

Chapter 10

Financial Audits in Departments and Crown Agencies

Contents

Background	195
Scope	196
Financial audits in departments	197
Financial audits in Crown agencies	203
Losses through fraud, default or mistake	207

Financial Audits in Departments and Crown Agencies

Background

10.1 The Legislative Assembly approves the budget that sets out the government's financial plans. The duties imposed on our Office require us to audit the actual financial results and report our findings to the Legislative Assembly.

10.2 Our audit work encompasses financial transactions in all government departments. As well, we audit pension plans and other trust funds.

10.3 We also audit the Crown Corporations, Boards, Commissions and other Agencies which are listed below. By the date this Report is released we will have issued audited financial statements of all these agencies for the year under review.

10.4 Agencies included in the Public Accounts:

- Advisory Council on the Status of Women
- Algonquin Golf Limited
- Algonquin Properties Limited
- Kings Landing Corporation
- Lotteries Commission of New Brunswick
- NB Agriexport Inc.
- New Brunswick Credit Union Deposit Insurance Corporation
- New Brunswick Crop Insurance Commission
- New Brunswick Highway Corporation
- New Brunswick Municipal Finance Corporation
- New Brunswick Research and Productivity Council
- Premier's Council on the Status of Disabled Persons
- Provincial Holdings Ltd.
- Regional Development Corporation
- Regional Development Corporation - Special Operating Agency
- Youth Council of New Brunswick

10.5 Other Agencies:

- Le Centre communautaire Sainte-Anne
- Legal Aid New Brunswick
 - Criminal Legal Aid Fund
 - Domestic Legal Aid Fund
- New Brunswick Public Libraries Foundation

Scope

10.6 To reach an opinion on the financial statements of the Province, we carry out audit work on the major programs and activities in departments. In addition, we audit major revenue items and a sample of expenditures chosen from all departments. We also test controls surrounding centralized systems.

10.7 We take a similar approach to our testing of the Province's pension plans. Our objective in doing this work is to reach an opinion on the financial statements of each plan.

10.8 Because of the limited objectives of this type of audit work, it may not identify matters which might come to light during a more extensive or special examination. However, it often reveals deficiencies or lines of enquiry which we might choose to pursue in our broader-scope audit work.

10.9 It is our practice to report our findings to senior officials of the departments concerned, and to ask for a response. Some of these findings may not be included in this Report, because we do not consider them to be of sufficient importance to bring to the attention of the Legislative Assembly.

10.10 Our work in Crown agencies is usually aimed at enabling us to give an opinion on their financial statements. During the course of this work, we may note errors in accounting records or weaknesses in accounting controls. We bring these matters to the attention of the agency, together with any recommendations for improvement.

10.11 This chapter of our Report summarizes issues related to departments, pension plans and Crown agencies which we consider to be significant to the members of the Legislative Assembly.

10.12 Our examination of the matters included in this chapter of our Report was performed in accordance with generally accepted auditing standards, including such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions as to compliance or non-compliance with respect to matters not reported.

Financial audits in departments

Results of general expenditure testing

10.13 As discussed under “Scope”, we select for testing a sample of expenditures from government departments. This sample is selected using statistical sampling techniques. However in some cases, expenditures are audited more efficiently by using other audit procedures. The overall approach is designed to give us confidence that, in total, provincial expenditures reported on the financial statements are correct in all material respects.

10.14 Our tests and procedures are not just designed to reveal monetary errors, of which there are few. We also check to ensure the expenditure is properly approved, is reasonable in the circumstances and complies with the legislation, regulations and policies which give authority to the transaction. We find more deficiencies in these areas. When we suspect a deficiency is more than just an isolated incident, we may schedule additional audit work in that particular area to confirm or deny our suspicions. This additional work may take place in a subsequent audit year.

10.15 The deficiencies noted in our 2000 audit of expenditures are summarized below. Where the deficiencies related to statistical samples, they are shown as a percentage of the number of items sampled.

- Documentation did not properly support the expenditure recorded (4.3%). For example, no agreement was present to support payment, supporting documentation did not agree with amount paid or email was used as support.
- Transactions were not properly authorized (5.7%). For example, payment was approved by persons without proper signing authority (the result of out-of-date signing authority listings).
- Payments were made late which exposes the Province to the risk of being charged interest on overdue accounts (2.6%).
- Purchases did not agree to contract or tender price (2.3%).

