

# Audit of the Financial Coding

**November 2005**

**Report Clearance Steps**

Planning phase completed	February 2005
Report sent for management response	September 2005
Management response received	October 2005
Report completed	October 2005
Report approved by Departmental Audit and Evaluation Committee (DAEC)	November 24, 2005

**Acronyms used in the report**

ACL	Audit Command Language
CASS	Corporate Administrative & Support Services
CEAA	Canadian Environment Assessment Agency
CMC	Canadian Meteorological Centre
DAO	Departmental Accounting Office
EC	Environment Canada
FCB	Financial Coding Block
FI	Financial Management
FIS	Financial Information Strategy
FMA	Financial Management Advisor
NCR	National Capital Region
TBS	Treasury Board Secretariat

**Prepared by Audit and Evaluation**

**Acknowledgments**

The Audit and Evaluation Project Team including Lise Gravel and Brian Fehr, led by Stella Line Cousineau under the direction of Jean Leclerc, would like to thank those individuals who contributed to this project and particularly all departmental interviewees who provided insights, and comments crucial to this review.

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## **EXECUTIVE SUMMARY**

The need to perform an audit of financial coding was identified as part of the planning exercise of fiscal year 2004-2005. Concerns were raised over the reliability of financial coding because it relates directly to the integrity of all financial statements and reports, and confidence in overall financial management.

The main objective of the audit was to review, verify and provide an opinion on the accuracy of the coding of financial transactions in Environment Canada. The audit did not assess whether EC's financial coding structure was in line with the government-wide Chart of Accounts<sup>1</sup>.

The scope of the audit included a review of financial transactions from all services and regions, for the period of April 1, 2004 to January 31, 2005.

Audit activities such as documentation review, detailed testing and interviews were conducted as part of this audit. Financial data were obtained from Finance and Corporate Branch. These data did not include the Canadian Environmental Assessment Agency transactions or EC's salary and revenue transactions. Based on a 95% confidence level and a 7% margin of error, a random sample of 206 transactions was selected with ACL. The sample was selected in proportion to the total value of the transactions in each region.

Overall, 90% of the transactions reviewed were accurately coded. The value of the miscoded transactions, represent less than 1% of the total value of all transactions.

Environment Canada's financial coding structure currently has over 9000 different codes. The financial coding structure is quite complex and sometimes the description offered is too vague and similar transactions could easily be coded under different codes and deemed to be correct.

There are various practices in terms of how and by whom transactions are coded. Managers are aware that they are responsible for the accuracy of the coding. However, this responsibility is often delegated to administrative staff or accounts payable clerks. In some instances, managers leave a portion of the financial coding block blank, relying on the finance staff to complete the field. The tools used to code the transactions range from electronic look-up systems, manual look-up sheets and the financial coding manual.

Although financial training is available in all regions, not all staff have availed themselves of training and instead learned on-the-job. Managers and staff with financial coding responsibilities should take advantage of periodic, formal training.

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<sup>1</sup> Government-wide Chart of Accounts provides the framework to identify, aggregate, and report financial transactions for planning, resources allocation, management control, accounting, statistical and evaluation purposes.

Recommendations:

The Chief Financial Officer should:

1. further review the current financial coding structure to determine whether additional codes can be combined or eliminated. The coding requirements resulting from the implementation of Financial Information Strategy (FIS) should also be re-examined;
2. ensure that the coding descriptions are clear and concise;
3. look at opportunities to increase the cross validations within the new financial system being developed to ensure better integrity of data;
4. ensure that a unique version of the financial coding structure exists;
5. ensure that any changes to the financial coding structure are communicated to all managers and regions;
6. assess the various practices to determine the most efficient and effective tools to code transactions and ensure consistency throughout the Department;
7. develop training sessions for staff with delegated financial signing authority and regional coordinators responsible for screening requests for changes to codes. The training should include information on the importance of accurate coding.

Transformation of Environment Canada's governance structure will necessitate a new coding structure for the Department. Finance and Corporate Branch has been tasked with developing a strategy for working towards a new coding structure for Environment Canada. The results of this audit should be considered during this exercise.

**Management Response:**

Finance Directorate will provide leadership in ensuring that continued communication and training is offered to all staff on the financial coding structure to increase the integrity of all financial information and overall financial management.

The departmental chart of accounts will be revised to reflect Environment Canada new governance structure for 2006-2007.

