

# Audit of Accounts Payable – NCR

April 2005

***Audit and Evaluation  
Directorate***



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**Acronyms used in the report**

AEB	Audit and Evaluation Branch
AMEX	American Express
DAEC	Departmental Audit and Evaluation Committee
EC	Environment Canada
FAA	Financial Administration Act
FAS	Financial Accounting System
FSD	Financial Services Directorate
FMS	Financial Management Services
GAC	Government Acquisition Card
LOBJ	Line Object
LPO	Local Purchase Order
MSB	Management Services Branch
NCR	National Capital Region
P&C	Policy and Communications
PWGSC	Public Works and Government Services Canada
RC	Responsibility Centres
TAA	Travel Authority and Advance
TB	Treasury Board
TES	Travel Expert System

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## Table of Contents

<b>1. EXECUTIVE SUMMARY .....</b>	<b>V</b>
<b>2. INTRODUCTION .....</b>	<b>1</b>
<b>2.2 CONTEXT .....</b>	<b>1</b>
<b>2.2 OBJECTIVE .....</b>	<b>1</b>
<b>2.3 SCOPE .....</b>	<b>1</b>
<b>2.4 AUDIT APPROACH &amp; METHODOLOGY .....</b>	<b>1</b>
<b>2.5 CRITERIA .....</b>	<b>2</b>
<b>3. FINDINGS AND RECOMMENDATIONS.....</b>	<b>3</b>
<b>3.1 OVERALL FINDINGS.....</b>	<b>3</b>
<b>3.2 OBSERVATIONS .....</b>	<b>4</b>
<b>3.2.1 Transaction Initiation.....</b>	<b>4</b>
<b>3.2.2 Certification of Work Performance.....</b>	<b>5</b>
<b>3.2.3 Payment Legitimacy .....</b>	<b>7</b>
<b>3.2.3 Payment Verification.....</b>	<b>8</b>
<b>3.2.3 Management Control Framework .....</b>	<b>9</b>
<b>Roles &amp; Responsibilities.....</b>	<b>9</b>
APPENDIX A: METHODOLOGY .....	10
APPENDIX B: OBJECTIVE AND CRITERIA.....	12



## 1. Executive Summary

The Audit of Accounts Payable was conducted as part of the 2004-2007 Departmental Audit and Evaluation Plan. The services of Samson & Associates were retained to conduct the audit.

The objective of the audit was to determine whether accounts payable existing controls and practices were in line with the *Financial Administration Act* (FAA), Treasury Board (TB) policies and directives, and Environment Canada (EC) policies.

The scope of the audit included an assessment of the internal financial and administrative controls over the accounts payable function of the National Capital Region. The period covered by the audit included all accounts payable transactions from September 1, 2003 to August 31, 2004.

The audit methodology was similar to that used for the 2003 Audit of Accounts Payable completed for the Atlantic, Ontario, Prairie and Northern, and Pacific and Yukon regions. A combination of interviews, documentation review, process mapping and sampling was carried out. The sampling methodology was also comparable to the one previously used, providing a 95% confidence level with a tolerable error rate set at 5%, representing no more than one error per audit criterion.

The audit team found that existing accounts payable controls are working as intended and respect the requirements of the FAA, TB policies and directives and EC policies. Results of interviews with accounts payable staff revealed a good knowledge and understanding of the relevant policies and procedures. It was also noted that some staff have substantial accounts payable experience.

The audit team found that while no significant control deficiencies existed, a number of areas for improvement were identified. The results of the detailed testing revealed that current practices have resulted in an error rate of 8%, which is in excess of the tolerable limit set at 5%. The errors were identified in the areas of Certification of Work and Services Performance, Payment Legitimacy and Payment Verification. It should be noted that most anomalies identified (7% out of 8%) were on transactions processed prior to the implementation of the Payment Statistical Sampling Verification process in May 2004. The implementation of this process has had a positive impact on reducing the error rate.