10.16 One issue we noted this year is the use of email as the backup for certain transactions. The current provincial policy does not allow email as support for an expenditure.

10.17 We were told the policy for using email as backup is presently under review. According to the Comptroller, departments should obtain the best supporting documentation available under the circumstances. We are interested in the tendency towards the use of email in this increasingly electronic age. We intend to monitor it in the upcoming year. Our concern is that the current practice and government policy be the same.

10.18 We want to emphasize that the Province spends in excess of \$4 billion each year. The instances referred to in this chapter of our Report represent a tiny fraction of these expenditures. No large organization can operate perfectly, all the time. Errors can occur, and mistakes can be made. The overwhelming majority of transactions processed by the Province are accurate, authentic and in compliance with established policies and legislation.

Annual review of the internal controls

Bank reconciliations

10.19 Monthly bank reconciliations are a key control for the management and control of government financial data. At the time of our audit in March, the last completed reconciliation was for the month of December. However we did note that one key aspect of the bank reconciliation is performed each day. Cancelled cheques are reconciled to the accounts payable system on a daily basis and discrepancies are followed up immediately.

10.20 We also noted that the completed reconciliations are neither signed nor dated. As well, although someone is responsible for reviewing the reconciliations, there was no evidence of this review having been completed. We recommended that the bank reconciliation be performed each month on a timely basis. The reconciliation should be signed, dated and reviewed. There should be evidence of the review noted on the reconciliation.

Provincial financial accounting system

10.21 For the last few years, the Office of the Comptroller (OC) has been developing and implementing a new financial accounting system for the Province. The OC is customizing accounting software called Oracle Financials. By December 1999, this new system was being used to process payments for government transactions. Because of its significance, and the fact we rely on it for our provincial audit, we decided to review the system. Our review focused mainly on the system's security. However, we also had findings with respect to Internal Audit's review of the system and the general management of the development efforts.

No formal process for granting or changing system access

10.22 Through discussions with members of the development team, we discovered that there is no formal process in place for granting system access to new users. We believe that having a formalized process in place to grant access to new users is extremely important. It provides a mechanism that the OC can use to ensure all users are valid and authorized. It also provides a process for departments to follow when requesting access.

Recommendation

10.23 We recommended that the OC develop and document an Oracle system access policy. This policy should describe the process to be followed for granting or changing system access. We also recommended the OC inform departments of the process they should follow when requesting system access.

Four Oracle users had incompatible functions

10.24 As part of our review of the Oracle system, we compared users who had “input access” in the system to users who had a “release responsibility” in Oracle. (These two functions are incompatible as one allows a user to enter transactions and the other allows a user to effectively submit or approve the transaction for payment.) We identified four users who had the ability to both input and release transactions. The separation of these functions is an important internal control as it prevents one individual from having total control of the payment. A good accounting practice would see transactions initiated and approved by different individuals. Discussion with the OC revealed a staff member does verify that there are no conflicting responsibilities before a new user is added. However, this verification process is time consuming and thus subject to error. The OC was going to make changes to eliminate these incompatible access rights.

Recommendation

10.25 We recommended that the OC continue to verify that there are no conflicts before approving user responsibilities in Oracle. However, the verification method should be modified so that it is easier to identify potential incompatibilities. Also, the OC should ensure the rights of the four users we identified are changed so that they are no longer incompatible.

Multiple users with system administrator rights

10.26 During our system review, we noticed that at least four members of the development team have system administrator rights. System administrator rights give a user complete access to the system. The team members noted that being able to perform some of the system administration duties, in a sense, provides a backup of the system administration function. While having a backup to this critical position is good, we question whether more than two people should have system administrator rights. Increasing the number of users with system administrator rights increases the risk of error and of unauthorized access to the system should a password become known.

Recommendation

10.27 We recommended that the OC review the necessity of having multiple (more than two) users with system administrator rights.