1. Before the beginning of each fiscal year, Finance reviews the validity of the financial coding structure (including FIS requirements) for the new fiscal year, thereby eliminating unnecessary codes. It intends to maintain this practice.
2. Finance will review the financial coding descriptions to make them more succinct during the review of the chart of accounts.
3. Additional cross validation rules will be created to report on the new governance structure (e.g., by outcome projects).
4. A unique version of the financial coding is now accessible on the EC Finance Web-Site. Other versions in other locations will be deleted.
5. All financial coding changes are communicated to the FMAs and the Regional contacts in a timely manner. Finance will ensure that contacts disseminate the information throughout the organization.
6. TBS is developing general principles to guide future departmental investment into financial systems during the CASS implementation. As such, significant investment will require the approval of TBS via a business case. As this recommendation will require a significant investment in our financial system, we do not intend to create or

modify existing tools. However, through communication and training sessions, we will promote consistency in the application of the financial codes.

7. All program managers with delegated signing authority will receive training. Those who code invoices will receive specific training on the revised Chart of Accounts and its approach.





## **1.0 INTRODUCTION**

### **1.1 Background**

The need to perform an audit of financial coding was identified as part of the planning exercise of fiscal year 2004-2005. Concerns were raised over the reliability of financial coding because it relates directly to the integrity of all financial statements and reports, and confidence in overall financial management.

Environment Canada's (EC) Finance and Corporate Branch and Regional Finance offices are collectively responsible for providing modern, innovative, high quality financial services and ensuring that sound values and standards of public accounting are applied across the Department. Operational advice is offered in areas such as grants and contributions, financial reporting, financial systems, budgets and forecasting, and accounting services (travel, relocation, hospitality, etc.).

To meet financial information requirements, Treasury Board Policy on *Classification and Coding of Financial Transactions* requires departments to:

- ❖ use a four-way classification of transactions by authority, purpose, responsibility and object;
- ❖ relate transactions to the uniform government-wide classification maintained by the Receiver General for objects and for programs' activities; and
- ❖ identify internal transactions.

Departments are expected to produce annually a full set of financial statements that can withstand the test of audits.

To measure the impact of government transactions on the economy and to provide transparent and accountable management, expenditures are classified according to the type of resources (goods and services) acquired, revenue earned or the transfer payment made. Various classifications of expenditures are required to:

- ❖ control expenditure levels;
- ❖ provide information to Treasury Board Secretariat and other government agencies; and
- ❖ provide management with information essential to managing the finances and activities of the department.

The financial coding structure provides the means of implementing essential controls and providing management information. In addition, the coding provides flexibility for individual managers to satisfy specific or unique information requirements.

At Environment Canada, all financial transactions are identified by a twenty-one digit input coding block which provides for all the classifications required by central agencies and the department. The departmental financial coding block is divided into six "fields" of three, four or five digits, each part being for specific classification purposes. The following is a description of the financial coding block showing the division into six fields:

Organization Codes	Activity Codes	Project Codes	Authority Codes	Line Object Codes	Departmental Codes
XXXX (4)	XXXX (4)	XXXXX (5)	XXX(3)	XXXX (4)	X (1)

For example, if EC had a contribution agreement with a national organization for delivering the One-Tonne Challenge in a youth-friendly format, the coding could look like this:

0882 (Climate Change Action Fund)	2420 (Canadian Take Action on Climate Change)	0830 (Youth and Educators)	333 (Climate Change Action Fund)	4407 (Non-Profit – National Organization)	1
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Environment Canada's financial coding structure currently has over 9000 different codes. Currently the financial system does a cross validation between the following:

- ❖ the Canadian Environmental Assessment Agency (CEAA) and EC's transactions;
- ❖ the line object and the authority codes; and
- ❖ some work in progress project codes and the line object.

The system accepts all other combinations of valid codes.

## **1.2 Objective(s)**

The main objective of the audit was to review, verify and provide an opinion on the accuracy of the coding of financial transactions in Environment Canada. The audit did not assess whether EC's financial coding structure is in line with the government-wide Chart of Accounts.

## **1.3 Scope**

The scope of the audit included a review of financial transactions from all services and regions representing different parts of the country and diverse operating environments, for the period of April 1, 2004 to January 31, 2005.

## **1.4 Methodology**

In order to gain a solid working knowledge and understanding of the process surrounding the coding of financial transactions, a number of audit activities were undertaken:

- ❖ review of policies and directives relevant to financial coding;
- ❖ detailed review of documentation for a sample of 206 transactions; and
- ❖ interviews with regional and corporate finance staff and project managers with financial signing authority.

