



November 2020

Report of the Auditor General of Canada to the Parliament of Canada

Commentary on the 2019–2020 Financial Audits



Office of the
Auditor General
of Canada

Bureau du
vérificateur général
du Canada



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Table of contents

Introduction	1
Impact of the COVID-19 pandemic on our financial audits	1
Results of our 2019–2020 financial audits	3
Opportunities for improvement noted in our 2019–2020 financial audits	4
The Auditor General’s observations on the Government of Canada’s 2019–20 consolidated financial statements	6
Pay administration	6
National Defence inventory and asset pooled items	10
Department of Finance Canada payments	12
About our financial statement audits	13
Glossary	14

Introduction

1. This report is not an audit report. Instead, it highlights the results of the **financial audits*** we—the Office of the Auditor General of Canada—conducted in federal organizations for fiscal years ended between July 2019 and April 2020. (We refer to these as the 2019–2020 financial audits.) This report also provides a commentary based on those audit results.

Impact of the COVID-19 pandemic on our financial audits

New considerations emerged for our financial audits

2. The COVID-19 pandemic significantly affected the operations of our office and those of the federal organizations we audit. By mid-March 2020, most of our staff and those of the organizations we audit were working from home and had stopped all travel in response to public health measures. This situation created challenges in communicating with organizations, obtaining audit documentation, and managing the audit process remotely.
3. Canadian auditing standards require that we gain an understanding of the systems and **internal controls** of the federal organizations that we audit, particularly those relating to financial reporting. Because of working remotely, many organizations modified their business processes and controls, such as how transactions are approved. For our 2019–2020 financial audits, we used our understanding of these modifications to consider any increased risks of **material errors in financial statements**. As a result, we changed the way we audited certain processes and controls.
4. We performed additional audit work in higher-risk areas. The following are examples:
- We examined areas in which the pandemic affected accounting estimates prepared by management, such as **allowances for doubtful accounts**, provisions for loans, and loan guarantees. We did this because of the uncertainties in establishing key inputs—such as credit risk ratings and **discount rates**—used to measure certain accounting estimates.
 - We examined the federal government’s estimated tax revenues and the related allowance for doubtful accounts. These estimates are based, in part, on the amount of tax payments received and the information in assessed tax returns. The many deadline extensions for tax payments and filings affected key inputs to the estimates.

* Bolded terms are defined in the Glossary.

- We assessed whether significant new benefit programs announced in the *COVID-19 Emergency Response Act* were recorded in the correct fiscal period.

5. We expect that the pandemic will continue to have an impact on our 2020–2021 financial audits, mainly the audit of the federal government's 2020–21 consolidated financial statements (which are included in the **Public Accounts of Canada**). The consolidated financial statements will contain significant amounts of spending on programs responding to the COVID-19 pandemic. For this reason, we will continue to consider the need to adjust the nature, timing, and extent of our future annual audit work. We will make any adjustments as we plan each financial audit.

Certain financial audits were delayed

6. Our reduced staff capacity due to the pandemic, beginning in March 2020, meant that we had to reassess our priorities. We made considerable efforts to continue our work despite the challenging circumstances. Among other things, we hired more contract financial auditors to supplement our resources.

7. We collaborated with the federal organizations we audit and with **central agencies**. We wanted to understand the challenges they were facing and to determine how to plan our audit work in response to these challenges. In April 2020, we decided to delay some of our financial audits.

8. We delayed the audits of the following independent agents of Parliament:

- Office of the Chief Electoral Officer
- Office of the Commissioner of Lobbying of Canada
- Office of the Commissioner of Official Languages
- Office of the Information Commissioner of Canada
- Office of the Privacy Commissioner of Canada
- Office of the Public Sector Integrity Commissioner of Canada

There is no legislated deadline for financial reporting for these organizations. We have since resumed work on these audits, and by the end of October 2020, all but 2 were completed. We plan to complete the audit of the Office of the Commissioner of Official Languages and the Office of the Chief Electoral Officer in November 2020.

9. The financial audits of the following federal Crown corporations were also delayed:

- National Capital Commission
- Telefilm Canada

10. As a result, these 2 corporations were not able to submit their annual reports to their ministers within the 90 days following their fiscal year-ends as required by legislation. Given the exceptional circumstances of the pandemic, we did not consider these delays to be significant. Therefore, we did not modify our opinions on compliance with authorities in our **independent auditor's reports**. We resumed work on these audits and completed our audit of Telefilm Canada in August 2020 and the National Capital Commission in October 2020.

