



Santé  
Canada

## **Final Audit Report**

# **Audit of Financial Forecasting and Year-End Expenditures**

**September 2009**

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## Executive Summary

This report sets out the observations, conclusions and recommendations from the *Audit and Accountability Bureau's* audit of the Financial Forecasting and Year-End Expenditures. This audit was included in the multi-year Risk-Based Audit Plan and focused on key controls set out in the *Core Management Controls* guidelines from the Office of the Comptroller General. These guidelines are consistent with the ten elements of the federal government's *Management Accountability Framework*.

The objective of this audit was to provide the Deputy Minister and the Departmental Audit Committee with assurance on the effectiveness of the processes and controls surrounding the financial forecasting and year-end expenditures. The audit was conducted in accordance with the Internal Auditing Standards for the Government of Canada, and has examined sufficient, relevant evidence and obtained sufficient information and explanations to provide a reasonable level of assurance in support of the audit conclusion.

At Health Canada, guidance on the budgetary and financial forecasting is provided by the *Budget Management Framework* (BMF). This policy suite, which took effect April 1, 2008, replaced the former *Budget Management Directive (2001)*. The BMF is the Department's response to an observation of the Auditor General's report of 2006 Chapter 8 ("*Allocating Funds to Regulatory Programs*") that highlighted the need to improve budget management practices.

Overall, we have found that the departmental processes and controls related to financial forecasting and year-end expenditures are effective.

Management is in agreement with the recommendation included in this report.

## Introduction

### Background

The Government of Canada defines governance as a suite of processes and controls intended to set the strategic direction, operational plans, objectives and priorities of an organization, and to provide clear direction on how resources should be allocated to enable it to fulfill its objectives and achieve its mandate. Governing bodies are established to set an organization's policy and strategic direction, while its management translates them into operational activities. In order to ensure fiscal responsibility, operational activities must be quantified through an effective budgetary process and its corresponding financial forecasting processes.

Financial forecasting is a management tool that provides management with a systematic approach to determining the resources necessary to deliver on the organization's mandate. It also provides information on the financial position of the organization at a point in time. Effective controls for budget processes can contribute significantly to the attainment of departmental priorities within the established financial constraints.

At Health Canada, guidance on the budgetary and financial forecasting is provided by the *Budget Management Framework* (BMF). This policy suite, which took effect April 1, 2008, replaced the former *Budget Management Directive (2001)*. The BMF is the Department's response to an observation of the Auditor General's report of 2006 Chapter 8 ("*Allocating Funds to Regulatory Programs*") that highlighted the need to improve budget management practices. Regardless of the further improvements that are needed, it should be emphasized that Health Canada has been historically spending its annual departmental allocations effectively. The total lapse, on a year-over-year basis, has been around 1%. In 2008-09, the total budgetary allocations were \$3.506B, of which \$3.504B were spent, bringing the lapse even lower at about 0.07%.

### Objectives

The objective of this audit was to provide the Deputy Minister and the Departmental Audit Committee with assurance on the effectiveness of the processes and controls surrounding the financial forecasting and year-end expenditures.

### Scope and Approach

The audit was undertaken by the Audit and Accountability Bureau as per the Health Canada Risk-Based Audit Plan for 2008-2009 which was approved by the Departmental Audit Committee on April 3, 2008 and was conducted in accordance with the Internal Auditing Standards for the Government of Canada, and has examined sufficient, relevant

evidence and obtained sufficient information and explanations to provide a reasonable level of assurance in support of the audit conclusion.

The audit examined the life-cycle controls surrounding Health Canada's budgetary framework. The audit focused on key controls set out in the *Core Management Controls* guidelines from the Office of the Comptroller General. These guidelines are consistent with the ten elements of the federal government's Management Accountability Framework. Audit criteria are provided in **Appendix A**.

The audit covers policies, practices and procedures that were in place in fiscal year 2008-09 (except, as noted below, for the detailed testing of year-end transactions).