Financial data for the period of April 1, 2004 to January 31, 2005 were obtained from Finance and Corporate Branch. These data were extracted from the financial system (Merlin) database using Discoverer. The database did not include the Canadian Environmental Assessment Agency (CEAA) transactions or EC's salary and revenue transactions. The original file contained 393,585 records for a total value of \$340,318,568. Some transactions, such as interest charges and suspense accounts, were removed from the file resulting in a total of 271,372 records with a value of \$291,040,996.

The Audit Command Language (ACL) software was used to perform integrity tests to identify transactions with anomalies such as corrupted data, completeness of the file and blank fields. Based on a 95% confidence level and a 7% margin of error, a random sample of 206 transactions was selected with ACL.

The sample was selected in proportion to the total value of the transactions in each region.

	Absolute Value	Proportion	# of Samples
Atlantic	\$15,709,432.48	5.4%	11
Burlington	\$28,175,319.15	9.7%	20
Dorval CMC	\$16,693,102.90	5.7%	12
Downsview	\$45,137,088.09	15.5%	32
Edmonton	\$30,855,950.85	10.6%	22
NCR Accounting	\$113,455,603.37	39.0%	80
Quebec	\$17,253,285.48	5.9%	12
Vancouver	\$23,761,213.68	8.2%	17
Total	\$291,040,996.00	100%	206

For each transaction in the sample, background documentation was acquired from the appropriate Departmental Accounting Office (DAO). Each sample was reviewed based on the following:

- ❖ Is the organization code valid? Does the person who signed section 34 have authority for the organization code? Is the type of expense in line with the organizational unit?
- ❖ Is the activity code valid? Is the expense in line with the description of the code?
- ❖ Is the project code valid? Is the expense in line with the description of the code?

- ❖ Is the authority code valid? Is the expense in line with the description of the code?
- ❖ Is the line object code valid? Is the expense in line with the description of the code?

A complete description of the coding block is provided under section 2.1.

When background documentation was not sufficient to assess whether the transaction was coded accurately, an interview with the person who signed Section 34 was conducted by phone to better understand the nature of the purchase. Section 34 signatories that were interviewed included managers, support staff and financial officers. In addition to answering questions specific to the transaction, each interviewee was asked some questions regarding financial coding practices in general.

## 2.0 FINDINGS AND RECOMMENDATIONS

### 2.1 Coding Accuracy

Overall, 90% of the transactions reviewed were accurately coded. The value of the miscoded transactions represents less than 1% of the total value of the transactions.

Employees interviewed felt that the choice of codes was overwhelming and that the description was often too vague. The audit noted that similar transactions could be coded under different codes and still deemed to be correct. Of the employees interviewed, 80% had responsibility for more than one organization, activity, and/or project code. The employees interviewed also mentioned that since the implementation of the 'Financial Information Strategy' (FIS), financial coding was much more complicated with many codes appearing to have the same meaning.

Finance and Corporate Branch has recently taken steps to better ensure the integrity of the data in EC's financial system. The number of people who manage coding changes have been restricted. A full time position has been dedicated to the maintenance of the financial coding structure and the number of people having access to the module was reduced from 20 to 4 people. Also, a review of financial codes was undertaken resulting in the elimination of over 500 codes.

The auditors noted that there are various practices in terms of who codes the transactions. During the interviews, managers acknowledged that they were responsible for the accuracy of coding the transactions. However, in many areas, the transactions are being coded by support staff and then signed off by the manager. In one region, the coding of all expenses is done by the accounts payable clerks who then forward the transactions to managers for their approval. In another region, managers code their transactions up to the authority code, leaving the line object field blank. This is then completed by the accounts payable clerk. According to the region, this practice has reduced the number of errors occurring at the line object level. However, finance staff feel that this practice does not provide managers with the opportunity to learn how to accurately use line object codes.

The following is a summary of the documentation review:

Of the 206 transactions reviewed, 21 transactions contained errors in the coding block. The majority of errors were found in the line object field. No errors were found in the organization field. The following table presents number and dollar value of errors by code:

<b>Fields</b>	<b>Number of Errors</b>	<b>Value</b>
Organization Codes	0	0
Activity Codes	6	\$28,023.02
Project Codes	3	-\$16,457.97
Authority Codes	1	\$57.00
Line Object Codes	11	\$498,596.16
<b>Total</b>		<b><u>\$510,218.21</u></b>

Organization Codes

The purpose of the organization segment is to identify who is responsible for each transaction and the related budget that supports the transaction. No errors were found regarding the organization code.

Activity Codes

The activity code is used to link overall departmental objectives to outcomes. EC's activity code structure provides a hierarchical breakdown of each Business Line's functions by component and sub-component. Each activity code falls within one of four departmental business lines as noted below.