### **A summary of observations raised are as follows:**

**Certification of Work/Services Performance:** NCR Accounting (Administrative and Financial Guide, October 2000) and TB policies requires a segregation of duties between the person obtaining the goods or services and the person exercising section 34 authority, when that person can directly or indirectly benefit from the goods or the services. This practice is not always respected.

**Payment Legitimacy:** some documentation on file to substantiate payments was inadequate.

**Payment Verification:** supporting evidence of approval under FAA, Section 33 is not always consistent.

Management has been proactive in responding to the observations and recommendations of this report and have already initiated actions to correct some anomalies such as coding errors.

In the audit team's 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 are based on an assessment of the situations against the audit criteria, as they existed at the time.

## **2. Introduction**

In the Fall of 2001, Environment Canada's Audit and Evaluation Branch developed an audit strategy on departmental financial controls. The Financial Controls Audit Strategy identified a series of issues relating to the accounts payable function. Subsequently, in 2003, the Audit and Evaluation Branch completed an audit of the accounts payable function in four regions: Pacific and Yukon, Prairie and Northern, Ontario, and Atlantic. The National Capital Region (NCR) and the Quebec Region were excluded at the time because they were in the process of restructuring their accounts payable function. The results of the 2003 audit were tabled for approval at the Departmental Audit and Evaluation Committee (DAEC) in January 2004, at which time the Committee requested that a similar audit be completed for the accounts payable function in the NCR.

### **2.2 Context**

Although responsibility for certification of Section 33 under the *FAA* rests with the NCR Accounting Services, the Policy and Communication Branch, who are independent from the NCR Accounting Services also have an accounts payable function. This organization provides administrative staff to assist managers with the financial coding and application of the *FAA* Section 34.

The Financial Services Directorate (FSD) provides functional direction to the NCR Accounting Services on policy development and interpretation and is also responsible for the functionality of software applications such as Merlin, the departmental financial system, the Travel Expert System (TES) and the Government Acquisition Card system (GAC).

### **2.2 Objective**

The objective of the audit was to determine whether the accounts payable existing controls and practices in the NCR were compliant with the *FAA*, TB policies and directives and EC policies. A total of 20 different policies were taken into consideration to conduct this audit.

### **2.3 Scope**

The scope of this audit included an assessment of the internal financial and administrative controls over the accounts payable function of the NCR. Detailed testing of a representative sample of accounts payable transactions between September 1, 2003 and August 31, 2004 was also completed.

### **2.4 Audit Approach & Methodology**

The audit involved a preliminary review of background information and interviews with management and staff. The audit methodology (see Appendix A for details) included:

- Development of a policy framework document which included a summary of the key Treasury Board and departmental policy requirements applicable to accounts payable. This policy framework was used in the development of the audit criteria.

- Development of detailed process flowcharts and control mapping of the accounts payable process. This was to determine if the controls and practices in place were designed to ensure that expenditures incurred were complete, accurate, properly authorized and in compliance with existing authorities related to the following: roles and responsibilities; segregation of duties; account verification procedures; delegations of authority; and password protection.
- Verification of a representative sample of accounts payable transactions. The sample took into consideration the risk categories as defined in the EC Accounts Payable Verification policy. This testing was to determine the effectiveness of the controls in place for various high risk transactions such as: petty cash; use of acquisition cards (MasterCard, AMEX); contracting practices (sole source, temporary help services, hiring of related parties); travel claims; grants and contributions; hospitality and others (taxis, telephone, relocation, control of assets and attractive items).

The testing included both an attribute and a judgemental sampling of 310 transactions to ensure a balanced analysis of data.

- The attribute sampling reflected the audit criteria and was based on a population of 100,029 transactions, with a value in excess of \$311 million, processed in the NCR during the 12 months covered by this audit. The sampling methodology was comparable to the one used in 2003, referring to a 95% confidence level with a tolerable error rate set at 5%, representing no more than one error per audit criterion. The sample included 95 files for a value of \$332,949.
  - The judgemental sampling was based on a selection of 215 high risk transactions, with a total value of \$260M, identified using an automated data analysis software package, Audit Command Language (ACL). The transactions were reviewed for compliance.
- Preparation and presentation of a preliminary survey report highlighting areas of high risk.

