



Health  
Canada

Santé  
Canada

## **Final Audit Report**

# **Audit of Capital Asset Management**

**December 2009**

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## Executive Summary

As of March 31, 2009, Health Canada was responsible for managing capital assets with a net book value of \$139.4 million and located across Canada.

The objective of this audit was to determine whether Health Canada has put in place an adequate management control framework for capital assets (i.e. assets with an initial cost of \$10,000 or more), and whether transactions involving capital assets are recorded in the financial system in compliance with applicable Treasury Board of Canada and departmental policies and procedures.

The Audit and Accountability Bureau conducted this audit 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 to support the audit conclusion.

In response to recommendations made in reviews conducted in 2007 and 2008, the Department has recently introduced the new *Asset Management Policy Framework* and the proposed *Accounting for Capital Assets Policy*. Once this new framework is fully implemented, it has the potential to strengthen the Department's processes and controls related to managing its assets. This said, the mandate of the new Assets Management Committee should be expanded to include financial aspects such as accounting policies and records relating to asset management, in addition to operational aspects (e.g. asset procurement and identification, transfers, disposals, etc).

Building on the lessons learned from the Capital Asset Review conducted in 2008, the Chief Financial Officer Branch has improved the monitoring of its capital assets, for example by conducting a mandatory count of all capital assets every year. However, there is still a need for a process to ensure that all expenses incurred on capital projects are capitalized.

Based on the results of testing a sample of transactions recorded in fiscal years 2007-08 and 2008-09, the audit found, for the most part, compliance with Treasury Board policies and Health Canada policies and procedures. Corrective measures were only needed in three areas.

Management agrees with the report recommendations and has committed to take actions as evidenced by the submission of an action plan. Detailed responses follow the recommendations in the report.

## **Introduction**

### **Background**

According to Treasury Board policy direction, individual assets that cost more than \$10,000 shall be treated as capital assets. As of March 31, 2009, Health Canada was responsible for managing capital assets, with a net book value of \$139.4 million (**Appendix A**), located across Canada.

A sound asset management program and an effective system of internal controls are essential to ensuring that assets are procured at an appropriate time, maintained effectively, and contribute to meeting the Department's priorities.

The management of capital assets involves both operational and financial aspects. At the operational level, Cost Centre Managers are responsible for managing assets according to a life cycle approach i.e. they are responsible for the planning, acquisition, operation, use and maintenance; and disposal of capital assets. They are supported in this role by the Material and Assets Management Directorate, within the Chief Financial Officer Branch (CFOB) who provide them with functional direction.

At the financial level, the Financial Operations Directorate, also part of CFOB (including Branch/Regional Financial Services), is responsible for recording costs and depreciation of departmental capital assets.

### **Objective**

The objective of this audit was to determine whether Health Canada had put in place an adequate management control framework for capital assets, and whether transactions involving capital assets are recorded in the financial system in compliance with applicable Treasury Board and departmental policies and procedures.

### **Scope and Approach**

The Audit and Accountability Bureau conducted the audit in accordance with Health Canada's Risk-Based Audit Plan, which was approved by the Departmental Audit Committee on April 3, 2008. 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 to support the audit conclusion.

The audit examined the controls over Health Canada's asset management framework. The focus of the audit was 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 have been derived from these controls and have been vetted with management (**Appendix B**).

The scope included policies, practices and procedures that were in place in fiscal years 2007-08 and 2008-09. Field work was completed in July 2009.

In assessing the key controls in the process for managing assets, the audit approach included:

- reviewing relevant Treasury Board of Canada and Health Canada policies related to asset management;
- interviewing Branch Senior Financial Officers and key individuals in various directorates; and
- reviewing various documents, reports and accounting records.

The audit also included testing a judgemental sample of 90 transactions recorded in fiscal years 2007-08 and 2008-09 to determine whether key processes and controls had been followed, including those dealing with authorizing and recording transactions. This sample consisted of 45 acquisitions (of which 10 were further tested for amortization) and 45 disposals or retirements. There was also testing of a judgmentally-selected sample of 10 additional transactions to determine whether they were recorded in the right fiscal year.

