

**2011–12 Annex to the
Statement of Management Responsibility,
Including Internal Control
over Financial Reporting**



Office of the Auditor General of Canada

Note to the reader

The Treasury Board Policy on Internal Control requires that organizations demonstrate the measures they are taking to maintain an effective system of internal control over financial reporting (ICFR).

As part of this policy, organizations are expected to conduct annual assessments of their system of ICFR, establish action plans to address any necessary adjustments, and attach a summary of their assessment results and action plan to their Statement of Management Responsibility.

Effective systems of ICFR aim to produce reliable financial statements and to provide assurance that

- transactions are appropriately authorized;
- financial records are properly maintained;
- assets are safeguarded from risks such as waste, abuse, loss, fraud, and mismanagement; and
- applicable laws, regulations, and policies are complied with.

It is important to note that the system of ICFR is not designed to eliminate risks, but rather to mitigate risks to a reasonable level, with controls that are balanced with and proportionate to the risks they aim to mitigate.

The maintenance of an effective system of ICFR is an ongoing process designed to identify and prioritize risks and the controls to mitigate these risks, as well as to monitor the system's performance in support of continuous improvement. As a result, the scope, pace, and status of organizations' assessments of the effectiveness of their systems of ICFR will vary from one organization to another, based on risks and each organization's unique circumstances.

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2011–12 Annex to the Statement of Management Responsibility, Including Internal Control over Financial Reporting

1 Introduction

This document is attached to the Office of the Auditor General's (OAG) Statement of Management Responsibility, Including Internal Control over Financial Reporting for the 2011–12 fiscal year. As required by the Treasury Board Policy on Internal Control, this document provides summary information on the measures taken by the OAG to maintain an effective system of internal control over financial reporting (ICFR). In particular, it provides summary information on the OAG's assessment as of 31 March 2012, including progress, results, and related action plans along with some financial highlights pertinent to understanding the control environment unique to the OAG.

1.1 Authority, mandate, and program activities

Detailed information on the OAG's authority, mandate, and program activities can be found in its Departmental Performance Report and its Report on Plans and Priorities.

1.2 Financial highlights

The OAG's annual audited financial statements for the fiscal year ended 31 March 2012 can be found in its Departmental Performance Report. Financial information can also be found in the Public Accounts of Canada.

- The OAG is financially dependent on Parliament for its funding. The appropriations of \$89.8 million provided by Parliament for the year represent just under 87 percent of the total cost of \$103.3 million. An additional 14 percent of total costs, or \$14.7 million, are services provided without charge by Public Works and Government Services Canada (PWGSC). Just under 1 percent, or \$0.8 million, represents recovered costs.
- Salaries and employee benefits, excluding employee insurance plan costs, account for the majority (73 percent or \$75.4 million of total costs) of the OAG's total expenses. The costs of accommodations (\$9.0 million) and employee insurance plans (\$5.7 million) make up the \$14.7 million for services provided without charge by PWGSC. The remaining expenses (13 percent or \$13.2 million) are for mostly professional services, travel, communication, and other equipment and supplies.
- Tangible capital assets comprise 88 percent, or \$2.3 million, of the OAG's total non-financial assets of \$2.6 million. Financial assets are composed mostly of an amount due from the Consolidated Revenue Fund of \$6.6 million.
- Post-employment benefits and compensated absences (sick leave) account for the majority (61 percent or \$14.8 million) of total liabilities. Accounts payable and accrued liabilities comprise the remaining 39 percent (\$9.3 million) of total liabilities. The accrued liabilities include accruals for salary, overtime, and vacation pay.

- The OAG has information systems that are critical to its operations and financial reporting, such as its financial system, GX Financials.

1.3 Service arrangements relevant to financial statements

The OAG relies on other organizations for processing certain transactions recorded in its financial statements:

- PWGSC centrally administers the payment of salaries as well as the payment of invoices to suppliers through the Standard Payment System.
- The Treasury Board of Canada Secretariat provides the OAG with information to validate calculations for various accruals and allowances, such as the accrued severance liability.

1.4 Material changes in 2011–12

Changes in operations

In 2011–12, there have been no significant changes to the OAG's authorities and no changes in its operations that would have an impact on the financial statements, which continue to be prepared in accordance with Canadian Public Sector Accounting Standards.