## **2.5 Criteria**

The criteria used to assess compliance of the accounts payable transactions were based on the FAA, TB policies and directives and EC policies. Five main categories were covered including: transaction initiation; certification of work performance; payment legitimacy; payment verification and contracting. The audit criteria are attached in Annex B.



### 3. Findings and Recommendations

#### 3.1 Overall Findings

##### Overview

Overall the audit team found that no significant control deficiencies existed. However, the following areas for improvement or identification of best practices were identified:

- Results of the attribute sampling testing revealed an 8% level of error, slightly higher than the established 5% tolerable limit. Errors were identified in the areas of Certification of Work and Services Performance, Payment Legitimacy and Payment Verification.

In May 2004, the Financial Services Directorate introduced the Payment Statistical Sampling Verification process. The audit team noted that most anomalies identified during the detailed testing (7% out of the 8%) occurred prior to the implementation of this verification process. Similarly, based on information provided by NCR Accounting Services, there has been a continuous decrease in the error rate since the implementation of the verification process.

- Results of the judgemental sample testing revealed that all 215 transactions were in compliance with policies and directives.
- Although minor adjustments to some accounts payable practices are required, the controls and practices in place respect the requirements of the FAA, TB policies and directives and EC policies.
- The knowledge and expertise of the accounts payable staff is generally high. A good understanding of the relevant policies and procedures was demonstrated during the audit. It was also noted that some staff have substantial accounts payable experience.
- The management of the accounts payable function appears to be sound. NCR Accounting Services has incorporated the systems and best practices implemented by the Financial Services Directorate over the past few years as part of the accounts payable process. Examples include:
  - Implementation of the Payment Statistical Sampling Verification process;
  - Single source invoicing for suppliers such as Bell Canada, BMO Master Card, Public Works Government Services Canada (PWGSC) and Taxi Services, etc.;
  - Hospitality Plan for events over \$1,500;
  - Travel Expert System (TES); an automated departmental tool to assist staff in completing various tasks, such as travel approval, travel claims, identification of Section 34 signing authority, and completion of payment requisitions online;
  - Intranet sites providing sound financial information to staff in a user-friendly manner; and

- Government Acquisition Card (GAC) allowing the review of transactions online, thus reducing the timeline to process invoices.
- In addition, NCR Accounting Services has put in place a number of best practices:
  - A trainer fully dedicated to providing financial system training to departmental staff and the development of new initiatives; and
  - The requirement for accounts payable clerks and financial officers to initial documentation and payment registers as evidence that payment verification has been completed.
- Results of our testing revealed that established turn-around times for the various types of accounts payable transactions were being respected.
- No anomalies were identified with the purchase orders and contracts reviewed. Appropriate approvals were evident, amounts were within the authorized limits and payment processing was timely.

## **3.2 Observations**

### **3.2.1 Transaction Initiation**

As required by the TB Account Verification Policy, transactions are to be initiated against an authorized expenditure, approved by the right authority, and subsequently recorded in the appropriate financial system module to commit funds as per FAA, Section 32. The TB Travel Directive (Authorization) further outlines the requirements for authorization of travel.

Of the 24 travel transactions reviewed, the audit team noted one instance where a travel expenditure was incurred without proper approval. Travellers are required to obtain authorization to travel through the Travel Expert System (TES). However, in this instance, TES was not used and the traveller was required to complete a paper Travel Authority Advance (TAA) form and did not obtain the proper approval.

This instance represents a situation of non-compliance with TB Travel Directive and the Account Verification Policy.

### **Recommendation**

**The Chief, NCR Accounting Services should ensure immediately that all travel expenditures are supported with the proper approval to ensure compliance with requirements of the TB Travel Directive and the TB Account Verification Policy.**

## Management Response

The practice of NCR Accounting Services to return transactions with unacceptable authorization to seek the appropriate signature will be reinforced.