11. We also had to adjust the timing of our audit work on the federal government's 2019–20 consolidated financial statements. Both our office and the government adjusted year-end time frames as a result of the impact of the COVID-19 pandemic on the government's preparation of the consolidated financial statements and on the execution of our work. We completed our audit in October 2020.

Results of our 2019–2020 financial audits

Most audited financial statements were credible and provided on time

12. The Office of the Auditor General of Canada provided the Government of Canada with an **unmodified audit opinion** on its 2019–20 consolidated financial statements. This opinion provides credibility to the government's financial reporting. Financial reporting is one way the government demonstrates accountability to elected officials and the public. The audit opinion is also an important contribution to meeting Canada's commitments under the United Nations' 2030 Agenda for Sustainable Development. In particular, the opinion helps Canada meet sustainable development target 16.6: "Develop effective, accountable and transparent institutions at all levels."

13. Overall, we were satisfied with the timeliness and credibility of the financial statements prepared by 68 out of the 69 government organizations we audit, including the Government of Canada. For the organizations for which we postponed audits because of the COVID-19 pandemic, we were satisfied with the timeliness of the financial statements because of the exceptional circumstances and we considered the delay to be temporary. For the audits that were not yet complete, we were satisfied with the credibility of these financial statements on the basis of having completed most of our audit work.

14. Our audit opinion on National Defence's Reserve Force Pension Plan remained outstanding. For many years, we had not been able to issue an audit opinion on the plan's financial statements. This was because of significant and persistent problems with National Defence not having all the documents supporting the data used to estimate pension obligations. After considerable efforts made in the last year, National Defence has gathered the supporting documents needed for us to complete our audit.

On the basis of this progress and the audit work we performed to date on the plan's 31 March 2018 financial statements, we expect to complete the audit in late 2020. Once the 2018 audit is complete, we will start the audit of the 31 March 2019 financial statements, which we expect to complete in 2021.

We noted 3 significant instances of non-compliance

15. We noted 3 recurring instances of non-compliance with the *Financial Administration Act* during 2 financial audits of Crown corporations this year. We first reported on these persisting situations in our Commentary on the 2017–2018 Financial Audits. Two of these instances related to appointments of officer-directors, which came up during the financial audits of Ridley Terminals Inc. and the Canada Development Investment Corporation. The third instance related to the remuneration of the President and Chief Operating Officer of Ridley Terminals Inc.

16. For Ridley Terminals Inc., the instances of non-compliance persisted until 19 December 2019, the end of the period that we audited. After the audit period, the government sold Ridley Terminals Inc. As a result, the corporation is no longer subject to the *Financial Administration Act*. No annual report was published for 2019. However, the financial statements and our auditor's report were sent to the minister responsible.

17. For more details about the financial audit of the Canada Development Investment Corporation, refer to our independent auditor's report in the corporation's 2019 annual report.

Opportunities for improvement noted in our 2019–2020 financial audits

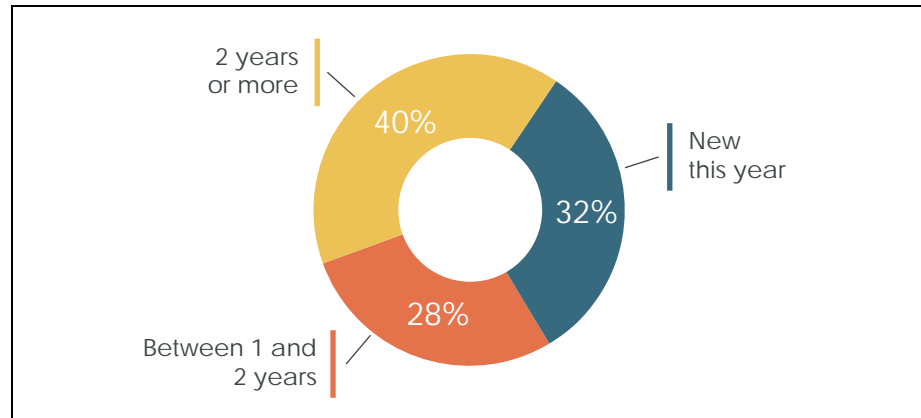
We informed federal organizations, including Crown corporations, of opportunities to improve their practices

18. Financial audits identify opportunities for organizations to improve their systems of internal control, streamline their operations, or enhance their financial reporting practices. We issue **management letters** to inform the organizations about these opportunities and about more serious points, such as inadequate internal controls that can create risks of errors in financial reports.

