Environment Canada Environnement Canada

Audit of Specified Purpose Accounts

March 2010

Canada

Audit Key Steps

Planning completed	July 2008
Field work completed	February 2009
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Prepared by the Audit and Evaluation Team

Acknowledgements

The audit team, composed of Abdellah Ismaili, Auditor, and Bruno Pilotte, Financial Audit Manager, under the direction of Jean Leclerc, would like to thank all those who contributed to this project and, in particular, those employees who provided insight and comments as part of the audit.

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EXECUTIVE SUMMARY

Background

This audit engagement was part of Environment Canada's 2008–2011 Risk-Based Audit and Evaluation Plan, which was approved by the Deputy Minister. Field work was conducted over the 2008-2009 and 2009-2010 period.

Environment Canada receives funds for specified purposes. These funds can come in the form of donations, court awards or funds received in the context of joint projects or cost-shared agreements. Because of the particularity of these funds, it is essential to keep them in separate accounts in order to ensure that the funds are not used for purposes other than those for which they were originally received.

The management of specified purpose accounts is, in large part, governed by the Treasury Board Policy on Specified Purpose Accounts, established in accordance with the *Financial Administration Act* and by the departmental accounting handbook.

At the end of the 2008–2009 fiscal year, Environment Canada's specified purpose accounts balance totaled more than $7.01 million and comprised 148 accounts. Of these, 77 were joint or partner agreements ($4.9 million), 69 were court awards ($1.97 million), 2 were donations ($0.14 million). Seventy other accounts were active in the financial system but showed a zero balance by the end of the fiscal year. All departmental accounting offices participate in the management of these accounts.

Even though the court award amounts did not represent large sums at the end of 2008–2009, it is very likely that they will significantly increase, given the amendments made to the Environmental Enforcement Bill at the beginning of 2009.[1]

Risk Assessment

A preliminary risk assessment has been conducted during the planning phase of the audit, based on the review of the relevant documents, including the analysis of financial data, combined with meetings with the key stakeholders. Following this exercise, the key risks that have been identified were related to the management framework and the financial mechanism used for the management of specified purpose accounts, the requirements of agreements with third parties, the accounting for funds for specified purposes, and the recurring carry-over of remaining balances associated with expired agreements.

Objectives, Scope and Methodology

The objectives and scope of the audit were defined based on risk assessment. The intent of the audit was to ensure that the management framework for specified purpose accounts is effective and efficient, and that these accounts are managed in compliance with the applicable laws, policies, agreements and accounting requirements. The audit covered all types of specified purpose accounts of the Department.

[1] This bill amends six laws under the responsibility of Environment Canada and three under that of Parks Canada with the objective of allocating the amounts of all fines received to the Environmental Damages Fund.

The gathering of information consisted mainly of an examination of the relevant documents; meetings with managers, functional specialists in finance and a representative from Legal Services; and reviews of files and the analysis of financial data.

A sample of 36 specified purpose accounts was selected based on judgment from 2007-2008 transactions and included 41 agreements. The selection criteria included factors such as region, branch, nature of the accounts, the materiality and the nature of the transactions.

The analysis of financial data was based solely on the authority codes for specified purpose accounts. Therefore, this analysis did not allow for the detection of specified purpose accounts that could have been recorded without correct identification, as part of the Department's regular operations (standard authority codes). The account analysis covered transactions from 2006-2007 to 2008-2009 fiscal years.

The audit criteria are outlined in Annex 3.

Statement of Assurance

This audit has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and the *Policy on Internal Audit* of the Treasury Board of Canada.

In our professional judgment, 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 were based on a comparison of the situations, as they existed at the time, against the audit criteria.

Summary of Findings and Conclusions

Departmental policy and functional authority– Environment Canada has no departmental policy on specified purpose accounts but the Chapter 9 of its EC Accounting Manual provides a good overview of the processes in place to manage such accounts. The Manual is currently being reviewed by Accounting Operations. The current version does not define the roles and responsibilities of key stakeholders, which was recognized as the common cause of other findings discovered during the audit. Furthermore, it has been confirmed during the interviews with finance specialists that the new version will not provide more information on roles and responsibilities. As well, it was not clear during the audit who had functional authority on the content of the specified purpose account agreements. It was understood by most interviewees that program managers are responsible for the content of the agreements and that Financial Services was responsible to provide functional authority on financial matters.

Classification of funds received – The analysis of the files showed that at least 30% of accounts ($0.94 million) did not meet all the audit criteria that define a specified purpose account. This increases the risk that the Department manages regular appropriations through a specified purpose account. The accounting treatment of a specified purpose account and regular appropriations is different, in particular is the possibility to carry-over a specified purpose account funds from year to year while regular appropriations expire at the end of the fiscal year. In addition, the justification for classifying accounts as specified purpose accounts was never documented for any of them.

Content and compliance with agreements – The results of the audit show that some information is consistently missing from the agreements. The most common omissions were the clauses regarding the final disposal of the goods acquired during the project, the intellectual property and the processing of remaining balances

Account reconciliation – Accounting Operations indicates that account reconciliation is performed only once a year. The nature of the errors most frequently found during the audit were the following: incorrect use of financial coding (use of regular operating funds with codes reserved for specified purpose accounts and vice versa), remaining balances not refunded to the appropriate third party or not transferred to the Consolidated Revenue Fund, and the creation of debit balances. Most of the financial coding errors have been identified by finance and corrected before year-end.

Separate accounting for specified purpose funds – The analysis of the accounts revealed that 14 of the 218 accounts (6.4%) were not kept separate from the Department's regular funds. These 14 accounts were therefore not subject to the system of internal control set up for specified purpose accounts. The total balance of the accounts was $24,520 in 2006–2007, $570 in 2007–2008 and $19,952 in 2008–2009. Even if these balances are not significant, the fact remains that several hundred incorrect transactions were made to these accounts over the course of the fiscal year and had to be corrected (efficiency of operations). In addition, 2 of the 36 sampled accounts contained more than 1 agreement. One of the 2 accounts included 5 and the other included 2. The individual agreements in each grouping had the same purpose, so proper usage of funds was not a problem. However, this hinders reconciliation work and the effective monitoring and reporting on specific agreements.