### 3.2.2 Certification of Work Performance (Signing Authority under FAA Section 34)

#### *Segregation of Duties*

As described in Section 34 of the FAA, certification of work performance means that the authorized person with delegated authority exercises the proper verification and certification.

Results of our detailed testing revealed that the segregation of duties between the person exercising Section 34 and the person obtaining the goods is not always respected. The audit team noted a situation where an acquisition cardholder, occupying a management position, signed for their own purchases under Section 34 of the FAA. Segregation of duties is a fundamental control principle that should be maintained within the department, as stated in the TB Policy on Account Verification (Section 4.f). This requirement is further reinforced in the TB Payment Requisitioning and Payment on Due Date Policy, (Section 5 c):

*“No person shall exercise spending authority (section 34) with respect to a payment from which he or she personally can benefit, directly or indirectly.”*

Although we did not find any malversation, it is believed that this practice could result in potential misuse of acquisition cards. In this particular situation, the NCR Accounting Services practice of returning irregular certification for resignature under FAA Sec. 34 was not followed.

#### *Payment on Due Date*

As required by the TB Account Verification (Section 4.f) and Payment Requisitioning and Payment on Due Date (Section 5 c) policies, invoices are to be date stamped upon receipt at departmental premises and forwarded for payment prior to the payment due date.

Due date, unless specified by the procurement contract, is defined as 30 days from the later date of receipt in the department of:

- the goods or services, in an acceptable condition, at the location(s) specified in the contract; or
- an invoice, in proper form, at the address designated in the contract.

The audit team noted that when the staff in programs receive the initial invoice, it is not current practice to identify the received date on the invoice. It is important that this date

be clearly indicated on the invoice as it will determine the payment due date as well as any applicable interest charges.

Invoices forwarded to NCR Accounting Services for payment are date stamped upon arrival ensuring that unnecessary interest charges are not incurred. For the period under review, a total of \$141,813.00 was paid in interest charges.

Managers with authority under section 34 of the FAA are responsible to present all invoices for payment prior to the payment due date. In cases where the payment due date is overdue, the managers are responsible to pay the interest charges incurred.

The current practice of ensuring payment on due date does not reflect the best practices as suggested by NCR Accounting (Administrative and Financial Guide, October 2000) and Treasury Board Policies.

#### *Evidence of Section 34*

The NCR Accounting Services, Administrative and Financial Guide, recommends a number of best practices such as the use of a rubber stamp or a coding form to capture the information required by the payment officer. It should be noted that there is no obligation to use a specific coding form in the Department, however, the use of the form would provide evidence of audit verification.

Results of our detailed testing revealed instances of variances:

- in two, the coding form was not used;
- in four, the coding form was used but was incomplete;
- in two, FAA Section 34 delegation of authority could not be verified since the individual's initials were illegible;
- in two, the certification under FAA Section 34 was not dated.

Without the use of the proper coding form accurately completed, or a rubber stamp indicating Section 34 certification, it becomes difficult to ensure that the payments are processed according to the service standards.

#### ***Recommendation***

**The Chief, NCR Accounting Services should immediately ensure that the Payment Statistical Sampling Verification process be expanded to include a review of segregation of duties between the person authorizing a transaction and the person receiving the goods or services. The Chief, NCR Accounting Services should also ensure that all invoices are date stamped upon departmental receipt to ensure compliance with the TB Account Verification Payment Requisitioning and Payment on Due Date policy and that the coding form is accurately completed.**

## Management Response

NCR Accounting Services will expand the Payment Statistical Sampling Verification process to include a review of the segregation of duties as recommended.

NCR Accounting Services will remind departmental managers to date stamp on receipt all invoices and to use the coding form before processing for payment.