19. As part of our annual financial audits, we follow up on the points we have raised in previous years so that we can monitor management's progress in addressing them.

20. Our 2019–2020 financial audits have raised management letter points, some of which were not resolved within the year. Of the total management letter points that were unresolved as of 30 June 2020, 40% have been unresolved for 2 years or more, 28% have been unresolved for between 1 and 2 years, and another 32% were newly issued within the past year (Exhibit 1).

Exhibit 1 Unresolved management letter points from our 2019–2020 financial audits



21. We noted opportunities for improvement in various areas. Similar to last year, the most common were the following:

- information technology (IT) general controls over systems supporting financial reporting, mainly related to access
- internal controls related to financial reporting
- compliance with government policies, legislation, and regulations
- accounting and financial reporting practices

We continued to note opportunities for improvement of IT general controls, mainly those related to access

22. Similar to what we reported last year, more than one third of the unresolved management letter points as of 30 June 2020 resulted from our reviews of IT general controls over systems supporting financial reporting. Such controls included access to programs and data, program development, program changes, and computer operations.

23. Our reviews are limited to certain financial audits, and the specific controls reviewed depend on our audit approach. We targeted access controls because they are fundamental for financial processes that depend on IT. Access controls, however, go beyond financial processes. In an IT environment, access controls ensure that only authorized individuals can access electronic data. If those controls are absent or weak, the data's integrity is at risk.

24. Most of these unresolved management letter points related to the need to improve controls over the access granted to organizations' IT systems. Recurring points we noted included access given to people who did not need it, access retained by people who no longer needed it, and weaknesses in the controls over access granted between organizations.

25. We informed organizations of the need to correct these important points because strong access controls are needed to safeguard the integrity of the government's data.

The Auditor General's observations on the Government of Canada's 2019–20 consolidated financial statements

Pay administration

Our audit approach for pay transactions has evolved

26. Pay and benefits are one of the largest expenses in the Government of Canada's consolidated financial statements. Every year, we test a sample of federal employees' pay transactions as part of our audit of the consolidated financial statements to ensure that pay expenses are **fairly presented**.

In 2016, the government's Transformation of Pay Administration Initiative centralized pay processing for 46 departments and agencies into a Public Service Pay Centre and launched the Phoenix pay system for all 101 departments and agencies. We expanded our testing as a result of the internal control weaknesses in the then-new "HR-to-pay" process, which linked information in human resources (HR) systems with the pay system.

27. In our previous testing, we found a number of pay errors. The number of employees in our sample who were paid incorrectly, either too much or not enough, at least once during the fiscal year was 67% in 2018–19 and 62% in both 2017–18 and 2016–17. As reported in our previous observations, progress in addressing the errors in employee pay has been slow. Although these errors had an impact on employees, they did not have a significant impact on the consolidated financial statements. That is because total overpayments and underpayments partially offset each other and the government recorded year-end accounting adjustments to improve the accuracy of its pay expenses.

28. In each of the fiscal years since 2016, we tested all payments made to a sample of employees across departments and agencies for the entire year. We tested payments such as the following:

- basic pay (which includes items such as base salary and salary adjustments for promotions and for cost of living)
- pay for temporarily working at a higher level (acting pay)
- allowances (such as for education or for living in remote locations)
- a bonus for working in a bilingual position

29. Our audit approach is always evolving, and we made changes this past year as we determined where to focus our efforts to achieve the best value for Canadians. We considered the risk of pay errors having a significant effect on pay expenses reported in the consolidated financial statements. Our testing of pay transactions for the past 3 years consistently showed that overpayments and underpayments partially