Recommendations

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer, should ensure that:

1. the functional authority for the content and management of the agreements is assigned to a responsible manager and clearly defined and communicated;
2. the version of the departmental accounting handbook currently being developed clearly defines the roles and responsibilities for the financial management of specified purpose accounts and that these stakeholders receive proper training and/or guidance;
3. that the functional authority is implicated early in the process, before the agreements are signed and the funds are received, to review all of the agreements associated with revenue generation and ensure that the funds are accounted under the right mechanism. In addition, decisions that support the classification of funds as specified purpose accounts are justified and documented; and
4. managers receive guidance to ensure that the agreements for specified purpose accounts include, when possible, all of the basic information required by the Treasury Board Policy on Specified Purpose Accounts. When this information is not included in the agreements, the justification should be documented. The managers should be informed of these requirements.
5. managers responsible for expired agreements with an outstanding balance refund the donator or return the balance to the consolidated fund, as required.

Management Response

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer agrees:

1. The CFO will propose a management framework for specified purposes accounts which will serve to clearly assign the functional authority(ies) and responsibilities for the content and management of the agreements, and well as outline an action plan and key steps. The proposal will be submitted to a senior management committee for discussion prior to approval, and subsequently to EAAC.

   The proposed management framework would be completed in 2010-11.

2. The departmental accounting handbook will be revised once functional authorities have been more clearly defined, and will cover the roles and responsibilities of financial management for the specified purpose accounts.

3. Finance will assist the organization assigned as the functional authority or lead for specified purpose accounts to review the associated business process and document all actions to be taken to ensure funds are properly accounted for under the right mechanism, and decisions that support the classification of funds as specified purpose accounts are justified and documented.

4. The organization assigned as the functional authority will provide guidance to managers with respect to the Treasury Board Policy on Specified Purpose Accounts once the process is reviewed and validated. Finance will be involved with respect to providing guidance on financial and accounting aspects.

5. The proposed process identified above should include further guidance to ensure responsible managers properly dispose of any outstanding balance at the end of the agreements. Finance will strengthen its monitoring of Specified Purpose Accounts to ensure balances are properly disposed.

The detailed actions required in support to items 2 to 5 (above) will first require a decision on the assignment of functional authority(ies) over SPAs and clarification of roles and responsibilities. As such, it is not possible at this time provide a precise timeframe. Our estimate at this time would that these actions should be undertaken in fiscal year 2011-12, after completion and approval of the proposed management framework planned for 2010-11.

Conclusion

The specified purpose accounts are generally managed following the *Financial Administration Act*, the Treasury Board policy on specified purpose accounts and the agreements with third parties. However, the management framework for specified purpose accounts can be improved by implementing the recommendations mentioned above.

1 INTRODUCTION

The Audit and Evaluation Branch undertook an audit of Specified Purpose Accounts for the Department. This audit engagement was part of the 2008–2011 Environment Canada Audit and Evaluation Plan, which was approved by the Deputy Minister. Field work was conducted over the 2008-2009 and 2009-2010 period. The audit was identified as high risk by senior management during the consultation on the risk-based audit plan. In addition, specified purpose accounts had not previously been audited.

1.1 *Background*

Environment Canada receives funds that must be kept in accounts that are separate from its regular operating accounts. Because of the particular nature of these funds, it is essential to keep them in separate accounts in the General Ledger to ensure that the funds are not used for purposes other than those for which they were originally intended. The accounts, called specified purpose accounts, enable the Department to properly manage and report on the funds. These funds may be in the form of donations, court awards or agreements for joint projects or partnerships with parties outside the Government of Canada.

1.1.1 Authorities

The management of specified purpose accounts is governed primarily by the Treasury Board Policy on Specified Purpose Accounts, established under section 21 of the *Financial Administration Act* and by the Receiver General Directive on Specified Purpose Accounts. The Finance and Corporate Branch developed a chapter in the Departmental Accounting Handbook for the management of specified purpose accounts, which is currently being revised by the Department's accounting team, as well as, the year-end procedures for these accounts.

1.1.2 Overview of Environment Canada's Specified Purpose Accounts

The results of the specified purpose accounts analysis at the end of the 2008–2009 fiscal year, which is based on the Department's financial system, demonstrated that the balance for all categories of specified purpose accounts combined, amounted to close to $7.01 million and comprised 148 accounts. Of these accounts, 77 were cost-sharing agreements or joint projects ($4.9 million), 69 were court awards ($1.97 million), 2 were donations ($0.14 million) and 70 other accounts showed a zero balance by the end of the fiscal year (*Figure 1*).

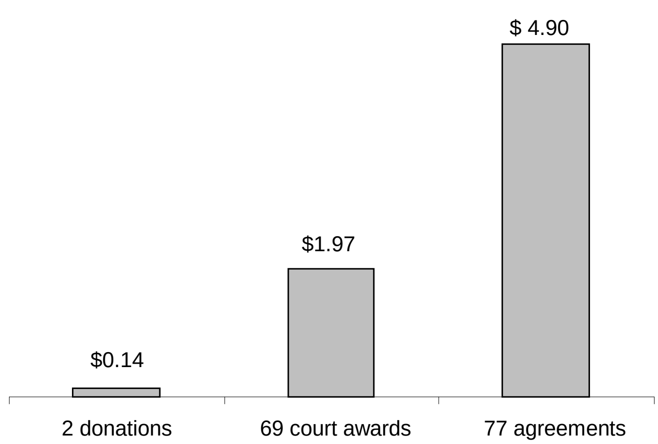

Figure 1: Balance of specified purpose accounts in 2008–2009 *(in millions of dollars)*

The balance of $7.01 million at the end of the 2008–2009 fiscal year was the result of approximately $7.55 million in funds carried forward from previous fiscal years and a net reduction of $0.54 million during the fiscal year.