### 3.2.3 Payment Legitimacy

Detailed testing included the following attributes under Payment Legitimacy:

- the invoice submitted for payment was an original received from a legitimate payee with whom the Department had previously raised a contract;
- inadmissible charges such as provincial sales tax have been deducted and documentation to support the payment was verified;
- the payment was legitimately coded to reflect the type of goods supplied or service rendered and was recorded in the financial system; and
- attractive and non-consumable items were reported in the appropriate inventory system.

Our review revealed that there were some inadequacies with respect to substantiation for payment. The observations resulting from the testing have been regrouped under three areas, namely Payment Documents, Receipts, and Coding.

#### *Payment Documents*

Local Purchase Orders (LPO's) are procurement instruments used to obtain goods and services under the \$5K threshold. The audit team noted the following anomalies:

- in one instance, services which included provision for travel, were contracted under an Local Purchase Order (LPO). Original receipts were not on file since the contractor had submitted invoices and receipts in PDF format through e-mail;
- in one instance, an invoice relating to a contract for access to the Barreau du Québec Data Bank, was submitted before the contract was prepared.

#### *Receipts*

The audit team noted that supporting documentation relating to travel, such as airline tickets and ground transportation were not always attached to the travel claim. Furthermore, original receipts or personal declarations required when receipts have been lost were not always obtained.

Section 1.9.1 of the TB Travel Directive, in effect at the time of the audit, stated that *'receipts must be attached to the "Travel Expense Claim" form to support all travel expenditures, including transportation ticket stubs'*. In addition, Section 1.9.3 of the Travel Directive stated that, *when travelers certified that the receipt was lost, a personal declaration may replace the receipt*. Finally, Section 1.5.2 of the revised Travel Directive

states that travelers should 'complete and submit travel expense claims with necessary documentation'.

#### *Coding*

Parking charges incurred within NCR were coded against a line object specific to 'Taxi Services' instead of the dedicated line object 'Travel within NCR'. We were informed that action has already been taken to correct this anomaly.

#### **Recommendation**

**The Chief NCR Accounting Services should immediately ensure that accounts payable staffs closely monitor travel claims to ensure that original receipts are provided or in the absence thereof, that declarations are submitted. He/she should also ensure that Responsibility Centre managers are informed of non-compliance with the TB policy on Account Verification and the TB Travel Directive occurring in their areas of responsibility.**

#### **Management Response**

The Chief NCR Accounting Services will remind departmental managers about their responsibilities under the Travel Directive and their requirements to submit original receipts or personal declarations as per the TB policy on Account Verification.

#### **3.2.3 Payment Verification**

Financial officers with payment authority, pursuant to FAA Section 33, are responsible for providing assurance of the adequacy of account verification, FAA Section 34. The audit team found that an adequate segregation of duties existed between the persons exercising authority pursuant to both FAA Sections 33 and 34.

However, the audit team noted that practices to provide evidence of approval under FAA Section 33 are not always consistent amongst Accounts Payable Clerks. Our testing revealed that out of 95 transactions reviewed, initials certifying FAA Section 33 on the Payment Register Document were missing in five cases.

#### **Recommendation**

**The Chief NCR Accounting Services should ensure that Accounts Payable Clerks initial certification of Section 33 on the Payment Register.**

#### **Management Response**

The Chief NCR Accounting will ensure that Accounts Payable Clerks initial certification of *Section 33 of the FAA* on all the Payment Register.

### 3.2.3 Management Control Framework

#### *Roles & Responsibilities*

The audit team noted that an additional NCR accounts payable process, independent of NCR Accounting Services, exists within Policy and Communications (P&C). P&C uses administrative staff to assist managers with the financial coding, application of Section 34 and undertaking an initial “vetting” of the documents, which are then forwarded to NCR Accounting Services for accounts payable processing. P&C transactions represent approximately 11% of the volume of transactions processed during the period covered by this audit. NCR Accounting Services and P&C are physically located in two different buildings.

An overview of the P&C process is as follows:

- P&C ensures the first level of review and evidence using the same batch numbering format as NCR Accounting Services.
- NCR Accounting Services ensures the second level of review prior to releasing payment (Section 33).
- The two offices work well together with regard to sharing of information.
- There exists a risk of misplaced payment documents and delay in the processing of transactions because they are in different locations.