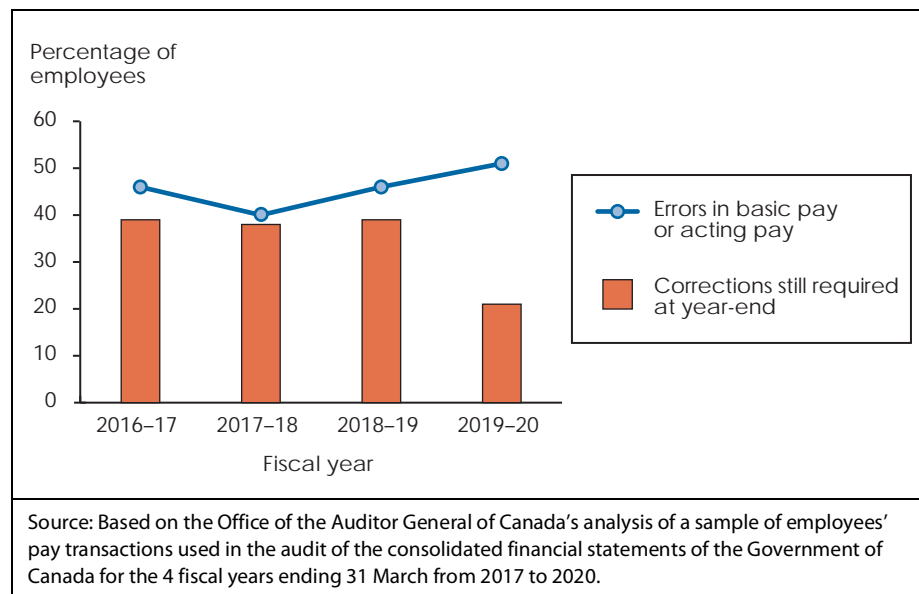
offset each other and therefore did not have a significant effect on the amount of pay expenses reported. We considered this trend and revised our testing approach to continue to improve its efficiency.

30. Our new approach tested only basic and acting pay for a sample of selected employees. We used this approach because those types of payments represent 92% of the \$26 billion processed by the Phoenix pay system during the year. Our new testing continued to provide statistically sound evidence to support our independent auditor's report. To compare results from year to year, we adjusted the prior-year results in the next section to reflect our new approach.

Pay errors continued for many employees

31. As a result of our audit work, we found that 51% of employees we sampled had an error in their basic or acting pay during the 2019–20 fiscal year, compared with 46% in the prior year. We also found that 21% of employees we sampled still required corrections to their pay as at 31 March 2020, an improvement over 39% in the prior year (Exhibit 2).

Exhibit 2 Percentage of employees in our sample with an error in basic or acting pay and who were awaiting a correction at year-end



32. Our current-year testing showed that overpayments and underpayments made to employees continued to partially offset each other. The government again recorded year-end accounting adjustments to improve the accuracy of its pay expenses. These adjustments changed only the reported pay expenses in the consolidated financial statements. The adjustments did not correct the pay errors for the employees who were overpaid or underpaid.

33. We concluded that pay expenses were presented fairly in the Government of Canada's 2019–20 consolidated financial statements.

The number of outstanding pay action requests decreased but continued to affect employees' pay

34. In the past few years, we have reported on the number of employees with outstanding **pay action requests** in the departments and agencies served by the Public Service Pay Centre. In the current year, the pay centre served 50 departments and agencies. As at 31 March 2020, there were 156,400 employees with pay action requests remaining to be processed (compared with 171,600 as at 31 March 2019). These employees had 334,000 outstanding pay action requests (compared with 427,000 the previous year). In June 2020, 3 months after the government's fiscal year-end, the number of outstanding pay action requests further declined to 289,000, affecting 144,300 employees.

35. The number of outstanding pay action requests has been steadily declining for the past 2 years. However, on the basis of the current rate at which the pay centre is reducing the number of pay action requests, we estimate that it could take until December 2022 to address those currently outstanding. Given that the oldest pay action requests are not necessarily resolved first, it can take years for an employee's pay to be fully corrected. As at 31 March 2020, 30% of requests were 2 years old or more (compared with 19% as at 31 March 2019) and 19% of requests were between 1 and 2 years old (compared with 29% the year before). The government expects that after December 2022, there will always be outstanding pay action requests as a result of normal ongoing pay transactions.

36. Exhibit 3 shows the number of employees with outstanding pay action requests, and Exhibit 4 shows the number of outstanding pay action requests. These exhibits show only the outstanding pay action requests for the departments and agencies served by the Public Service Pay Centre. They do not show the pay action requests in the other departments and agencies.