The balance of the specified purpose accounts decreased slightly during the course of the past 3 fiscal years (decreasing from approximately $8 million at the end of 2006–2007 to approximately $7 million at the end of 2008–2009). However, even if the amounts of the court awards are not significant, it is very likely that they will increase considerably given the changes made at the beginning of 2009 to Bill C-16[2].

All regions participate in the management of specified purpose accounts.

The ten largest specified purpose accounts at the end of 2008–2009 represented approximately 51.8% of the total balance of all accounts and comprised eight joint projects (46.0% of the total account balance) and two court awards (5.81% of the total account balance).

1.1.3 Overview of the Decision-making Process for New Funding Sources

The funds that the Department receives from parties outside of the federal government can be classified in various ways depending on the nature and the content of the agreement. The two main categories under which Environment Canada receives such funds are cost recovery and specified purpose accounts. The way in which these funds are classified is extremely important, since it will indicate the sections of the *Financial Administration Act*, regulations, policies, procedures and standards that must be applied. Specified purpose accounts must never be used to replace or impede normal cost-recovery operations.[3]

Treasury Board Policy on Specified Purpose Accounts defines the situations where new sources of funding can be classified as specified purpose accounts. The following are the main criteria that have been identified:

1. funds are received from a third party;
2. funds are received before expenditures have been committed;
3. the expenditures that are charged to them are subject to restrictions; and
4. the third party does not receive any goods or services in exchange[4] or, should this occur, their nature is unknown.

1.1.4 Overview for Specified Purpose Accounts Management Process

Interviews with managers, departmental accounting officers in regions and Accounting Operations employees enabled the audit team to document the existing management process for handling specified purpose accounts. The steps of the process are outlined in Annex 1.

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[2] Bill C-16: the *Environmental Enforcement Act* received Royal Assent on June 18, 2009. This bill amends six laws under the responsibility of Environment Canada and three under that of Parks Canada with the objective of allocating all fines to the Environmental Damages Fund. This fund is administered by Environment Canada and is classified as a specified purpose account (court awards) in its ledgers.

[3] Treasury Board Policy on Specified Purpose Accounts – Section 6 – paragraph i)

[4] Unless the third party is another level of government.

1.2 *Risk Analysis*

An analysis was performed at the beginning of the audit to establish, evaluate and prioritize the risks associated with managing specified purpose accounts. This analysis was based on a review of the relevant documentation, interviews with the primary stakeholders in the management of these accounts, and an analysis of data from the departmental financial system. The following potential risks were identified and were used to define the audit criteria:

- inefficiency of the specified purpose accounts management framework;
- incorrect choice of funding mechanism;
- non-compliance with the requirements arising from third-party agreements;
- recurring carry-over of remaining balances associated with expired agreements;
- the Department's commitment to agreements without prior Legal Services review;
- transfer of funds from other sources into specified purpose accounts; and
- non-compliance with the requirement of the Treasury Board Policy on Specified Purpose Accounts.

Annex 2 provides the details of the activities performed at this stage, as well as the main risks and impacts identified.

1.3 *Objectives and Scope*

The objectives of the audit were intended to provide assurance that

- the control framework for specified purpose accounts is effective and efficient; and
- specified purpose accounts are managed in accordance with the laws, policies and agreements with third parties, as well as with the applicable accounting standards and principles.

The audit included all the types of specified purpose accounts in the Department, whether they were for donations, court awards or joint project agreements.

We only analyzed the financial data coded as SPA[5] in the departmental financial system. This allowed us to identify cases where regular accounts would have been miscoded as SPA. We did not conduct the reverse analysis, trying to identify regular accounts that should have been coded as SPA.

[5] 525 – Collection and disbursements of all specified purpose accounts, excluding donations and court awards: 527–Donations; 530 – court awards.

1.4 *Methodology*

After a general analysis of the accounts, a judgmental sample of 36 specified purpose accounts were selected. The 36 sampled accounts covered 41 agreements. One of the accounts covered 5 agreements and another covered 2. In addition, 2 accounts were not audited because they were not specified purpose accounts (incorrectly identified using financial coding reserved for specified purpose accounts). The selection criteria focused on factors such as region, branch, nature of the account, materiality threshold and the nature of the transactions among others. All specified purpose accounts that had a balance in 2007–2008, whether they were created during the targeted fiscal year or during an earlier fiscal year, were considered for the sample.

The following activities were performed during the audit:

- Review of relevant documentation; such as the results of the study of 100 agreements related to specified purpose accounts conducted by Accounting Operations in 2007.
- Computer-assisted tools were used to conduct analysis of transactions from 2006-2007 to 2008-2009 fiscal year in order to identify specific situations, such as:
    - the carry-over of remaining balances related to expired agreements;
    - the creation of opening balances during a given fiscal year that do not match the closing balances from the previous fiscal year;
    - the recording of transactions that created debit balances in specified purpose accounts; and
    - the incorrect use of financial coding.
- A review of agreements selected during the sampling to determine, among other things, whether
    - the nature of the agreements complies with the requirements of specified purpose accounts;
    - the content of the agreements complies with the basic requirements of the Treasury Board Policy on Specified Purpose Accounts; and
    - the required audit trails are kept in the files.
- Interviews were conducted with selected managers, functional specialists in finance and a representative from Legal Services to enable us to formulate an opinion on the management framework for specified purpose accounts; this involved identifying, assessing and documenting the following:
    - the roles and responsibilities of key stakeholders;
    - best practices and activities that require improvement; and
    - processes and controls.

Annex 3 outlines the audit criteria used.

