looked at have risk mitigation plans. The risk tolerance definition is still a bit weak. While we're saying there has been good progress, it doesn't mean we have wrestled this one firmly to the ground. In fact, if you speak with most of the deputy heads, they indicate the groundwork has been laid, but we really have to get in to make sure we have the right risks identified and the proper risk management plan.[13]

She went on to clarify that "risk management is broader than the financial risk. It has to take into consideration the strategic risk, environmental risk, operational risk, and program risk, which are beyond financial risk."[14]

Considering the importance of properly evaluating, mitigating and tolerating risk, the Committee encourages departments to continue their work developing comprehensive risk management profiles and risk management plans, as noted by the Assistant Auditor General, while working closely with departmental audit committees and the TBS Centre for Excellence in Risk Management.

C. Human Resource Capacity in Financial Management

According to the OAG, financial human resource capacity had been enhanced since 2006. The OCG had put in place several measures in this regard, including:

- guidelines on qualifications of chief financial officers;
- mandatory training courses for financial staff;
- forums and exchanges on best practices in financial management;

[12] Meeting 17, 1630.

[13] Meeting 17, 1625.

[14] Meeting 17, 1700.

- continuation of the Financial Officer Development Program and introduction of the Chartered Accountant Student Training Program for entry-level positions in government; and
- promotion of professional accounting designations for mid-level financial officers and financial managers.

The OAG identified an improvement regarding the qualifications of senior-level financial managers. In 2002, 33% of senior financial managers in federal departments had professional accounting designations. In 2010, 82% of chief financial officers and an identical proportion – 82% – of deputy chief financial officers in the 22 largest departments had accounting designations, with the result that most departments complied with the Guidelines on Chief Financial Officer Qualifications. As it stands, the OCG pointed out that 100% of departments have at least one person in the Chief Financial Officer or Deputy Chief Financial Officer position with this designation, enhancing the capacity of senior financial officers to manage financial statements. The Committee congratulates the OCG and departments on this progress.

The OAG found that departments were at various stages in the process of implementing strategies to address the anticipated turnover of senior financial executives, since a number of them are eligible to retire in the near future. The Comptroller General noted, “We are particularly interested in succession planning for the leaders in the financial community.”[15] However, he provided no further information on this matter during the Committee’s hearing. With the possibility of significant capacity gaps if proper succession planning is not undertaken, the OAG recommended in its report that departments collaborate with the OCG to ensure that succession strategies are in place to address upcoming vacancies in key senior financial positions. The Committee agrees with this approach, noting that without serious consideration of the issues accompanying the public service’s aging demographic, the government may be unprepared and may lack personnel with the necessary skills to manage complex government financial management responsibilities.

[15] Meeting 17, 1540.

Accrual-based Budgeting and Accrual-based Appropriations

Departmental use of accrual-based budgeting and the use of accrual-based appropriations are long-standing issues that the OAG felt had not been sufficiently addressed by the government.

According to the OAG's *2011 Status Report* Chapter 1, this is an important issue because:

> Accrual-based financial information reflects a more complete picture of government resources, obligations, financing, costs and the impact of activities than cash-based accounting. Applied to budgeting and appropriation of funds, it is intended to provide management with complete cost information[16] and allow for more informed decision making, such as when evaluating the cost-effectiveness of in-house delivery versus contracting for services. Having this financial information provides improved transparency and accountability and better information for planning and controlling operating and capital spending. This, in turn, can give legislators more information to consider in holding government accountable for
>
> - the stewardship of public assets,
> - the full costs of programs, and
> - its short-term and long-term financial obligations.[17]

At the Committee hearing, the Assistant Auditor General offered this perspective: "Our position is very clear: we're solidly behind accrual-based budgeting as well as accrual-based appropriations. What I was explaining was that it is not for the auditors to say that this has to be the government's position. In my view, it is the government's call which method they choose to put forward parliamentary votes."[18]

The Comptroller General shared his thoughts on this matter, stating, "In terms of the merits of whether or not the recommendation is a good idea, there are many aspects. This has been a long journey. We adopted accrual-based accounting; we have

[16] For example, under cash-based accounting, the acquisition of a new building by the government would be recorded in the fiscal year in which the money was spent to purchase the building. Under accrual-based accounting, the building would be recorded as an asset that is expensed over time as the building ages.