Exhibit 3 Number of employees with outstanding pay action requests in the departments and agencies served by the Public Service Pay Centre

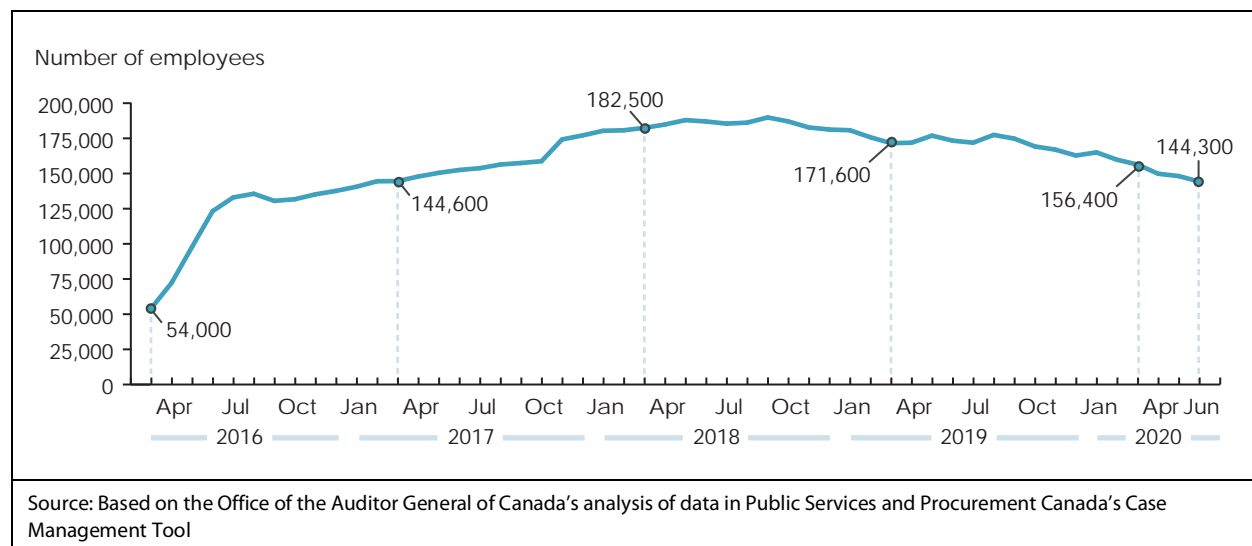
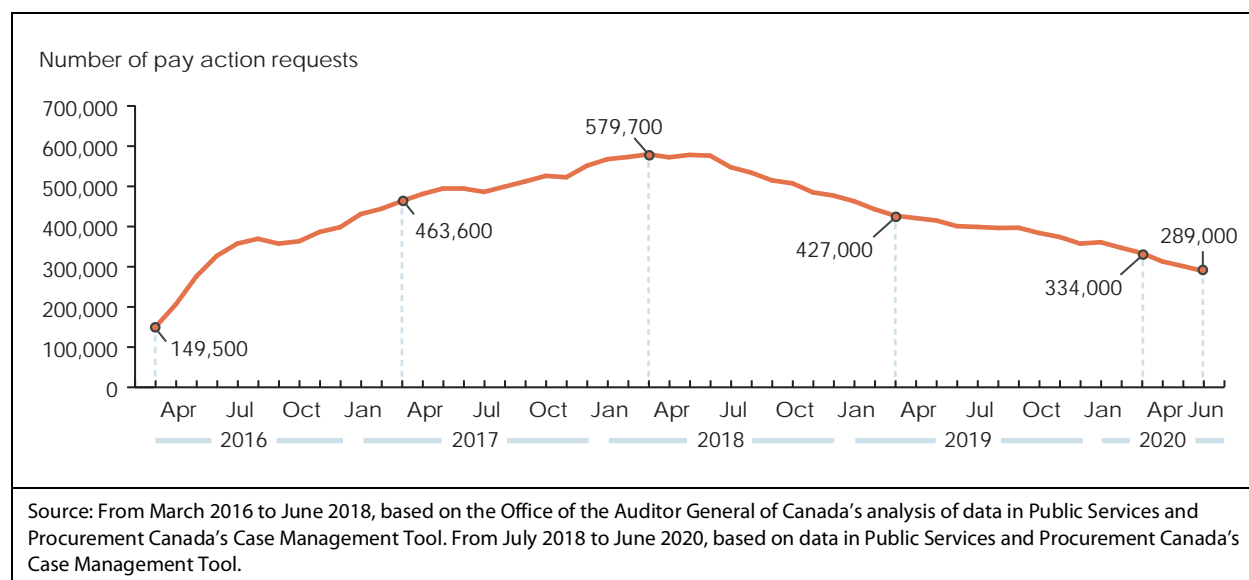