This was not a financial attest audit and therefore excluded examination of amounts in the departmental financial statements. The audit did not cover real property assets, or intangible assets (such as copyrights and patents), which are not capitalized, and assets with an initial cost under \$10,000.

## Findings, Recommendations and Management Responses

### Policy Framework

#### Audit Criteria

Financial management policies and authorities are established, communicated and reviewed regularly. Policies and guidelines are in place with regard to safeguarding of capital assets.

#### Policy Modernization

In the fall of 2007, Health Canada had a Readiness Assessment performed to evaluate its ability to meet requirements of the Office of the Comptroller General to have their financial statements audited. The report that resulted from this assessment made recommendations aimed at improving capital asset management within Health Canada. In addition, a physical count completed by the Department in 2008 demonstrated that there was a need to strengthen controls over safeguarding of assets.

In response, an action plan was developed and the CFOB's Internal Controls Division was tasked with monitoring its implementation. This action plan resulted in the replacement of the *Assets Management Policy* (2003) by a new suite of asset management policies which became effective January 1<sup>st</sup>, 2009. This policy suite includes the phased-in introduction of the following:

- *Assets Management Policy Framework*, which identifies departmental policies and associated policy instruments that provide specific policy direction related to the various categories of assets;
- *Policy on the Management of Assets*, which covers life cycle management of all moveable assets, excluding motor vehicles;
- *Asset Management Standards*, which identifies the mandatory procedures regarding the life cycle management of assets;
- *Accounting for Capital Assets Policy* (still in development), aimed at ensuring that capital assets are appropriately and consistently accounted for throughout their life cycle in the departmental financial statements and reports;
- *Assets Inventory Instruction Guide*, which describe the different types of assets, how they are recorded, monitored and disposed; and
- *Fleet Management Guide*, aimed at ensuring that departmental vehicles are managed in accordance with the life cycle approach to materiel management.

The new policy suite and guidance is communicated to Cost Center Managers on the departmental intranet.

The review of the asset management policies was also made necessary by the introduction of the new Treasury Board of Canada *Policy on Internal Control* requiring Deputy Heads to sign an annual departmental *Statement of Management Responsibility Including Internal Control Over Financial Reporting*, which will preface departmental financial statements effective in fiscal year 2009-10.

### **Operational and financial integration**

At the time of this audit, the Material and Assets Management Directorate was also developing terms of reference for a new Asset Management Committee. It was also drafting an Internal Control Protocol and Verification Plan that will include regular reviews of asset records and policies. CFOB is confident that these new measures will help strengthen controls over asset management.

However, it was noted that the terms of reference of this committee are focused primarily on the operational management of assets (e.g. asset procurement and identification, transfers, disposals, etc), as opposed to financial considerations (i.e. how these assets are reflected in the departmental financial statements and safeguarded with adequate internal controls). In addition, this committee did not include members of the financial community. Accordingly, the operational and financial aspects of managing assets over their life cycle were not integrated.

### **Recommendation No. 1**

*The Chief Financial Officer should ensure that the mandate and membership of the Assets Management Committee is modified to facilitate integration of the operational and financial aspects of asset management.*

### **Management Response**

The Chief Financial Officer will ensure the alignment of the financial and operational management aspects of Capital Assets at Health Canada by using an existing governance structure within the Senior Management Board Finance, Evaluation and Accountability (SMB-FEA), with support and reports from working level committees such as the Asset Management Committee. This Committee reports through SMB FEA, including major decisions on the financial and operational management aspects. Its Terms of Reference will be updated to include a representative from Finance (financial management aspects) and reflect its formal link to SMB FEA. This will be implemented in December 2009.

## **Internal Controls**

### **Audit Criteria**

Assets and records are periodically verified for existence and completeness. Reviews are conducted to analyze, compare and explain financial variances.

### **Capital Asset Review**

In fiscal year 2008-09, in order to gain a better appreciation of the status of Health Canada assets, the Material and Assets Management Directorate initiated an exercise called the *Capital Asset Review*. It also included a physical count that was completed using the figures in effect as of March 31, 2008, and resulted in significant adjustments to SAP's Asset Accounting Module. This review provided valuable information on the status of asset records and adjustments needed to bring them up-to-date.