No documentation of unique system functions

10.28 The OC has made many customizations to the out-of-the-box Oracle Financials application. Inherent in any such customizations is the need to document the customizations and their effect on the application. This is necessary because the application is no longer in its original state and parts of it are now unique to the organization. If key personnel were no longer available to work on the project, this documentation would help protect the organization from unnecessary delays and errors. New personnel should be able to review the documentation and quickly be knowledgeable on the unique features of the application.

10.29 From our discussions, we learned that the OC has documented many of the customizations that it has made to the application, but more

work is needed especially in the area associated with the Database Administrator.

Recommendation

10.30 We recommended that the OC review documentation for the Oracle application and ensure there is adequate documentation for anything that is unique to its installation and necessary in case of personnel turnover. This includes the unique functions of the Database Administrator, the System Administrator and any other key personnel.

Lack of system sign-off by internal audit

10.31 The Internal Audit section of the OC reviews all key financial systems implemented by government to ensure these systems have adequate internal controls. Before the systems go into production, the OC signs-off on the systems based on the results of the review conducted by Internal Audit.

10.32 We were informed that in the case of the Oracle system, Internal Audit did not perform this formal review or sign-off. The OC had many individuals with a background in financial accounting working on the project. These people were very conscious of the need for systems to have strong internal controls. Also, the manager of information systems audit attended regular project meetings and could give her input on issues and problems at those times. We were told that because of the foregoing considerations, Internal Audit did not perform a formal review or system sign-off.

10.33 In the absence of a formal review by Internal Audit, we believe that the person or group that is responsible for testing the system should sign-off as evidence that controls are in place and working properly. We found no such evidence of a documented system sign-off. We believe the lack of a formal review by Internal Audit does not relieve the OC of the responsibility to ensure there is a formal sign-off to support the system implementation decision. This sign-off should be supported by documented evidence that the system has been adequately tested. This documentation should be available for all future major enhancements.

Recommendation

10.34 We recommended that the OC have a formal sign-off to support system implementation decisions. This sign-off should be supported by documented evidence that adequate internal controls are present in the system and operating effectively.

System development methodology and project management

10.35 The Oracle financial system had to be implemented before the year 2000, as its predecessor would have been unable to carry out key functions at that time. Essential parts of the system were implemented by that date. Thus the OC was successful in accomplishing one of its major goals - having the key parts of the system in place prior to year 2000.

10.36 During our review, we noticed that some important documentation traditionally found in system development projects was

not prepared. Such items as a detailed project plan, a detailed budget and a detailed tracking of project costs were not available. While the OC was successful in meeting this major goal, we wonder if its success could have been even greater had it used some aspects of traditional system development methodologies and project management practices.

10.37 We believe it would be useful for the OC to prepare a project plan for the additional system enhancements yet to be implemented. This would help determine the scope and expected length of the project. It would also enable government departments to know the future direction of the Province's financial information system.

10.38 We also believe it would be useful for the OC to prepare a budget for expected future system costs. Even though this may be a difficult task, it will provide valuable information for decision-making. It will also make some form of performance measurement possible and enhance accountability.

10.39 We would also like the OC to track project costs in detail. These costs should include not only the salary of the development team, but also an estimation of the cost associated with the OC and Department of Supply and Services staff who have spent time working on the development of the project. This would enable the government to get a picture of the actual cost of the project.

Recommendation

10.40 We recommended that the OC implement some key aspects of traditional system development methodologies and project management practices. In particular, we would like to see a future project plan and budget. We also recommended that the OC track project costs and compare such costs to the budget. This should assist in managing the future work.

Department of Education

Reconciliation of accounts

10.41 A great deal of our time this year was spent in auditing certain clearing or suspense accounts. Our audit determined that both the opening and closing balances in one major account were incorrect. We believe the error could have been prevented if the Department had better procedures for reconciling accounts at year end. We recommended the Department improve its year end reconciliation procedures.

Transfer of funds to TeleEducation

10.42 TeleEducation is a branch within the Department. It receives funding for its innovative work from a variety of government organizations. These include the federal government, the community colleges and the Maritime Provinces Higher Education Commission (MPHEC).

10.43 In regards to an amount of \$350,000 transferred from MPHEC to TeleEducation, we had two concerns. The first is that there appeared to be no formal written agreement between MPHEC and TeleEducation

specifying the amounts to be paid. We believe that there should have been, and recommended that to the Department.