Exhibit 4 Number of outstanding pay action requests for the departments and agencies served by the Public Service Pay Centre



Continued data quality problems could affect the transition to a new pay system

37. Quality HR and pay data is critical to carrying out the government's intention to create a long-term, sustainable, and efficient HR and pay system. HR and pay data affects not only salary payments but also other systems, notably pension and benefits. Many parties are involved in the HR-to-pay process: employees, supervisors, compensation advisors, HR teams, finance teams, and others. These parties share a responsibility in keeping accurate HR and pay records so that employees can be paid accurately and on time.

38. Our testing has once again identified problems in HR and pay data quality. Following are examples from our audit testing:

- Departments and agencies delayed either providing timely information to the Public Service Pay Centre or processing transactions. The delays resulted in inaccurate data used to calculate pay and consequently in pay errors. In 1 instance, an employee was overpaid for the last week of work in 2017. The recovery of the overpayment from the employee has yet to be initiated, and the person is no longer employed by the government. The untimely processing of this transaction increases the time and effort required to recover the overpayment.
- Departments and agencies delayed approving changes in pay for some employees who had assumed temporary roles. Documents that were needed to process changes in pay were not approved until months after employees started in their new roles. In this example, an employee began an acting assignment in February 2019, but the approval document was not completed until 3 months later. As a result of this delay, the employee was underpaid for a 3-month period.

39. We are concerned that if the government transitions to a new pay system, it could repeat weaknesses in the HR-to-pay process and continue paying employees inaccurately. For example, if data quality problems persist, they could result in errors in employee pay, regardless of which system processes the pay transactions.

40. The successful design and implementation of a possible new payroll system that can accurately process the complex and numerous government pay rules will require many elements, including the following:

- identifying the key risks
- designing appropriate and effective processes and controls
- quality data
- conducting pilots
- performing system testing
- training
- the collaboration of key functions in all departments and agencies
- an independent project oversight mechanism

We will continue to monitor and have discussions with the government on its progress toward a long-term, sustainable, and efficient HR and pay system.

National Defence inventory and asset pooled items

41. For 17 years, we have raised concerns about National Defence's ability to properly account for the quantities and values of its inventory. We have also reported on National Defence's asset pooled items, which are tangible capital assets that are managed like inventory. As at 31 March 2020, inventories at National Defence were valued at about \$5.1 billion (or about 83% of the government's total inventories). Asset pooled items were valued at about \$3.6 billion and were included in the government's tangible capital assets.

National Defence made progress on its long-term action plan, but we noted errors in inventory and asset pooled items

42. National Defence submitted a 10-year inventory management action plan to the House of Commons Standing Committee on Public Accounts in the 2016–17 fiscal year. The plan set out actions to resolve challenges in properly recording the quantities and values of inventory. We are encouraged that National Defence reported to the committee by its annual deadline of 30 May 2020 that it had met nearly all the commitments in its inventory management action plan to date.

43. One of the inventory management plan's key commitments is to add a modern scanning and barcoding capability to National Defence's inventory management system. This capability is intended to increase the traceability of inventory and to provide more accurate and timely inventory data. The initiative is complex and is scheduled to be implemented by the end of the 2026–27 fiscal year. In our view, this capability will help strengthen inventory management and improve the accuracy of inventory and asset pooled items reported in the government's consolidated financial statements.

44. National Defence continues to make progress to address its inventory management challenges. However, during this year's audit, we found discrepancies in the reported amounts of inventory and asset pooled items. We noted a combined understatement at year-end of an estimated \$759 million.

45. Maintaining adequate records and strong controls is important to managing assets for which National Defence is accountable. Inaccurate records, when pervasive, can affect National Defence's ability to deliver its programs efficiently and cost-effectively. It could also result in decisions being made on the basis of inaccurate information. Moreover, in spring 2020, we reported that overall poor supply chain management often prevented National Defence from supplying the Canadian Armed Forces with inventory when it was needed (see the 2020 Spring Reports of the Auditor General of Canada to the Parliament of Canada, Report 3—Supplying the Canadian Armed Forces—National Defence).