Activity Code (Range)	Corresponding Business Lines
1000 - 1999	Weather & Environmental Prediction
2000 - 2999	Clean Environment
3000 - 3999	Nature
4000 - 4999	Management, Administration & Policy

The documentation review found 6 transactions that were miscoded in the activity code field. Of the 6 transactions, 5 were coded against the appropriate Business Line, however, the wrong activity number had been chosen within the Business Line. The other transaction was coded against the wrong business line. The transaction was for a value of \$440.00.

Project Codes

Although this code is not used to report to Treasury Board, it is used for capturing/tracking information that has not been included in any other coding block segment. Project codes are left to the discretion of the service or the region and the numbering convention is established by the region. Project codes are used to capture information such as work in progress, grants and contributions, court awards and specified purpose accounts. EC's financial coding structure lists over 6000 different project codes.

The documentation review found 3 transactions with project fields that were miscoded. In one case the transaction was incorrectly coded because there was no money allocated to appropriate code. Although Departmental budgets are not allocated at the project code level, some managers with a single cost centre choose to track different functions within that cost centre with different project codes. For example, Audit and Evaluation could use different project codes to differentiate expenses related to either Audit or Evaluation. In another instance, the employee was not aware of the creation of a new project code, therefore, continued to use an old code that was applicable to another project. The third error was simply a misunderstanding in the interpretation of the code description.

Authority Codes

Authority codes are used by the department to track and report on funds by their source. They identify the statute or allotment under which each transaction is authorized.

Authority Code (Range)	Transaction Type
001 - 099	Salary Expenditures
101 - 199	Operating Expenditures and Vote Netted Revenues
201 - 299	Capital Expenditures
301 - 399	Grants & Contributions
401 - 499	Consolidated Revenue Fund Revenues
525	Specified Purpose Accounts
530	Court Awards
590 - 599	Other Government Department Suspense Accounts
Others	Refer to Coding Manual

There are currently 269 different authority codes that can be used. The documentation review found one transaction where no authority code was used.

**Line Object Codes**

Line objects are used to identify the nature of the expenditure. Line objects are used for both internal and external reporting. EC’s financial coding structure lists 949 different line object codes.

The sample contained 11 transactions that were miscoded in the line object field. The following table presents the discrepancies between the code used and the appropriate code.

<b>Miscoded</b>	<b>Correct Code</b>	<b>Amount</b>
Administrative Office Building	Engineering – Architectural Service	\$60,005.92
Courier Services	Transportation of goods	\$2,929.79
Sewer and water services	Electricity	\$53,374.67
Management Consulting and other Professional Services	Translation Services	\$8,600.00
Legal Services	Expenses charges for secondments and similar arrangement	\$284,576.93
Building (office admin). Rental	Building (other) rental	\$13,699.89
Building (other) Rental	Administrative/Office Building	\$60,981.31
Management Consulting and other Professional Services	Lease of Motor Vehicles	\$1,775.36
Aircraft & Helicopters – Rental	Road Motor & Misc. Vehicles	\$91.53
Other Service Contract	Prov/Terr – Environmental Project Payments	\$12,500.00
<b>Total</b>		<b><u>\$498,596.16</u></b>

Recommendation

The Chief Financial Officer should:

1. further review the current financial coding structure to determine whether additional codes can be combined or eliminated. The coding requirements resulting from the implementation of Financial Information Strategy (FIS) should also be re-examined;
2. ensure that the coding descriptions are clear and concise;
3. look at opportunities to increase the cross validations within the new financial system being developed to ensure better integrity of data; and

Management Response

Before the beginning of each fiscal year, Finance reviews the validity of the financial coding structure (including FIS requirements) for the new fiscal year, thereby eliminating unnecessary codes. It intends to maintain this practice.

Finance will review the financial coding descriptions to make them more succinct during the review of the chart of accounts.

Additional cross validation rules will be created to report on the new governance structure (e.g., by outcome projects).

## **2.2 Financial Coding Manual**

At the on-set of the audit, the team found that various electronic versions of the financial coding manual existed. One version could be accessed under the 'Public Folder' in Microsoft Outlook, another could be generated in Discoverer, and a hyperlink on Finance's internal web site could also be used to generate another version of the coding manual. The results of our interviews indicated that the version residing under 'Public Folder' had not been updated with the ongoing changes throughout the fiscal year. Finance and Corporate Branch has since rectified the situation by replacing the outdated coding structure residing in the Public Folder with a link to Discoverer.