10.44 Secondly, the Department considers the money TeleEducation receives from MPHEC as a reduction of expenditures, not revenue. In our opinion, however, the funds received from MPHEC are clearly revenue. Disclosing them instead as a reduction of expenditures obscures the true size of the TeleEducation component. We recommended the Department review the accounting and budgeting procedures for TeleEducation to ensure the users of financial information are provided with a clear picture of financial plans and results.

Department of Municipalities and Housing

Grant with no authority

10.45 The *Community Planning Act* states that the Minister may enter into an agreement with a planning commission to share expenses. We examined a grant to a planning commission in an amount of \$95,000 but were unable to find an agreement that authorized the grant. We understand that grants have been given to planning commissions since 1995. We conclude that this grant has been issued without the necessary authority in a manner that is not in compliance with legislation.

Departmental response

10.46 *Agreements, as defined as duly executed contracts, between the District Planning Commissions and the department are not held. We believe, however, that an agreement, as defined as an arrangement to a course of action, does exist between the individual Commissions and the department. This arrangement has been ongoing since 1995. It is evidenced by the published paper "A Proposal for Improving Service Delivery", discussions and negotiations between the parties, and the annual budget approval process which records the grant as a portion of the individual Commission's funding. To remove any doubt as to the interpretation of an agreement, the Department will undertake to obtain signed contracts with each of the Commissions. However, we believe the Department has not made an expenditure "without authority".*

State of emergency funding

10.47 According to a regulation under the *Emergency Measures Act*, municipalities may obtain assistance from the government when a state of emergency had been declared. We found that although some municipalities did receive assistance following the event referred to as the January 2000 storm surge, no state of emergency had been declared. The Department accrued an expense of \$2.4 million.

Departmental response

10.48 *The Department acted under the authority of Section 9(1) of the Financial Administration Act, which allows the Minister to enter into agreements with Canada pursuant to any financial assistance program of the Government of Canada. Copies of letters between the Minister of Municipalities and Housing and the Minister responsible for Emergency Preparedness Canada in regard to assistance under the federal program, Disaster Financial Assistance Arrangements, for the January 2000 Storm Surge are on file. The procedures involved in the actual granting of*

financial aid were in accordance with the Disaster Financial Assistance Manual. We believe the Department has not made an expenditure “without authority”.

10.49 *We agree that there appears to be an inconsistency between Regulation 83-71 of the Emergency Measures Act and the direct involvement of Emergency Measures Organization staff in the granting of financial aid. The Department of Public Safety has indicated it will undertake a review of the regulation and procedures and take whatever steps are necessary.*

Department of Human Resources Development and Housing

10.50 As at 31 March 2000 the Department of Human Resources Development and Housing (HRD) had approximately \$27.5 million in accounts receivable resulting from overpayments of assistance to clients. In a report to the Department this fiscal year the Comptroller recommended that they once again consider participating in a project to use Revenue Canada set-off to help collect overpayments receivable.

10.51 Although the Province chose not to pursue the initiative at that time, our understanding is that other provinces have achieved substantial results through their participation. HRD staff indicated to our Office that they continue to support this collection initiative. We recommended the Province enter into an agreement with Revenue Canada to help collect overpayments.

Financial audits in Crown agencies

New Brunswick Highway Corporation

10.52 On 22 January 1998 the Province, through the New Brunswick Highway Corporation (NBHC), entered into agreements with a private sector consortium, the Maritime Road Development Corporation (MRDC) and a not-for-profit company, the New Brunswick (F-M) Project Company Inc. (Project Co.) to develop, design, build, operate, maintain, rehabilitate, and finance a toll highway between Longs Creek and Moncton.

10.53 Effective 1 March 2000, the Fredericton-Moncton Highway agreement was amended to eliminate tolling on the highway. Repayment of the underlying toll-based debt will now be funded through traffic volume payments. These are monthly payments being made by the Province through NBHC to Project Co. based on usage of the highway. The responsibility of the Province to make semi-annual payments through NBHC to service lease-based debt issued by Project Co. remained unchanged under the amended agreements.