[17] Chapter 1, paragraph 1.45.

[18] Meeting 17, 1640.

adopted accrual-based budgeting at the government level as a whole. We are working at accrual-based budgeting at the departmental level…”[19] With regard to accrual-based budgeting, he said:

> I think we certainly can say we've achieved the production of the numbers. The point that remains to be evaluated is whether the users, the MPs and others, have found that effort to be useful or not. Until we find out if it's being used by the very people who asked for it, we can't say for sure whether it's been a success. A certain amount of cost is involved in the systems to convert these appropriation numbers into this new format. Therefore, it is a bit of a burden on the financial community to produce the results, but that's the extent of it. On the accrual appropriation side, I think it goes beyond that, because you're then going to be fundamentally changing the way Parliament has controlled expenditures for many years. I think that's an institutional change that surpasses a mere accounting change, and I think that needs to be thought through very carefully.[20]

The Comptroller General indicated that the OCG is on track with the timeline to complete an evaluation in 2012–2013 that will report on the merits of the Government of Canada using accrual-based budgeting and accrual-based appropriations.

The Committee agrees that accrual-based budgeting and accrual-based appropriations are complex issues with many facets that must be considered before any decision on whether to move forward is taken. The Committee also notes that this topic has been under discussion since 1998. As such, the Committee recommends:

RECOMMENDATION 2

That the Office of the Comptroller General complete its evaluation of accrual-based budgeting and accrual-based appropriations, and prepare an evaluation report that provides recommendations on whether the Government of Canada should pursue accrual-based budgeting in departments and accrual-based appropriations in its financial reporting system. This evaluation report should be presented to the Public Accounts Committee no later than the end of fiscal year 2012–2013.

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[19] Meeting 17, 1550.

[20] Meeting 17, 1550.

RECOMMENDATION 3

That, following the completion of the Office of the Comptroller General's evaluation, the Treasury Board determine whether accrual-based budgeting in departments and accrual-based appropriations will or will not be adopted, in whole or in part, for use in the Government of Canada's financial management system, and also establish a firm schedule for when any changes would be implemented.

CONCLUSION

The Committee recognizes the importance of financial management and control, and notes the improvements that have been made since related issues were last examined by the Auditor General in 2003 and 2006. The Assistant Auditor General stated that the "government has laid excellent groundwork to improve financial management and internal controls"[21] with the creation of the Internal Control Framework, the professionalization of the CFO positions and the development of improved risk management profiles.

However, the OAG has also indicated that, despite marked improvements, there is work to be done. Assessments of internal controls are incomplete and it is uncertain when these will be done, as there is no deadline for completion. As noted by the Assistant Auditor General at the hearing, the OAG may wish to do more work on assessing internal controls in a number of departments in the future.

The Committee also notes that risk management frameworks need upgrading and succession planning for senior financial managers remains a concern. Further, the government is still uncertain about whether it will pursue accrual-based accounting at the departmental level and accrual-based appropriations.

Due to the importance of effective financial management, financial control and risk management, the Committee encourages the OCG and departments to continue making improvements in these vital areas and to consider the concerns of the OAG and the Public Accounts Committee while moving forward.

[21] Meeting 17, 1700.

APPENDIX A
LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
Office of the Auditor General of Canada	2011/11/28	17
Nancy Cheng, Assistant Auditor General		
Michael Pickup, Principal		
Treasury Board Secretariat		
Gonzague Guéranger, Executive Director, Financial Management Policy		
Paule Labbé, Executive Director, MAF and Risk Management Directorate		
Jim Ralston, Comptroller General of Canada		

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (41st Parliament, 1st Session: Meetings Nos. 17, 30 to 32 and 34) is tabled.

Respectfully submitted,

David Christopherson, M.P.

Chair