As per the proposed *Accounting for Capital Assets Policy*, the Materiel and Assets Management Directorate is now responsible for conducting an annual review of all capital assets and forwarding results to the Financial Operations Directorate, which is responsible for updating the Asset Accounting module of SAP. This includes a reconciliation of all capital asset records in SAP. It is understood that this will also include an analysis of adjustments such as those identified during the physical count conducted in 2008 and the implementation of corrective measures.

### **Work-in-progress**

Some capital assets are developed in house, such as computer applications that are not readily available on the open market. During its development, such assets are considered a "work-in-progress" for accounting purposes. As such, the costs (e.g. salaries and professional services) associated with the development of these assets must be appropriately recorded in temporary accounts, until the time when they are put in service.

During the audit period, the Financial Operations Directorate identified instances where significant expenses were inappropriately coded to Operating and Maintenance expenses that were actually work-in-progress disbursements. As a result, there was a need to make year-end adjustments. The Directorate is in the process of developing corrective measures to address this problem manually, on a quarterly basis, while waiting for an automated solution to be developed.

### **Recommendation No. 2**

*The Chief Financial Officer should direct that a process be implemented to ensure that all expenses incurred on capital projects are capitalized.*



## **Management Response**

A module in the department Financial System (SAP) is being developed to automate the capitalization of work in progress. However, it will not be ready until July 2010. In the mean time, the Chief Financial Officer Branch will continue to use an existing manual process to capitalize work-in-progress for capital projects on a quarterly basis during 2009-2010. The new SAP module will commence capitalizing work-in-progress on an automated basis in 2010-2011.

## **Recording of assets acquisitions and disposals in financial statements**

### **Audit Criterion**

Transactions are recorded in Health Canada financial information systems accurately and in a timely manner to support information processing.

### **Acquisitions and disposals**

A judgemental sample of 100 transactions was tested in order to determine if they were adequately recorded and supported. This included the areas of asset acquisitions, amortizations, disposals and write-offs. For the sample selected, we found that the acquisitions and disposals were properly recorded (i.e.):

- assets were properly coded and recorded in the proper fiscal year and value;
- descriptions were accurate;
- transactions were supported by approved documentation;
- the gain or loss on disposal was accurately recorded; and
- amortization was calculated using the prescribed rates.

There was non-compliance with policies and procedures in three areas, one of which will be dealt with in the next section of this report (“Information Systems”).

*Generally accepted accounting principles* and the proposed *Accounting for Capital Assets Policy* require that assets be recorded at their original historical cost. When original cost information is not available (e.g. no invoice is on file), section 7.4 of the Policy describes how to determine the value of an asset through independent appraisals or comparison with other capital assets with similar characteristics and acquisition dates to establish historical cost. In 7 cases out of 21 tests, there was no supporting information on file to support the adequacy of the amount at which the capital asset was recorded.

As part of the testing for asset acquisitions, three tests dealt with transactions for which the guidelines for bundling and assets under construction were applicable. In these three

cases, guidelines were applied incorrectly and assets were not recorded at their full acquisition costs.

### **Recommendation No. 3**

*The Chief Financial Officer should ensure better enforcement of departmental policies for documentation of recapitalizations as well as accounting treatment for asset-bundling and assets under construction.*

### **Management Response**

The Chief Financial Officer Branch is in the process of finalizing a new *Policy on Accounting for Capital Assets*. Once approved and implemented, the new policy will provide the basis for a formalized and consistent process for the capitalization of assets including the capture of work-in-progress data throughout the asset development process. The same policy will provide specific direction with respect to asset-bundling. This will be completed by March 1, 2010.

## **Information Systems**

### **Audit Criterion**

Information systems support the asset life cycle management.

### **Asset Master Records and Equipment Maintenance Records**

There are two modules related to assets in SAP. The first module, the Asset Master Record, is used for accounting purposes and tracks the historical cost and accumulated amortization of Health Canada's assets valued at more than \$10,000. The second module, the Equipment Maintenance Record, maintains operational data on assets, including operating costs and details on assets' use and maintenance.