1.5 *Statement of Assurance*

This audit has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and the *Policy on Internal Audit* of the Treasury Board of Canada.

In our professional judgment, 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 were based on a comparison of the situations, as they existed at the time, against the audit criteria.

2 FINDINGS AND RECOMMENDATIONS

2.1 *Control Framework for Specified Purpose Accounts*

2.1.1 *Roles and Responsibilities*

The Treasury Board Policy on Specified Purpose Accounts indicates that departments must establish policies and procedures that will ensure the proper management of specified purpose accounts.[6]

Environment Canada has no departmental policy but the Chapter 9 of the Departmental Accounting Manual provides a good overview of the processes in place that are related to the management of specified purpose accounts. However, the roles and responsibilities of the individuals or groups of individuals involved in these processes are not defined or documented in the Manual, which makes it difficult to ensure that there is compliance with all of the policy's requirements.

For example, the Environment Canada Accounting Handbook indicates the following:

> *"On a monthly basis amounts related to specified purpose accounts are to be reported in the Trial Balance to the Receiver General, and annually in EC's Financial Statements. As the Minister and Deputy Minister are now directly accountable for the accuracy of the Financial Statements, it becomes imperative for all managers and accounting staff to ensure the accuracy of coding when dealing with specified purpose account coding".*[7]

Besides Sections 32, 34 and 33 of the *Financial Administration Act*, there is no mention of how, in practice, these responsibilities should be shared between the managers, the departmental accounting offices and Accounting Operations.

[6] Treasury Board Policy on Specified Purpose Accounts - Section 6 – paragraph c)
[7] Environment Canada Accounting Handbook – Chapter 9 – paragraph 2.4

The Accounting Operations representatives confirmed during the interviews, that a new version of the Manual is being reviewed and developed but will not define the roles and responsibilities regarding the management of specified purpose accounts. As well, it was not clear during the audit who had functional authority on the content and management of the specified purpose account agreements. It was understood by most interviewees that program managers are responsible for the content of the agreements and that Financial Services was responsible to provide functional authority on financial matters.

2.1.2 *Legal Advice on Complex Agreements*

The Treasury Board Policy on Specified Purpose Accounts states that "Special attention should be given to proper use of authorities and to legal aspects of contracts, agreements and any other types of arrangements"...[8]

According to the interviews with managers and staff from the departmental accounting offices, it is up to management to identify the situations in which Legal Services must be consulted. The departmental accounting handbook does not provide any guidance on the matter.

A Legal Services representative expressed the opinion that the role of Legal Services is limited to examining agreements in order to identify situations that could potentially place the Department at risk, without taking into consideration the nature of the agreement itself. Classifying the nature of the agreement is the responsibility of Financial Services.

In addition, some managers indicated that they are not always certain under which circumstances they are required to contact Legal Services. It is not clear to them if they should submit all agreements to be assessed or only those that, in their opinion, present a higher risk and should be given special attention.

It is not clear right now who should provide this guidance to managers.

2.1.3 *Training and Communication*

During the interviews, the managers indicated that they were aware of neither the requirements of the Treasury Board Policy on Specified Purpose Accounts nor the departmental Accounting Handbook. They also stated that they rely primarily on their financial advisors to ensure that all the rules are followed.

The managers also stated that they do not have sufficient information on how specified purpose accounts operate. In their opinion, their role is limited to managing the agreements; however they also indicated that they have not received any specific training for managing these types of files. In one case, the manager could not define what a specified purpose account is and was unaware that he was responsible for one.

[8] Treasury Board Policy on Specified Purpose Accounts – Section 8 – paragraph c)

Recommendation

1. *The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer, should ensure that the functional authority for the content and management of the agreements is assigned to a responsible manager and clearly defined and communicated.*

Management Response

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer agrees:

> The CFO will propose a management framework for specified purposes accounts which will serve to clearly assign the functional authority(ies) and responsibilities for the content and management of the agreements, and well as outline an action plan and key steps. The proposal will be submitted to a senior management committee for discussion prior to approval, and subsequently to EAAC.
>
> The proposed management framework would be completed in 2010-11.
>
> The detailed actions required in support items 2 to 5 (above) will first require a decision on the assignment of functional authority(ies) over SPAs and clarification of roles and responsibilities. As such, it is not possible at this time provide a precise timeframe. Our estimate at this time would that these actions should be undertaken in fiscal year 2011-12, after completion and approval of the proposed management framework planned for 2010-11.

Recommendation

2. *The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer, should ensure that the version of the departmental accounting handbook currently being developed clearly defines the roles and responsibilities for the financial management of specified purpose accounts and that these stakeholders receive proper training and/or guidance.*

Management Response

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer agrees:

> The departmental accounting handbook will be revised once functional authorities have been more clearly defined, and will cover the roles and responsibilities of financial management for the specified purpose accounts.

2.1.4 *Continuous Monitoring and Accountability*

The Treasury Board Policy on Specified Purpose Accounts stipulates that departmental policies and procedures should clearly state that the manager responsible for the funds held in a specified purpose accounts is accountable for the management of the funds and for adherence to this policy.[9] The departmental accounting handbook does not meet this requirement. However, the audit team noted that a fiscal year-end certification process was recently implemented by Accounting Operations.

This certification process requires managers to certify that

- all transactions recorded in specified purpose accounts during the fiscal year have been properly classified;
- the closing balances of the specified purpose accounts at year-end are correct; and
- balances are associated with agreements that did not expire at fiscal year-end. All outstanding balances related to expired agreements must immediately be refunded to third parties or transferred to the Consolidated Revenue Fund.

This certification process is a good additional control ensuring that responsibilities are clear, and understood.

Accounting Operations indicated during the interviews that the monitoring of specified purpose accounts is usually conducted at fiscal year-end, on a yearly basis. There are no policy requirements for more regular reconciliation, However, a more regular reconciliation could help reduce the number of errors, and reduce the number of corrections to be made in the system.