**Further improvements
are needed to financial
reporting practices**

46. To report accurate and complete amounts of inventory and asset pooled items in the consolidated financial statements, National Defence needs to strengthen its internal controls. Although National Defence performs periodic inventory counts, we encourage it to make more effort to ensure reported balances are accurate and complete. National Defence could achieve this by doing further analysis and adding procedures to review balances of inventory and asset pooled items. These actions will contribute to validating the existence and valuation of the amounts in the consolidated financial statements.

47. Lastly, National Defence has made progress over the past year in its review of how it classifies items as either inventory or asset pooled items. We encourage National Defence to finalize its work in this area, including continual monitoring to further improve the accuracy of these balances.

Department of Finance Canada payments

Payments were made without the authority of Parliament

48. As legislative auditors, we have a responsibility to assess whether financial transactions are in compliance with significant authorities. One of these significant authorities is the authority to spend public money that is granted through legislation passed by Parliament.

49. We also have a responsibility to report any matters that we consider should be brought to the attention of Parliament. One such matter concerns the federal government's joint management partnership with the Government of Newfoundland and Labrador for the Hibernia offshore oil project. On 1 April 2019, the Minister of Finance signed an agreement with the province. The agreement stated that the federal government would make payments to the province totalling \$3.3 billion over 38 years and that the necessary legislative measures would be introduced to authorize payments. During the 2019–20 fiscal year, the Department of Finance Canada made payments totalling \$135 million to the province, through a payment mechanism. In our view, these payments were made without the proper legislative measures having been introduced. The department therefore did not obtain the authority of Parliament.

50. All spending of public money must be approved by Parliament to provide accountability and transparency to Canadians. This approval is one of Parliament's fundamental roles. We have recommended to the Department of Finance Canada that it obtain the proper authority from Parliament before making any other payments under this agreement.

About our financial statement audits

To find out more about the Office of the Auditor General of Canada's work on the government's financial statements, see the "Financial Audit" section on our website at www.oag-bvg.gc.ca.

Glossary

Allowance for doubtful accounts—Management’s estimate of the amount of accounts receivable that is unlikely to be paid. It reduces the amount of accounts receivable in the financial statements.

Central agency—An organization that works across government in a central coordinating role to ensure policy coherence and coordination. Central agencies may have either formal or informal authority over other federal organizations. In this report, we use the term to refer to the Privy Council Office, the Treasury Board of Canada Secretariat, the Receiver General for Canada, and the Department of Finance Canada.

Discount rate—The rate used by the Government of Canada or other federal organizations to estimate the value, in today’s dollars, of its long-term assets and liabilities.

Fairly presented—The characteristic of information in financial statements that faithfully represents the underlying transactions and events.

Financial audit—An examination as to whether the numbers presented in financial statements, or other financial information, are reasonably accurate. It isn’t designed to examine each dollar received or spent, to identify instances of fraud or wrongdoing, or to assess the merits of government policy decisions.

Financial statements—A representation of a government entity’s financial position and financial performance. Financial statements include the notes and schedules (such as tables) supporting the statements.

Independent auditor’s report—A written opinion of an auditor regarding an entity’s financial statements. The report is written in a standard format, as mandated by generally accepted auditing standards.

Internal control—An activity designed to mitigate risks and provide reasonable assurance that an organization’s objectives, including compliance with applicable laws, regulations, and policies, will be achieved.

Management letter—A letter that identifies opportunities for changes in procedures to improve an organization’s systems of internal control, streamline its operations and/or enhance its financial reporting practices.

Material errors—Errors or omissions in the financial statements that could reasonably be expected to influence the economic decisions of users of those financial statements.

Pay action requests—Anything from a request to change an employee’s address or bank account information, to a request to enter parental leave or a promotion, or a request to fix a pay error.

Public Accounts of Canada—The government’s annual report that includes the audited consolidated financial statements of the Government of Canada and other unaudited financial information, such as the financial statements discussion and analysis and supporting tables, contained in three volumes.

Unmodified audit opinion—An opinion expressed by an auditor when the auditor concludes that the financial statements gave a fair presentation of the underlying transactions and events according to accounting requirements.