In validating the key controls utilized in the budgetary process, the audit approach included:

- Reviewing relevant Treasury Board's and Health Canada policies related to financial forecasting;
- Conducting interviews with selected Branch Senior Financial Officers, Regional Senior Financial Officers, in addition to key individuals in various Directorates regarding the budgetary framework; and
- Reviewing various budgetary files (such as operating plans, and variance reports), processes, and workflows.

The audit also included a detailed review and testing, for the 4-year period of April 1, 2005 to March 31, 2009, of year-end transactions for adherence to key processes and controls. It examined the nature, the supporting documentation and the controls surrounding these transactions.

## **Findings, Recommendations and Management Responses**

### **Financial Management Policies**

#### **Audit Criteria**

Financial management policies and authorities are established, communicated, regularly reviewed by the Chief Financial Officer Branch (CFOB). Compliance with the *Financial Administration Act*, and applicable policies and authorities is monitored regularly.

The *Budget Management Directive (2001)* was replaced on April 1, 2008 by the *Budget Management Framework and Detailed Directions (2008) (BMF)*, which was developed by the CFOB following consultations with staff and senior management from all Branches and Regions across Canada. The BMF has received support from senior management that has communicated its importance to employees involved in the budgeting process at Health Canada. In addition, mandatory training had been provided to approximately 2,700 employees across Canada as of March 31, 2009.

The BMF contains specific requirements on functional reviews, and performance monitoring; reviews of internal and external auditor reports; and reviews of the reports and management representations. These requirements address some of the shortcomings that had been identified in the *Budget Management Directive (2001)*.

Currently, there is a requirement to review the BMF within three to five years of its implementation to ensure its relevance. However, it will be revised before that time should the need arise, for example as a result of significant changes in applicable Treasury Board's policies.

## **Planning and Budgeting**

### **Audit Criteria**

The CFOB has in place activities, schedules and resources that are needed to achieve the budgetary objectives. In addition, a process is in place within the CFOB in order to challenge the assumptions and related resource allocations within the budget and its amendments. Lastly, budget exercises are completed within preset timelines.

The CFOB has established a budgetary planning and compilation process. Moreover, the budgets and operational plans were established as per the set timelines.

Roles and responsibilities of the functions and groups involved in the process are adequately identified in the BMF and ensure consistency of desired operational practices among the various Branches. The BMF also offers sufficient guidance on the preparation of supporting working papers for the budgetary data.

## **Budget Monitoring**

### **Audit Criteria**

The CFOB has in place policies, procedures and processes to ensure that adequate financial management is exercised by cost centre managers.

### **Monitoring of Financial Results**

Cost Centre Managers are responsible to monitor, on a monthly basis, their respective budgets. This means ensuring that forecasted expenditures (i.e. actual expenses plus commitments and anticipated expenditures) are adequately identified and that potential surplus/deficit (or variance) is highlighted in a timely manner. This responsibility is fulfilled at month-end through the preparation of a Management Variance Report (MVR). This process is standardized across Health Canada by the use of a system that allows electronically preparing and archiving MVRs. This system was improved with the implementation of the new BMF.

The CFOB is responsible to ensure that the MVR exercises are adequately conducted and documented through a challenge function. For the period audited, we have found that the function was not consistently documented among the various Branch Senior Financial Officers and Regional Senior Financial Officers. Documentary evidence shows that some performed frequent and regular analysis of the periodic financial results and were in regular communication with the various cost centre managers while in other cases, some placed high reliance on the approved results submitted to their office. This situation resulted from insufficient guidelines in the former budget directive. It is important to note that it has been addressed in the BMF.

The BMF includes standards to document and file the results of the monthly financial reviews as well as the challenge discussions and corresponding findings. However, these standards are not consistently applied in some Branches. The retention and safeguarding of Health Canada documentation is critical to easily retrieve information whenever necessary.

### **Recommendation No. 1**

*The Chief Financial Officer should ensure the consistent application of documentation and filing standards for the results of the reviews and challenge discussions as well as for other forecasting files and tools that are used by Branches for financial analyses and reporting.*

### **Management Response**

Management accepts the recommendation.