2.1.5 *File Structure*

The Treasury Board Policy on Specified Purpose Accounts indicates that departments must establish appropriate internal control mechanisms, including the monitoring of funds collected, recorded and spent in connection with specified purpose accounts, as well as implementing regular reconciliations.[10]

The analysis of the sampled specified purpose accounts revealed that, in two instances, more than one agreement were covered under a single account (financial coding). In the first case, a single account covered five agreements and, in the second, the account covered two. The individual agreements in each grouping had the same purpose, so proper usage of funds was not a problem. However, this approach does not allow for proper monitoring of the transactions specific to each agreement, the control of the funds on an individual basis, the determination of the remaining balance of each agreement to be refunded to the third party or transferred to the Consolidated Revenue Fund of Canada (Section 2.2.4 of this report provides more details on this).

[9] Treasury Board Policy on Specified Purpose Accounts – Appendix A, paragrah 1a).
[10] Treasury Board Policy on Specified Purpose Accounts – Appendix A, paragraph 1b) and 8d)

Of all the sampled files, not one contained the information necessary to justify the decision to classify the funds received as belonging to specified purpose accounts. As a result, there was no information that justified to what degree the agreement met all of the criteria that define specified purpose accounts.

The lack of information explains, for the most part, the high number of files for which Accounting Operations officers could not provide an opinion during the review of approximately a hundred specified purpose accounts agreements in 2007–2008.

In addition, no information was kept in the files regarding any opinions that Legal Services may have provided on these agreements.

Recommendation 3 in Section 2.2.1 of this report addresses this issue regarding the justification and documentation of the decisions that underlie the classification of funds.

2.2 *Compliance with the Financial Administration Act, Policies and Agreements*

2.2.1 *Choice of Funding Mechanism*

Accounting Operations conducted a review of a hundred joint projects and cost-sharing agreements in 2006–2007, according to the recommendations of the Treasury Board of Canada Secretariat. The objective of this review was to determine whether all agreements that were classified as specified purpose accounts really met all of the criteria set by the Treasury Board Policy on Specified Purpose Accounts.

The results of our study revealed that at least 22 accounts were incorrectly classified since they did not meet all of the criteria for specified purpose accounts. The agreements associated with these accounts were geared more toward cost recovery. In addition, Accounting Operations officers could not reach a decision as to the nature of 36 accounts; either because the information was insufficient or because the agreements associated with them had not been provided by the departmental accounting officers. Table 1 shows the results of this study.

Table 1 – Results of the study on joint projects and cost-shared agreements conducted by Accounting Operations in 2007

Conclusion	Accounts	Value[1]	
	Number and %	$M	%
Specified purpose accounts	42	2.12	41.8
Accounts classified as specified purpose accounts, but do not meet the established criteria or only meet them partially (geared more toward cost recovery)	22	0.65	12.9
Accounts that were unclassifiable because there was insufficient information or because the associated agreements were not provided by the departmental accounting offices.	36	2.30	45.3
Total	**100**	**5.07**	**100**

[1] The total amount of $5 million included $5.8 million from previous years and a net reduction of $0.8 million during the 2007–2008 fiscal year.

Of the 36 agreements that could not be reviewed by Accounting Operations officers, 10 were examined during this audit. The results revealed that 2 of these are specified purpose accounts and 8 are not. Given this additional information, the percentage of non-compliance increased from 22% to at least 30%.

Following the 2007 study, a reclassification of all of the incorrectly classified agreements should have been conducted by Accounting Operations in the 2008–2009 fiscal year. At the time of this report, corrective measures were planned for 2009-2010.

The audit team started reviewing the 38 specified purpose account agreements (see note 12) that were part of the sample in order to establish whether these met the criteria set by the Treasury Board Policy on Specified Purpose Accounts. The criteria are shown in Annex 3 of this report.

After reviewing the first 21 agreements, it was evident that the results would be similar to those from the analysis of the hundred projects and agreements that had been conducted by Accounting Operations in 2007.

The number of classification errors of new sources of funding would be significantly reduced if all agreements were reviewed systematically by the same person or organization. Due to the decentralization of files in the regions, the agreements are currently not reviewed to ensure that they meet all of the specified purpose account criteria to confirm that all of the transactions attributed to each account are consistent with what is provided for in the agreements.

The review of the agreements should be done as early as possible in the process, before the agreement is signed and the funds are received. The Annex 1 presents the current process that is being followed, which demonstrate that decisions on the mechanism to account for new funds are usually made after the agreements are signed and funds are received.

Recommendation

3. *The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer, should ensure that the functional authority is implicated early in the process, before the agreements are signed and the funds are received, to review all of the agreements associated with revenue generation and ensure that the funds are accounted under the right mechanism. In addition, decisions that support the classification of funds as specified purpose accounts are justified and documented*.

Management Response

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer agrees:

> Finance will assist the organization assigned as the functional authority or lead for specified purpose accounts to review the associated business process and document all actions to be taken to ensure funds are properly accounted for under the right mechanism, and decisions that support the classification of funds as specified purpose accounts are justified and documented.

2.2.2 *Content of Agreements*

Treasury Board policy and Environment Canada Accounting Handbook list the elements that should be included in a well-written agreement. All specified purpose account agreements should include this basic information.[11]

The audit team reviewed 24 of the 38 sampled agreements[12] to determine whether they contained the minimum information specified by the Treasury Board Policy on Specified Purpose Accounts.

The results of this analysis show that the agreements do not contain all the basic information required. In fact, only one of the agreements contained all of the required information. In addition, the agreement format varies significantly from one account to another. The omission of information regarding the final disposal of goods acquired during the project, intellectual property and remaining balances increases the risks associated with projects that are still in progress or have expired.