We were informed that at one time, it was felt that P&C needed a personalised service to better respond to management needs. The requirement for P&C handling this type of financial services does not seem to apply any more. Further, the Corporate Services Blueprint, completed in September 2004, recognized a need to consolidate all Finance units under the ADM Human Resources and Service Innovation.

The audit team found no apparent added value with the two separate processes.

#### **Recommendation**

**The Director General, Financial Services Directorate, should consider integrating the two separate accounts payable processes;**

#### **Management Response**

It was agreed under the Corporate Services Blueprint to consolidate financial units under the Director General, Finance Services to integrate processes to reduce duplication and promote consistent. The implementation plan will include reviewing the accounts payable process.

**Appendix A: Methodology**

## Attribute Sampling

Attribute sampling is a statistical method used to estimate the proportion of items in a population containing a specific characteristic or attribute of interest. These characteristics or attributes reflect the audit criteria. A 95 percent confidence level with a tolerable error rate set at 5% was chosen representing no more than one error per audit criterion.

Confidence Level:	95%
Expected Error Rate:	1%
Tolerable Error Rate	5%

The testing determined the effectiveness of the controls in place for the transactions sampled and compliance with relevant policies and procedures.

## 1. Data

- Source of data: Payment transactions obtained from MERLIN.
- Time period – September 1, 2003 to August 31, 2004.

	Population Size	
	# of Transactions	Dollar Amount
<b>NCR Accounting Services</b>	100,029	\$311,139,334

2. Review and Analysis of Data

Steps performed on the data files included:

- Summarized and reviewed data by Line Object (LOBJ);
- Summarized and reviewed data by Vendor;
- Reviewed stratified data by dollar amount;
- Reviewed extreme values (very high and very low dollar values); and
- Reviewed stratified data by invoice date.

## 3. Sample

	Population Size	
	Number of Transactions	Dollar Amount
<b>NCR Accounting Services</b>	95	\$332,949

## Judgemental Sampling

The judgemental sample was conducted to ensure that those items considered to be of higher risk or special interest were selected.



The audit team reviewed the sampled transactions for compliance to ensure that they had been properly authorized. The following was checked:

- Was the delegated authorized Section 34 signature on the invoice?
- Was the signature per the Specimen Signature Card?
- Did the Section 34 signature have the appropriate delegation of signing authority in accordance with EC's guideline?

	Population Size	
	Number of Transactions	Dollar Amount
<b>NCR Accounting Services</b>	215	\$260M

## **Appendix B: Criteria**

### **Criteria 1**

Systems, controls, and practices in the National Capital Region are in line with the Financial Administration Act (FAA), Treasury Board, and Environment Canada policies on accounts payable.

### **Criteria 2**

Transactions are initiated against an authorised expenditure, approved by the right authority, and subsequently recorded in the appropriate financial system module to commits funds as per FAA, Section 32.

### **Criteria 3**

Purchase orders and contracts are properly prepared (approved by right authority, within the authorized limits and timely issued) routed through the purchasing function when required and entered in the financial system.

### **Criteria 4**

The authorized persons with delegated authority exercise the proper verification and certification, as per FAA Section 34. Invoices are date stamped on receipt at the department premises and forwarded to payment officer prior to payment due date.

### **Criteria 5**

The invoice is an original, subsequently prepared to the order. Inadmissible charges such as provincial sales tax are deducted and documentation to support the payment is verified. The payment is legitimately coded to reflect the type of goods supplied or service rendered and recorded in the financial system. Attractive and non-consumable items are reported in the appropriate inventory system.

**Criteria 6**

Financial officers with payment authority pursuant to FAA Section 33 provide assurance of the adequacy of the FAA Section 34 account verification. There exists auditable evidence of the verification process which includes the identification of the various individuals who performed the verification. Different person exercised signing authority pursuant to both FAA Section 33 and 34.