Discrepancies can be found in the data of these two modules. For example, the 2008 Capital Asset Review showed that 1,060 out of the 1,454 assets which were newly acquired had been added to the Asset Master Records but not to the Equipment Maintenance Records. The transaction testing completed during this audit revealed several instances where asset acquisition costs in the Asset Master Record differed from this information found in the corresponding Equipment Maintenance Record.

These discrepancies are due to the fact that the two modules are not integrated and that reconciliations are not performed on a periodic basis to ensure consistency of their respective data. As a result, this compromises the reliability and integrity of the information.

#### **Recommendation No. 4**

*The Chief Financial Officer should implement measures to ensure consistency of the two main information systems that capture data on assets.*

#### **Management Response**

An annual reconciliation of two SAP modules will be performed to ensure the ongoing consistency between the two systems. The Chief Financial Officer Branch will also perform a feasibility analysis for integrating and linking the two SAP modules that capture data on assets. This analysis will be performed in the first half of 2010-2011. This enhancement, if judged feasible, could be completed by the end of March 2011.

Deliverables and corresponding expected completion dates are as follow:

- Capital Assets Inventory (December, 2009)
- Capital Asset Reconciliation and required adjustment entries (March 2010)
- Feasibility Analysis (June 2010)
- Integration of the two modules that capture asset data in SAP (March 2011)

#### **Conclusion**

In response to recommendations made in reviews conducted in 2007 and 2008, the Department has introduced the new *Asset Management Policy Framework* and the proposed *Accounting for Capital Assets Policy*. They have the potential to strengthen the Department's processes and controls related to managing its assets through clarifying the roles and responsibilities of parties involved in capital asset management. The mandate of the new Assets Management Committee should be expanded to include financial as well as operational aspects.

The Department has improved the monitoring of its capital assets, but there is still a need for a process to ensure that expenses incurred on capital projects are capitalized. For the most part, transaction testing demonstrated the department was in compliance with Treasury Board policies and Health Canada policies and procedures.

## Appendix A: Tangible Capital Assets as of March 31, 2009

<u>Asset Class</u>	<u>Cost (\$000)</u>	<u>Accumulated Amortization (\$000)</u>	<u>Net Book Value (000\$)</u>
Land	1,180	0	1,180
Buildings	131,591	91,187	40,404
Works and Infrastructure	504	0	504
Leasehold Improvements	19,583	19,085	498
Machinery and Equipment	191,238	118,318	72,920
Vehicles	22,119	13,779	8,340
Asset under construction	15,524	0	15,524
<b>Total</b>	<b>381,739</b>	<b>242,369</b>	<b>139,370</b>

**Accounting Policies**

All tangible capital assets and leasehold improvements having an initial cost of \$10,000 or more are recorded at their acquisition cost. Health Canada does not capitalize intangibles, works of art and historical treasures that have cultural, esthetic or historical value, immovable assets located on Indian Reserves and museum collections.

Amortization of capital assets is done on a straight-line basis over the estimated useful life of the capital asset as follows:

<u>Asset Class</u>	<u>Sub-Asset Class</u>	<u>Amortization Period</u>
Buildings	Buildings	25 years
Works and infrastructure	Works and infrastructure	25 years
Leasehold improvements	Leasehold improvements	Lease term, max. 40 years
Machinery and equipment	Machinery and equipment	8-12 years
	Computer equipment	3-5 years
	Computer software	3 years
	Other equipment	10-12 years
Vehicles	Motor Vehicles	4-7 years
Other Vehicles	Other Vehicles	10 years

**Source: Health Canada Financial Statements**

## **Appendix B – Lines of enquiry and Audit Criteria**

**Line of Enquiry No. 1:** Adequacy and effectiveness of the capital asset management control framework.

**Audit Criteria:**

- Financial management policies and authorities are established, communicated and reviewed regularly.
- Policies and guidelines are in place with regard to safeguarding of capital assets.
- Assets and records are periodically verified for existence and completeness.
- Reviews are conducted to analyze, compare and explain financial variances.
- Information systems support asset life cycle management.

**Line of Enquiry No. 2:** Compliance with applicable Treasury Board and departmental policies and procedures in the recording of transactions involving capital assets.

**Audit Criterion:**

- Transactions are recorded in Health Canada financial information systems accurately and in a timely manner to support information processing.