Several agreements were written by third parties, which makes it more difficult for managers to ensure that all of the clauses required by the Treasury Board Policy on Specified Purpose Accounts are indeed included in the agreement. In such cases, the Department has little control over the content of the agreements. However, managers are responsible for taking the steps required to ensure that the agreements include the maximum amount of information to reduce the risks to the Department, to the greatest extent possible. The missing information is shown in Table 2.

[11] Treasury Board Policy on Specified Purpose Accounts – Section 3 – paragraph h) and Environment Canada Handbook – Chapters 9.1.3.1 b)

[12]

Number of specified purpose accounts selected	35
One account covered 5 agreements and another covered 2	5
Agreements not received by the audit team	-2
	38
Agreements that are not specified purpose accounts	-11
Number of donations (1) and court awards (2)	-3
Number of agreements eligible for the audit	**24**

Table 2 – Results of the analysis of the content of the sample agreements

Minimum required information	Agreements	
	Number	%
The beginning and end dates of an agreement	24	100
Objective, scope and expected results	23	96
Payment amounts and schedule	20	83
Nature of permitted expenditures	10	42
Final disposal of purchased goods	10	42
Final disposal of intellectual property	6	25
Final disposal of remaining balances	4	17
Mechanisms to resolve disputes	1	4
Mechanisms to handle unexpected expenditures	2	8

The above elements (in Table 2) were required under the previous policy but are not under the new 2009 Treasury Board Policy on Specified Purpose Accounts. Since the agreements are a key control mechanism to ensure funds are used for purposed intended, continuing to provide such information is a good management practice.

Recommendation

4. *The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer, should ensure that managers receive guidance to ensure that the agreements for specified purpose accounts include, when possible, all of the basic information required by the Treasury Board Policy on Specified Purpose Accounts. When this information is not included in the agreements, the justification should be documented. The managers should be informed of these requirements.*

Management Response

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer agrees:

> The organization assigned as the functional authority will provide guidance to managers with respect to the Treasury Board Policy on Specified Purpose Accounts once the process is reviewed and validated. Finance will be involved with respect to providing guidance on financial and accounting aspects.

2.2.3 *Separate Recording of Funds Received for a Specified Purpose*

Subsidiary accounts must be kept by the Department and reconciled monthly in the accounts of Canada.[13]

In order to meet the requirements in terms of reconciliation, reporting and accountability, the Department uses a combination of specific financial coding. However, the use of specific coding structure does not allow the recording of non-financial information for each of the accounts created, which would facilitate comprehensive analysis and monitoring.

Various control mechanisms are in place to ensure that the funds received for specified purpose accounts are not recorded with the Department's regular operations and that the expenses charged to these funds are legitimate and properly classified. These mechanisms include

1- the financial coding structure (specific authority and project codes, hierarchy of project codes, cross-validation rules, and standardized project descriptions to record them as specified purpose accounts);

2- certification based on the provisions of section 34 of the *Financial Administration Act*. Managers identify the right financial coding at this step;

3- budget controls integrated into the financial system for funds that are recorded using the financial coding reserved for specified purpose accounts; and

4- reconciliation reports that are accessible to managers, the departmental accounting offices and Accounting Operations.

Despite the existing controls, the analysis of all specified purpose accounts conducted by the audit team showed that project codes, not related to specified purpose accounts, have been used with authority codes reserved for these accounts. Most of these transactions have been corrected before year end, except for an amount of $3K which was corrected during the following fiscal year. Therefore the issue is not the materiality of those errors, but the time required to correct the erroneous coding.

Although internal controls have been put in place in the financial system to ensure that expenses charged to specified purpose accounts do not exceed the total amount of the agreements (see Section 2.2.5 of this report on debit balances), the controls cannot work if the specified purpose account funds are recorded under financial codes created for other purposes.

The implementation of recommendation 2 should help reduce the number of financial coding errors and thus ensure the separate recording of funds received for specified purpose accounts.

[13] Treasury Board Policy on Specified Purpose Accounts – Section 7 – paragraph c).

2.2.4 *Processing of Remaining Balances*

When a project that is classified as a specified purpose account has been carried out and the funds received have not been fully spent or are no longer required, they must be refunded to the individual or entity that contributed them unless the agreement stipulated another way to dispose of leftover funds or unless the individual or entity cannot be located or identified. If this occurs, the account balance is transferred to the Consolidated Revenue Fund of Canada.[14]

The analysis of specified purpose accounts along with the interviews with managers showed that the remaining project balances are not always refunded to the entity that contributed them or are transferred to the Consolidated Revenue Fund of Canada in a timely fashion. Remaining balances can be refunded long after the end dates of agreements. The analysis conducted by Accounting Operations officers confirms that these balances do exist. Table 3 shows a few of these cases. Definition of roles and responsibilities should clarify that managers are responsible to return the funds in a timely fashion as soon as the agreement expires and that Finance should monitor the balance amount on a regular basis.

Table 3 – List of expired agreements that still have an outstanding balance at the time of the audit

No.	End Date of the Agreement	Agreement Amount $	2007–2008 Balance $
1	December 31, 2007	5,803	8,613
2	December 31, 2007	6,219	839
3	January 31, 2007	89,949	16,082
4	June 23, 2005	115,628	115,628
5	September 1, 2007	132,266	129,936
6	April 27th, 2007	30,000	30,000
7	March 31, 2001	330	330
8	April 30, 2007	1,500	1,500
9	December 31, 2001	5,965	5,965
10	December 31, 2005	4,983	4,983

In addition to the cases shown in Table 3, the audit team identified a number of other cases in which balances have been outstanding in specified purpose accounts for the past few fiscal years. Even if these amounts are not individually material, it is very likely that they are remaining balances that should have been refunded.

[14] Treasury Board Policy on Specified Purpose Accounts – Section 7 – paragraph a).

As long as these funds are not refunded, they will continue to appear in the Department's accounts as well as in the reports that are generated (internal or external reports such as those on the departmental trial balance and financial statements).