The financial coding manual is reviewed and published annually. According to our findings, due to the extent of work required to make changes, the updated version of the manual is sometimes not made available to the users until later in the year. Until published, the managers code their transactions using the old structure. Consequently, a number of corrections are required to adjust the coding of the transactions processed before the issuance of the new manual.

Most of the employees interviewed were aware that there is a complete and updated financial coding manual in place and know who to contact in Finance for changes. However, these changes are not always communicated to all regions. Some managers are using either the paper or electronic versions of the financial coding manual while others use a reference sheet commonly referred to as cheat sheet.

Recommendation

The Chief Financial Officer should ensure:



4. that a unique version of the financial coding manual exists; and
5. that any changes to the financial coding manual are communicated to all managers and regions in a timely manner.

#### Management Response

A unique version of the financial coding is now accessible on the EC Finance Web-Site. Other versions in other locations will be deleted.

All financial coding changes are communicated to the FMAs and the Regional contacts in a timely manner. Finance will ensure that contacts disseminate the information throughout the organization.

### **2.3 Methods of Coding**

The results of our interviews with managers have revealed that various tools are used to code financial transactions. Some examples are as follows:

- ❖ an electronic system that links each of the financial code fields to the person with financial signing authorities. This application is located on the region's Info lane and available to all;
- ❖ a manual system in the form of a reference sheet that links each of the financial code fields to the person with financial signing authority. These are prepared by Finance staff and updated as required. The results of the interviews have revealed that many managers rely solely on these; and
- ❖ the financial coding manual.

#### Recommendation

6. The Chief Financial Officer should assess the various practices to determine the most efficient and effective tools to code transactions and ensure consistency throughout the Department.

#### Management Response

TBS is developing general principles to guide future departmental investment into financial systems during the CASS implementation. As such, significant investment will require the approval of TBS via a business case. As this recommendation will require a significant investment in our financial system, we do not intend to create or modify existing tools. However, through communication and training sessions, we will promote consistency in the application of the financial codes.

### **2.4 Training**

When asked about training regarding financial coding, 59% of the people interviewed said they had not received any formal training. However, those who received training mentioned that the training had occurred years ago and that a refresher course would be beneficial. Both groups expressed an interest in formal training.

Recommendation

7. Finance and Corporate Branch should develop training sessions for staff with delegated financial signing authority and regional coordinators responsible for screening requests for changes. The training should include information on the importance of accurate coding.

Management Response

All program managers with delegated signing authority will receive training. Those who code invoices will receive specific training on the revised Chart of Accounts and its approach.

**2.5 General Comments**

Interviewees were given the opportunity to express any concerns, views or comments regarding financial coding. Although most were addressed under the findings, the following are some other comments received.

- ❖ Several of the regions expressed concerns regarding late budget allocations. They feel that many corrections are required due to this. At the beginning of fiscal year, invoices are sometimes charged against temporary accounts and are then reversed to appropriate coding once budgets are allocated.
- ❖ Some of the employees interviewed find it difficult to code an expense when it involves more than one project/activity code; therefore, costs are being charged to where the majority of dollars are spent.
- ❖ Some of the finance staff interviewed expressed difficulties in keeping up with the training due to high staff turn over.

Management Response

This fiscal year, the budget allocation was done later in the fiscal year due to the re-organisation of EC. Budget allocation will be done earlier in the fiscal year once the re-organization is completed.

Finance will train employees when the revised chart of accounts will become effective.

There is a high turnover in the FI community throughout the federal government hence it is not unique to EC. Management will continue to promote a learning environment by encouraging staff to continuously upgrade their skills.

### **3.0 CONCLUSION**

Transformation of Environment Canada's governance structure will necessitate a new coding structure for the Department. Finance and Corporate Branch has been tasked with developing a strategy for working towards a new coding structure for Environment Canada. The results of this audit should be considered during this exercise.

In keeping with the 'One Department' approach, Corporate and Finance Branch should ensure consistencies across the department in order to strengthen the planning and reporting capacity of the organization.

In our professional judgement, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusions reached and contained in this report. The conclusions were based on a comparison of the situations as they existed at the time, against the audit criteria. The conclusions are only applicable for the Chief Financial Officer.



## **ANNEX 1**

### **List of Background Information and Supporting Documentation**

- ❖ Treasury Board Policy on Classification and Coding of Financial Transactions
- ❖ Treasury Board - Financial Systems and Controls
- ❖ Treasury Board Financial Information Strategy Accounting Manual
- ❖ Environment Canada - Policies and Procedures - Financial Coding
- ❖ Environment Canada – Financial Coding Manual (Discoverer)