The BMF contains clear detailed review and challenge process instructions. Over the period of July-August 2009, the Executive Director of Financial Management will brief all Branch and Regional Senior Financial Officers on the audit finding and the need to retain supporting documentation on file.

### **Benchmarking**

As per the Treasury Board Secretariat's *Guide to Financial Management Benchmarking*, benchmarking is an integral component of a performance management process. It involves the establishment of baseline measurements and/or benchmarks (either internal or external) as comparisons against which to measure future performance and encourage improvement within an organization. While the *Guide* recognizes that the use of benchmarking in the Federal Government is in its early stage, it encourages its use in order to provide a greater level of understanding of the financial performance within federal departments and agencies.

During this audit, it was found that, although comparisons of actual results to prior period and/or budgeted data are performed, the Department does not use benchmarks. Areas

that could potentially benefit from benchmarking include the expenditure cycle, revenue cycle, travel, financial planning and analysis, and general accounting and reporting.

The fact that CFOB is currently considering the potential integration and utilization of benchmarking tools in accordance with the *Guide to Financial Management Benchmarking* is welcome.

## **Transactional Monitoring**

### **Audit Criteria**

Management compares results achieved against expectations, on a periodic basis. Unusual spending patterns, or activity, are investigated. In addition, management conducts transactional reviews to ensure the procurement and settlement activities are undertaken in accordance with the budget.

### **Year-End Expenditures**

The CFOB is responsible for the review of the transactional expenditures to ensure that the procurement and settlement activities have been undertaken in accordance with established departmental policies and procedures.

A review of 75 year-end transactions has been performed to determine whether the established controls were adhered to; supporting documentation was sufficient and appropriate; and expenditures were adequately planned by Management. This sample, selected from the departmental accounting system (SAP), excluded uncontrollable costs such as salaries, wages and benefits as well as FNIHB Non-Insured Health Benefits. The sample included 57 transactions selected from Vote 1 (Operating Expenditures) and Vote 5 (Capital Expenditures) as well as 18 transactions selected from Vote 10 (Grants and Contributions). The above transactions were selected across ten regional processing centers, including the National Capital Region.

The transactions were selected using the following criteria:

- expenditures selected from fiscal years 2005-06 to 2008-09;
- emphasis placed on significant transactions;
- breadth of different type of transactions and Budgetary Votes was sought, including grants and contributions expenditures; and
- transactional representation among Regions, including the National Capital Region.

For the sample reviewed, we found that:

- expenditures were adequately planned and anticipated;
- account coding utilized was appropriate;
- expenditure approval process has been adequately adhered to;



- transactions were processed in the appropriate fiscal year;
- goods or services received were in accordance with the terms and conditions of their respective contractual document; and
- grants and contributions expenditures entered into were in accordance with their respective contractual terms and conditions.

These results indicate that processes and controls surrounding year-end expenditures are effective.

### **Year-End Expenditure Patterns**

As shown in the Tabled found in **Appendix B**, for each of the four fiscal years under review, approximately 23% of the annual expenditures<sup>1</sup> were recorded in the month of March, representing about three times the average rate of monthly expenditures recorded in previous months.

The main cause for this pattern is explained as follows. During the first 11 months of any given fiscal year (i.e. April of a calendar year to February of the next calendar year), expenses are solely recorded based on payments. Since these payments are generally made a few months after expenses have been incurred, each month includes some expenses that, in effect, belong to previous months. However, the same does not apply for the month of March where we ensure that expenses are recorded in the year where the services or goods were provided. Thus, in March, expenses are recorded on the basis of expenses paid and accrued as of March 31. This results in the recording of expenses in the month of March that would have otherwise been recorded in subsequent months.

Based on the analytical review of monthly expenses, we have found that this pattern explains a significant part of the increase noted in March. Furthermore, the testing of year-end expenditures, as commented in the above section, provided evidence that processes and controls surrounding the year-end expenditures are effective. Hence, we conclude that the increase of expenditures in March is not an indication of inadequate planning or inappropriate purchasing decisions but the result of the timing in accounting for expenditures.