The implementation of recommendation 2 should help identify the remaining balances as soon as agreements expire and refund the outstanding balances to the individual or entity that contributed them or transfer the balances to the Consolidated Revenue Fund.

Recommendation

5. *The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer, should request that the managers responsible for expired agreements with an outstanding balance refund the donator or return the balance to the consolidated fund, as required.*

Management Response

The Assistant Deputy Minister, Finance and Corporate Branch and Chief Financial Officer agrees:

> The proposed process identified above should include further guidance to ensure responsible managers properly dispose of any outstanding balance at the end of the agreements. Finance will strengthen its monitoring of Specified Purpose Accounts to ensure balances are properly disposed.
>
> The detailed actions required in support to management responses 2 to 5 (above) will first require a decision on the assignment of functional authority(ies) over SPAs and clarification of roles and responsibilities. As such, it is not possible at this time provide a precise timeframe. Our estimate at this time would that these actions should be undertaken in fiscal year 2011-12, after completion and approval of the proposed management framework planned for 2010-11.

2.2.5 *Debit Balance Controls*

According to the Treasury Board Policy on Specified Purpose Accounts, specified purpose accounts cannot be allowed to go into a debit balance and disbursements must not be made from the account if there are insufficient funds at the time the payment is to be made. Unless authorized by legislation, payments cannot be made from a specified purpose account if doing so produces a debit balance.[15] Therefore, expenditures must not be made from a specified purpose account if the funds have not been received. The Department should postpone the expenditure until more funds are received. In addition, all payments made from the Department's regular operating funds (A-Base) cannot be refunded at a later date with specified purpose account funds. However, managers indicated during the interviews that they proceeded in this way because the funds or budgets are often received too late during the fiscal year, leaving them with no other option but to start making expenditures even before having received the funds, in order to meet the deadlines set down in the agreements.

[15] Treasury Board Policy on Specified Purpose Accounts – Section 6 – paragraph j).

Creating debit balances could oblige the Department to use regular funds (A-Base) to cover expenditures generated in advance, since transfers from specified purpose accounts to regular operating funds are not permitted, and since there is always the possibility that the funds will never be received from the third party.

A detailed computer-assisted analysis was performed in order to identify specified purpose accounts that were part of the sample and that posted debit balances at a given time. The analysis covered all of the transactions recorded for these accounts during the 2006–2007, 2007–2008 and 2008–2009 fiscal years. The audit team identified 22 cases of debit balances during the 3 fiscal years in question. This could be due to the creation of a debit balance or the increase in a balance that was already a debit balance. Of the 22 identified cases, 18 occurred at the end of a period, 3 at the end of a fiscal year and 1 at the end of a project. Table 4 summarizes the results of this analysis.

Table 4 - Results of the analysis of accounts showing a debit balance

	Debit Balance Accounts at the End of a Period	Debit Balance Accounts at the end of a Fiscal Year	Debit Balance Accounts at the End of a Project
Number	**18**	**3**	**1**
Amount ($)	**136,997**	**54,820**	**25,090**
Average amount ($)	**7,611**	**18,273**	**25,090**

2.2.6 *Monitoring of Opening and Closing Balances*

The audit team analyzed all of the balance transfers in 178[16] specified purpose accounts from 2007–2008 by using the Department's financial reporting system (Discoverer). The analysis focused on the carry-over of funds from the 2006–2007 to 2007–2008 and the 2007–2008 to 2008–2009 fiscal years.

The analysis determined that, of the 485 cases of transfers recorded for these specified purpose accounts during the targeted periods, all of the balances were correctly reported in the following fiscal year except in one instance ($36,632 was not reported for a project conducted during the 2005–2006 to 2006–2007 fiscal years). However, this error was manually corrected during the following fiscal year.

[16] Based on a list of all accounts using specified purpose account authorities that was provided by finance

3 CONCLUSION

The specified purpose accounts are generally managed following the *Financial Administration Act*, the Treasury Board policy on specified purpose accounts and the agreements with third parties.

However, during the period covered by this audit, at least 30% of the agreements were classified as specified purpose accounts even when they did not meet all the criteria that defines this type of account. They have been managed as Specified Purpose Accounts while they should have been managed as cost recoveries. Special attention should be paid to agreements for new sources of funding in order to reduce, as much as possible, the number of errors in the classification of accounts. This should be done even before the funds are received. Also, decisions made regarding the classification of accounts should be justified and documented.

Also, the residual funds are not always returned to the third parties or to the consolidated revenue funds when the agreements expire.

The management framework for specified purpose accounts can be improved. It should be reviewed and strengthened by: defining who has the functional authority on the content and management of the agreements; better defining the roles and responsibilities for financial management; implementing an early review of agreements; and providing more guidance to managers.

Annex 1 – Overview of the Current Specified Purpose Account Management Process

1- Signature of an agreement, or receipt of a donation or a court award, depending on the nature of the transaction; at this point, if they deem it necessary, the managers contact Legal Services for advice before committing the Department to agreements of a more complex nature.[17]

2- Confirmation from the financial advisors that the funds to be received meet all the criteria of a specified purpose account and that these funds must be managed according to the rules set down for such account.

3- Creation of coding within the financial system for reports and controls, namely a unique project code combined with a specific authority code that reflects the nature of the account (joint project, donation or court award).

4- Receipt of the funds; the funds are accounted for as miscellaneous receipts through the accounts receivable module (no invoices are issued), using the financial code described in the preceding step.

5- Commitment of expenditures based on the funds received. No expenditures can be charged to a specified purpose account before the funds have been received. A specified purpose account cannot, under any circumstances, have a debit balance.[18]

   The nature of expenditures varies depending on the nature of the agreements and their content. By signing under section 34 of the *Financial Administration Act*, managers are confirming that the expenditures are indeed associated with a specified purpose account and that they comply with all of the clauses of the agreements.