Changes affecting the financial statements

In 2012, the Office engaged an actuary for the first time to determine the expected future use of the current accumulated sick day balance. In the past, no liability was recorded in the financial statements as it was not considered material. With the actuarial analysis performed this year using historical data concerning the Office's sick leave use, the accumulated deficit at the beginning of the year and liabilities have been increased by \$3.5 million. This restatement is due to a misinterpretation of data in prior years.

Changes in key personnel

Sheila Fraser's term as Auditor General ended in May 2011. John Wiersema acted as Interim Auditor General until his retirement in late 2011. Effective 28 November 2011, Michael Ferguson became Auditor General of Canada.

Changes to the terms and conditions of employment

The OAG, in collaboration with a committee that represents the Audit Professional group of over 250 employees, approved a revised salary structure. The impact of this revision was an increase to salary expenses in 2011–12 of about \$225,000.

As part of collective agreement negotiations with employee groups and changes to conditions of employment for executives, the accumulation of severance benefits under the employee severance pay program ceased in 2011–12 for the management and the information technology groups.

Accumulation of severance benefits will cease in 2012–13 for the audit services group and the audit practices group. Employees of the groups for whom the accumulation of severance benefits ceased in 2011–12 have been given the option to be immediately paid the full or partial value of benefits earned to date or collect the full or remaining value of benefits on termination of employment from the public

service. The same options will be given to the other two groups in 2012–13. These changes have been reflected in the calculation of the outstanding severance benefit obligation included in the financial statements.

2 The Control Environment Relevant to ICFR

The OAG recognizes the importance of setting the tone, starting with senior management, to help ensure that staff at all levels understand their role in maintaining effective systems of ICFR and are well equipped to exercise their responsibilities effectively. The Executive Committee provides overall direction and oversight for the OAG. It is supported by the Finance and Corporate Services committees, which conduct due diligence and provide advice on the development and implementation of OAG policies and controls, as well as other matters. An independent audit committee oversees key aspects of values and ethics, risk management, internal controls, and external audit of our financial statements, quality management, practice review and internal audit function, and accountability reporting.

The OAG’s organizational structure is clearly defined, and the lines of authority and responsibility are well established. Staff members are qualified and trained, and formal job descriptions are in place. An OAG code of values, ethics, and professional conduct sets out (in detail) the values and the ethical, professional, and other standards that guide staff in their work.

An integrated risk management framework is in place based on the enterprise risk management model of the Committee of Sponsoring Organizations of the Treadway Commission. The framework is monitored and updated regularly, and it provides the basis for an annual risk management report to the Executive Committee, which is reviewed by the Audit Committee.

The OAG’s Practice Review and Internal Audit function, which reports directly to the Auditor General, prepares an annual internal audit plan. The plan is based on a systematic assessment of business risk, which is developed using the risk management framework and other inputs. Internal audits assess significant administrative systems on a rotational basis. Annual practice reviews of all three major product lines assess the implementation of our quality management system for audit operations and make recommendations to improve the system’s design and function.

2.1 Key positions, roles, and responsibilities

The following are the key positions and committees with responsibilities for maintaining and reviewing the effectiveness of the OAG’s system of ICFR:

Auditor General (AG). As the OAG’s Accounting Officer, the AG assumes overall responsibility and leadership for the measures taken to maintain an effective system of internal control. The AG chairs the Executive Committee.

Chief Financial Officer (CFO). The CFO reports directly to the Auditor General and provides leadership for the coordination, coherence, and focus on the design and maintenance of an effective and integrated system of ICFR, including its annual assessment.

Chief Information Officer (CIO). The CIO is responsible for leading our Information Technology and Security groups, Knowledge Management groups, as well as special IT projects.

OAG senior managers. Senior managers are responsible for maintaining and reviewing the effectiveness of their system of ICFR that falls within their mandate.

Chief Audit Executive (CAE). The CAE reports directly to the Auditor General and provides assurance through periodic practice reviews and internal audits, which are instrumental to maintaining an effective system of ICFR.