## **Conclusion**

Overall, we have found that the departmental processes and controls related to financial forecasting and year-end expenditures are effective.

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<sup>1</sup> Net of Salaries and Wages.

## **Appendix A - Audit Criteria**

### **Audit Objective No. 1**

To provide assurance on the effectiveness of the processes and controls surrounding financial forecasting.

#### **Criteria:**

- Financial management policies and authorities are established, communicated, regularly reviewed by the Chief Financial Officer Branch (CFOB). Compliance with the *Financial Administration Act*, and applicable policies and authorities is monitored regularly.
- The CFOB has in place activities, schedules and resources that are needed to achieve the budgetary objectives. In addition, a process is in place within the CFOB in order to challenge the assumptions and related resource allocations within the budget and its amendments. Lastly, budget exercises are completed within preset timelines.
- The CFOB has in place policies, procedures and processes to ensure that adequate financial management is exercised by cost centre managers.

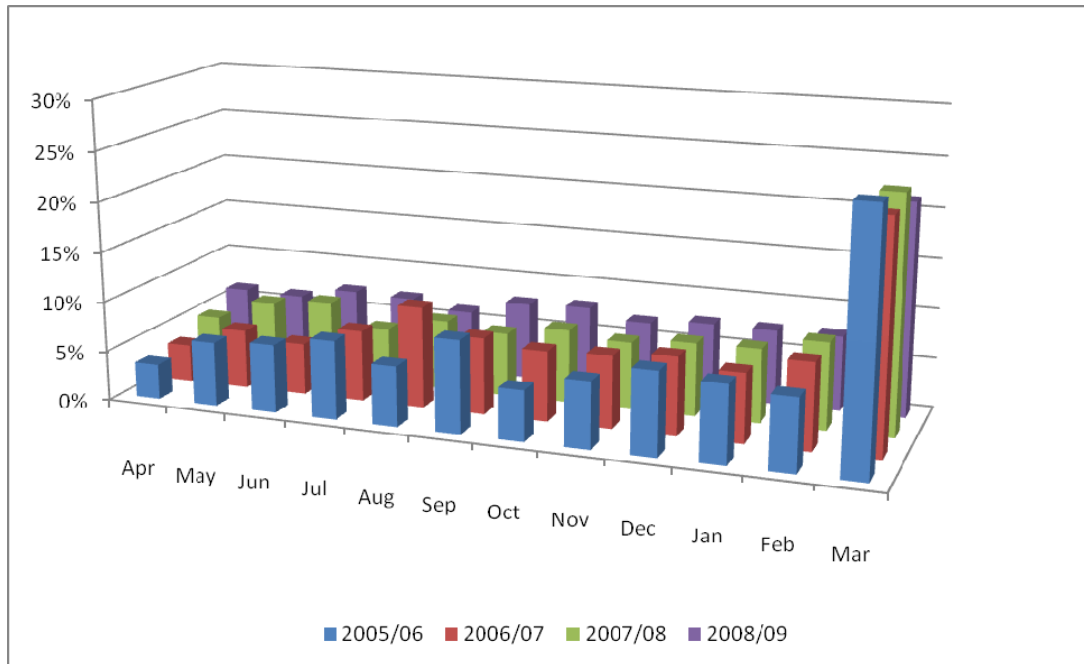
### **Audit Objective No. 2**

To provide assurance on the effectiveness of the processes and controls surrounding year-end expenditures.

#### **Criteria:**

- Management compares results achieved against expectations, on a periodic basis. Unusual spending patterns, or activity, are investigated. In addition, management conducts transactional reviews to ensure the procurement and settlement activities are undertaken in accordance with the budget.

## Appendix B – Monthly Distribution of Departmental Expenditures\*



(\*) Net of Salaries and Wages. Expenses recorded in March include accrued expenses as of March 31.