Direct cost implications

10.54 Certain direct costs associated with the removal of tolls from the Fredericton-Moncton highway were incurred by NBHC as detailed in the 1 March 2000 amendments to the agreements.

Fee paid to the Maritime Road Development Corporation	\$30,000,000
Reimbursement of costs incurred by the Maritime Road Development Corporation	\$400,000

Fee paid to the toll-based lenders	\$1,015,000
Legal expenses of the New Brunswick (F-M) Project Company Inc.	\$58,469
Legal and other expenses of NBHC	\$501,331

10.55 Total direct costs associated with the removal of tolls as reported in the 31 March 2000 financial statements of NBHC were \$31,974,800.

10.56 Additional direct costs to be incurred during the 2000-2001 fiscal year relate to the removal and restoration of toll plaza sites. It is our understanding that these costs will be borne by Project Co. and repaid by the Province through scheduled lease payments.

Other cost implications

10.57 The overall capital cost of the project was reduced by the decision to eliminate tolling on the highway. Eliminating tolling meant that the construction of toll plazas could be cancelled, and that related toll system operation, maintenance and management costs would be eliminated. A Province of New Brunswick press release dated 1 March 2000 indicated that the total savings as a result of eliminating tolling were in the order of \$34.5 million.

10.58 However, we would not necessarily conclude that the decision to eliminate tolling provided a net positive contribution to the Province. It was previously estimated that approximately twenty percent of toll revenues collected for the highway would have been from out-of-Province traffic. Therefore, given that the toll revenue over the thirty-year lease period was projected to be \$615 million, we would estimate that \$123 million in out-of-Province toll receipts were foregone through the elimination of tolls. Under the original agreement, these toll revenues were intended to help defray the provincial cost of servicing the toll-based debt.

Accounting implications

10.59 The decision to eliminate tolls on the Fredericton-Moncton highway had a major effect on the way in which the highway transaction was accounted for.

10.60 Initially, because over ten percent of revenue came from toll receipts, the Province accounted for the arrangement as an operating lease in accordance with accounting guidelines issued by the Canadian Institute of Chartered Accountants (CICA). This meant that the highway cost was to be expensed over the period during which lease payments were being made.

10.61 Once the toll revenue stream was eliminated, the arrangement no longer qualified as an operating lease, and therefore had to be accounted for as a capital lease. The Province, at that point, essentially purchased an asset, the Fredericton to Moncton highway. Consequently, the Province was required to recognize the cost of the highway, some \$872

million, during the fiscal year ended 31 March 2000. This was in keeping with the standards of the Public Sector Accounting Board of the CICA.

Kings Landing Corporation
Approval of the annual budget

10.62 Following the completion of our audit we raised an issue relating to the approval of the annual budget. The minutes of the Board of Directors' meetings should include a direct reference to the approval of the annual budget and include an attached copy of the approved budget. We found that the approval of the budget in the minutes of the board meetings was vague. The Corporation responded that the approved budget would be attached to the minutes when the 2000-01 budget is approved.

Expiration of board members' terms

10.63 We noted that the approved terms of the members of the Board of Directors had expired, yet the board continued to meet. There are no provisions in the *Kings Landing Act* that allow this. The Corporation noted our comments but did not report any specific action would be taken.

Advisory Council on the Status of Women
Accountability for disbursements

10.64 Early in the 2000-2001 year the Council spent funds on activities throughout the Province. The expense was recorded in the 1999-2000 year. We were concerned with the accountability for the disbursements. There was no evidence that the Council approved the amounts given out and the only supporting documentation for the payments, by the Department of Finance on behalf of the Council, was a letter from the Council itself.

10.65 We recommended that no amounts be given out to other groups or organizations unless the Council approved them. We also recommended that supporting documentation should be retained in support of all payments.

10.66 The Council responded that several projects had been proposed after the last board meeting of the year. The cheques were issued before closing the books for 1999-2000. All projects were subsequently approved at the next meeting of the Council.

Algonquin Properties Limited

10.67 Following our audit of Algonquin Properties Limited, we passed along some very positive comments to the Comptroller at the Algonquin Hotel. We are pleased to report that the accounting records created and maintained by the Controller and his staff continue to improve each year. The quantity and quality of the records placed at our disposal have increased dramatically and helped us to significantly reduce the work we must conduct to complete the audit.