OAG Audit Committee. The Audit Committee is an advisory committee that provides the Auditor General with objective views on the OAG risk management, control, and governance frameworks. The Audit Committee also recommends for approval the annual Report on Plans and Priorities and Departmental Performance Report (including audited financial statements) to the Executive Committee. The Auditor General is a member of the Audit Committee.

Executive Committee. The Executive Committee is the central decision-making body; it approves and monitors the OAG Risk Management Framework and the system of internal control, including the assessment and action plans related to ICFR. The committee, which comprises the Auditor General, Commissioner of the Environment and Sustainable Development, and assistant auditors general, sets policy and provides overall professional administrative direction for the OAG.

2.2 Key measures taken

The OAG's control environment equips its staff to manage risks well by raising awareness, providing appropriate knowledge and tools, and developing skills. Key control measures include the following:

- All OAG staff formally acknowledge compliance with the OAG code of values, ethics, and professional conduct annually; they are required to disclose any potential conflict of interest or holdings of certain assets, liabilities, or other interests.
- Staff in key financial management positions hold accounting designations.
- All OAG policies and procedures are available to staff on the OAG's INTRAnet site, and references to Treasury Board policies are provided. Awareness programs include group awareness sessions, bulletins, emails, and orientation sessions for new employees, as well as reminders on the INTRAnet home page.
- The detailed financial signing authority, which is updated regularly, is available on the INTRAnet.
- Main business processes and related key control points are documented to support the management and oversight of ICFR.
- Secure financial processing systems, with access limited to appropriate staff, are in place to ensure the integrity of financial data and processing of transactions.

3 Assessment of the OAG's System of ICFR

3.1 Assessment baseline

The OAG maintains an effective system of ICFR, with the objectives to provide reasonable assurance that

- transactions are appropriately authorized;
- financial records are properly maintained;
- assets are safeguarded from risks such as waste, abuse, loss, fraud, and mismanagement; and
- applicable laws, regulations, and policies are complied with.

The external auditors conduct an annual controls-based audit and are actively engaged (at least twice per year) through their attendance at audit committee meetings. As part of the requirements of the Treasury Board's Policy on Internal Control, the OAG is to annually assess both the **design** and **operating effectiveness** of key controls over financial reporting in support of continuous improvement.

Design effectiveness is the assurance that key control points are in place and that they are identified, documented, and aligned with the risks (that is, controls are balanced with and proportionate to the risks they aim to mitigate). This includes the mapping of key processes to the main accounts.

Operating effectiveness means that key controls have been tested over a defined period and that any remediation is addressed. Such testing covers all OAG control levels that include entity, general computer, and business process controls.

Ongoing monitoring means that a system is in place to ensure that risks are mitigated continuously within the main business processes and corrective actions are taken in a timely manner when required.

3.2 Assessment method

The OAG has taken measures to assess its system of ICFR starting from its financial statements, with a focus on the following main processes:

- Payroll (National Capital Region)
- Operating Expenditures
 - Contracting and procurement (professional services, goods, and other services) (National Capital Region and four regional offices)
 - Travel (National Capital Region and four regional offices)
 - Capital assets (National Capital Region)
- Revenues (National Capital Region)
- Year-end reporting (National Capital Region)

The OAG conducted its first assessment of the effectiveness of internal control over financial reporting last year. This involved an assessment of the design and operating effectiveness of the controls through testing samples of transactions in each of the main process areas. The results of that first-year assessment were reported in the Annex to the 2010–11 Statement of Management Responsibility, Including Internal Control over Financial Reporting, which contained an action plan outlining the work to be done in 2011–12 as follows:

- Perform walk-throughs, using a sample of transactions from the main business processes, to confirm that key controls continue to be designed appropriately and operate effectively.
- Review the general IT-related controls, which includes improving the documentation and expanding the coverage of testing of the key controls related to the OAG’s key systems.
- Formalize the process for establishing hourly billing rates for cost recoveries.
- Follow up on progress made in areas identified for improvement in 2010–11.

For 2011–12, in addition to addressing the above-noted action plan items (see Section 5.1), and in order to conclude on the effectiveness of internal controls for this reporting year, the OAG reconfirmed the design effectiveness of controls and tested operating effectiveness on a sample of transactions.

4 Assessment Results

In the 2011–12 fiscal year, the OAG’s assessment of internal controls was in large part a continuation of last year’s assessment, supplemented with additional in-depth reviews of general computer controls of its financial system.