6- Recording of adjusting entries during the fiscal year. In order to comply with the accounting requirements under the accrual accounting, expenditures charged to specified purpose accounts must have an adjusting entry to account for an equivalent revenue (null impact on statements of operations). Specific requirements may be present, depending on the nature of the account.

7- Reconciliation of annual balances by Accounting Operations.[19]

8- Carry-over, into the new fiscal year, of the balances of all accounts associated with agreements that did not expire at the end of the fiscal year. To do this, a manual journal voucher is recorded by Accounting Operations to create opening balances in the new fiscal year.[20]

9- Refunding of the remaining balance of the funds when the agreement expires. The remaining balance of the funds must be refunded to the third party or transferred to the Consolidated Revenue Fund of Canada according to the terms of the agreement.

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17 Presently, the process statrts when Financial Services receive the the agreement. In our opinion, there should earlier consultation with a functional authority.

18 The financial system contains a control mechanism for identifying all transactions that would create a debit balance in a specified purpose account. However, this control mechanism only works if the specified purpose account in question was created correctly in the first place. Exceptions were found during this audit (see Section).

19 Accounting Operations confirmed that they conducted this type of evaluation only once a year, at the end of the fiscal year.

20 For the purpose of the departmental reporting system only.

Annex 2 – Summary of Risk Assessment during the planning phase of the audit

Activity

- Review of relevant documentation
- Interviews with key stakeholders responsible for the management of specified purpose accounts
- Analyses of financial data from the departmental financial system

Scope

- *Financial Administration Act* and Treasury Board Policy
- Departmental Accounting Handbook
- Examples of agreements of each category
- Results of risk analysis done under the Departmental Audit and Evaluation Plan, including specific comments from management on specified purpose accounts
- Results of reconciliation work conducted by the Finance and Corporate Branch in 2007–2008.
- Assistant Deputy Minister and Chief Financial Officer
- Director General, Finance and Corporate Branch
- Director, Accounting Operations, Financial Policies and Systems and members of her team
- Legal Advisor
- Two managers of specified purpose accounts
- Reports on activities of all specified purpose accounts since 1999–2000 for a computer-assisted analysis to identify problematic or high-risk trends and situations.

Purpose

- Identify the main requirements of the *Financial Administration Act* and policies that govern the management of specified purpose accounts
- Become familiar with the content of each type of agreement
- Identify cases that may have been incorrectly classified as specified purpose accounts, as well as the main causes
- Get the perspective of individuals in charge of managing these accounts, with regard to the main risks, in their respective fields of expertise (processes, practices, management framework, etc.)
- Identify risk factors in the processing of these accounts, including: the number and nature of manual corrections; the nature of accounts by both the Department's Accounting Office and fiscal year; the nature of transactions recorded under these accounts; and, the number of balance carry-overs at year-end and remaining balances.

Identified Risks / *Steps in the departmental management process (Annex 1)*

1. Ineffectiveness of the specified purpose accounts management framework *(all steps)*
2. Incorrect choice of funding mechanism used to manage specified purpose accounts (step 2)
3. Non-compliance with third party agreement requirements (steps 5, 7 and 9)
4. Recurring carry-over of remaining balances (steps 8 and 9)
5. Commitment of the Department to agreements without prior review by Legal Services (step 1)
6. Transfer of funds from other sources to specified purpose accounts (steps 5 and 7)
7. Non-compliance with main requirements of the Treasury Board Policy (all steps)

Potential Impacts

1. Non-compliance with the *Financial Administration Act*
2. Carrying forward of funds that would otherwise be expired
3. Ineffectiveness of account management
4. Exposure of Department to third-party recourse in the event of non-compliance with agreements
5. The funds are not used for intended purposes
6. The errors in the accounts are not detected and are carried over from one fiscal year to the next
7. Difficulty to account for the use of funds
8. The files are incomplete and do not allow an effective audit or monitoring of the accounts

Annex 3 – Audit Criteria

OBJECTIF A – Effectiveness of the specified purpose accounts control framework

Criterion A.1

Internal policies, procedures and handbooks are made available, approved, communicated, up-to-date, completed and in line with those of the Treasury Board Secretariat

- The roles and responsibilities are well-defined, documented and approved;
- The internal policies and procedures clearly indicate that the managers responsible for specified purpose accounts are accountable for them.

Criterion A.2

Adequate training on the processes as well as the roles and responsibilities is provided to the different stakeholders involved in the management of specified purpose accounts.

Criterion A.3

Effective processes for continuous monitoring and accountability are in place. These processes are followed by everyone.

Criterion A.4

The scope of projects and related details are included in the agreements.

Criterion A.5

Complete audit trails are documented for specified purpose accounts.

Criterion A.6

The current financial system effectively supports the management of specified purpose accounts.

OBJECTIVE B – Compliance with the *Financial Administration Act*, policies, agreements, and accounting standards and principles

Criterion B.1

Receipt of funds and opening of specified purpose accounts

Criterion B.2

Management of funds during the project

Criterion B.3

Remaining balances at the end of the projects and closing of specified purpose accounts

The following criteria were used to determine whether the agreements classified as specified purpose accounts complied with all of the Treasury Board Policy's requirements.

Nature of agreement – Is it really a specified purpose account?

1. Were these funds received from a third party?
2. Were these funds received before the activity?
3. Is it actually a cost-recovery activity?
4. Did the supplier receive goods or services in exchange?
5. If yes, are the goods and services known?
6. Is the use of the funds restricted?

Content of agreements – Do they contain all of the required information?

1. Objective, scope and expected results
2. Start date of the agreement
3. End date of the agreement
4. Receipt amounts and schedule
5. Nature of allowed expenditures
6. Final disposal of remaining balances
7. Final disposal of purchased goods
8. Final disposal of intellectual property
9. Mechanisms for handling unexpected expenditures
10. Mechanisms for resolving disputes