Provincial Holdings Ltd.
Condition of the accounting records

10.68 In 1999 we sent a management letter to Provincial Holdings Ltd. (PHL). In this letter we explained that in recent years it has been necessary for our staff to spend considerable time to prepare the draft financial statements for the Company. We recommended that PHL

maintain complete financial records and that draft statements be completed in preparation for the audit.

10.69 This year we reported to PHL that there was some improvement over last year. However we still encountered many accounting deficiencies during the audit. It is the responsibility of PHL to perform the necessary accounting in a proper and timely manner. Our Office is engaged to perform an audit and this can only be undertaken in an efficient manner when the accounting work is complete.

10.70 We recommended that the deficiencies be dealt with.

10.71 PHL responded that all of the items raised in the letter can be or have been dealt with satisfactorily.

New Brunswick Public Libraries Foundation

10.72 The first ever audit of the Foundation was completed following the end of the 1998-99 year. We had several recommendations for the Foundation.

Accounting for Foundation transactions

10.73 During the year under audit the Foundation, as a separate entity, had been using the Province's library fund as the operating account for its transactions. It was determined from examining the *New Brunswick Public Libraries Foundation Act* and policies relating to the Foundation, that the purpose of this library fund was to control the Province's yearly maximum grant to the Foundation. The only transactions in this library fund should be valid claims by the Foundation for matching funds and a yearly replenishment of the fund by the Province.

10.74 We recommended that a separate operating account be set up for the Foundation. The Foundation Chairperson responded that they would establish both a separate bank account and a separate operating fund for its own purposes.

Receipts for donations

10.75 We found that receipts were not being issued for donations to the Foundation in 1998-99. We recommended that following each donation, a receipt should be issued to the donor showing the amount of the donation and the date and name of the donor. The Foundation responded that they have now designed an official receipt and have also implemented accounting procedures for recording donations.

Defining donations to the Foundation

10.76 There was a great deal of discussion on the definition of a donation that qualifies for a matching payment by the Province. Normally only funds directly received from private sources outside the library service should qualify for matching by the Province. In response to our concern the Foundation developed criteria which must be met in order to qualify as donations. We reviewed these criteria and suggested improvements that the Foundation accepted.

Research and Productivity Council

10.77 The Canadian Institute of Chartered Accountants (CICA) now requires the cost of employee future benefits, such as retirement allowances, to be recognized over the period in which the employee delivers the service to the employer. It is our understanding that the Research and Productivity Council (RPC) has historically recorded the cost of lump sum retirement allowances as an expense of the year in which the amount was paid.

10.78 The CICA change is to be adopted by all organizations that have a fiscal year commencing after 1 January 2000. As a result, we recommended that RPC develop appropriate methods for calculating and accounting for the cost of retirement allowances and other employee future benefits for the year ending 31 March 2001. The Council indicated that it would be taking the necessary action on this issue over the next few months.

Losses through fraud, default or mistake

10.79 Section 13(2) of the *Auditor General Act* requires us to report to the Legislative Assembly any case where there has been a significant deficiency or loss through fraud, default or mistake of any person.

10.80 During the course of our work we became aware of the following significant losses. Our work is not intended to identify all instances where losses may have occurred, so it would be inappropriate to conclude that all losses have been identified.

Department of Education

Missing equipment and supplies	\$13,733
--------------------------------	----------

Department of Health and Community Services

Ineligible service claims and theft of cash	\$2,946
---	---------

Department of Human Resources Development

Cheques cashed by persons not eligible to receive the funds	\$50,277
---	----------

Department of Justice

Cash shortages and amounts paid out in error	\$1,323
--	---------

Department of Labour

Cash receipts not deposited	\$33,549
Cash shortages unexplained	\$5,738

Department of Natural Resources and Energy

Loss of equipment	\$9,151
-------------------	---------

10.81 Losses reported by our Office only include incidents where there is no evidence of break and enter, fire or vandalism.

10.82 The Province reports in Volume 2 of Public Accounts the amount of lost tangible public assets (other than inventory shortages).

10.83 In 2000, the Province reported lost tangible public assets in the amount of \$219,158, compared to a loss of \$167,786 reported in 1999.