4.1 Design effectiveness

When performing walk-throughs of identified key controls, the OAG reviews whether processes continue to follow the documented procedures. If changes are identified, process descriptions are updated and controls are re-examined to ensure that they continue to be designed in a way that mitigates any associated risks. Our control walk-throughs performed in the 2011–12 fiscal year confirmed that the identified key controls have not changed significantly and are still appropriately aligned with the risks they aim to mitigate.

4.2 Operating effectiveness

As was the case last year, the OAG put together a review team that drew upon the experience of staff who work in audit operations. The team established a work plan, selected sample transactions (following audit methodology used by the OAG), and tested the transactions to ensure that the controls work effectively. The team also reviewed the sample transactions to ensure coverage of key components of the business processes over the entire fiscal year. The sample transactions covered subcategories of transactions within each cycle and also included a review of ongoing management and monitoring controls applicable to all cycles. The following summarizes what was done for each of the main business processes:

- Salaries are paid by PWGSC. Testing payroll involved reviewing the various pay actions initiated by compensation staff, including those related to new hires, terminations, promotions, and transfers. Detailed reviews of files were performed to ensure appropriate documentation of controls.
- Within operating expenditures, transactions reviewed included travel, hospitality, contracting, and purchase of supplies. The focus of this testing was to ensure that proper approvals for the expenditures were done and documentation supporting the transactions was on file.
- The revenue cycle consists of external revenues from the OAG's international audit engagements and other sources. The testing involved ensuring that billing was in line with established agreements.
- For the year-end reporting, a review of year-end procedures was done, covering the working papers, reviews, and sign-offs used in preparing the audited financial statements and public accounts submissions.

Finally, in response to last year's action plan items, reviews of key access and security controls and of the overall financial system management were done.

4.3 Conclusion

The system of internal control over financial reporting is well designed and functioning effectively. While no significant weaknesses were found, areas of improvement were identified for which follow-up actions either have been completed or are under way.

5 The Action Plan

5.1 Progress made as of 31 March 2012

In addition to assessing design and operating effectiveness of key controls in the main business processes, the OAG addressed the action plan items identified in 2010–11 as follows:

- The OAG conducted a review of the general information technology and security-related controls for the financial system. Access and security controls and the overall management process were reviewed. The review found that access to the system is restricted to appropriate staff and that formal policies are in place that define an approach to systems acquisitions and change management. Based on these findings, controls for the management of the financial system have been designed appropriately and are working effectively.
- As raised in the previous year's action plan, guidance on the use of chargeable billing rates has been introduced. The Office charges various rates for the different types of services provided, depending on the type of organization and work being performed. This new guidance will formalize those rates and create a process to ensure that rates are updated when salary revisions occur, thereby ensuring a more accurate recovery of costs.
- The OAG has taken actions to follow up on other areas for improvement identified in the prior year. These actions include enhancing the documentation and process for the S.33 payment approval for pay transactions and improving the segregation of duties within the payroll function.

5.2 Action plan for future years

The OAG has taken several important steps to ensure that an effective system of internal control over financial reporting is in place. That being said, continuous, ongoing efforts to maintain strong controls over the long term are necessary to build on the work already done. The following describes the actions that the OAG plans to take over the next two years:

2012–13

- Follow up on areas of improvement identified in 2011–12.
- Streamline the testing of identified key controls.
- Reconfirm design effectiveness of all identified key controls in the main business processes.
- Reconfirm the general IT controls for the OAG’s financial system. Limited testing will be performed, unless significant changes to systems have occurred.
- Update the OAG Security and Information Technology policies.
- Establish the following rotational assessment of operating effectiveness of the OAG’s internal control over financial reporting:
 - 2012–13—Payroll
 - 2013–14—Operating Expenditures
 - 2014–15—Revenues

2013–14

- Follow up on areas of improvement identified in 2012–13.
- Reconfirm design effectiveness of all identified key controls in the main business process.
- Reconfirm general IT controls for the Office’s financial system. Limited testing will be performed, unless significant changes to systems have occurred.
- Carry out the second year of rotational testing of the operating effectiveness of internal control over financial reporting:
 - 2013–14—Operating Expenditures