



BUDGETARY ALLOCATION AND FORECASTING

July 2010

Internal Audit Branch



TABLE OF CONTENTS

STATEMENT OF ASSURANCE	i
EXECUTIVE SUMMARY	iii
1. INTRODUCTION	1
1.1 Background	1
1.2 Audit Objectives and Scope	2
2. OBSERVATIONS – MANAGEMENT FRAMEWORK	3
2.1 Role and Responsibilities	3
2.2 Budget Management Framework	5
2.3 Financial Management Advisors	7
2.4 Revenue Forecasting	9
2.5 Expenditure Forecasting	12
2.6 Devolution of Budgets	13
3. OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES ..	17
APPENDIX A - CONTEXTUAL INFORMATION.....	21
APPENDIX B – AUDIT METHODOLOGY	25

STATEMENT OF ASSURANCE

We have completed the internal audit of budgetary allocation and forecasting in the Department of Justice. The main objective of the audit was to examine the adequacy of the management framework for budgetary allocation and forecasting including the processes and mechanisms that support a) planning, including the determination of service demands for sectors and portfolios, and b) budgetary allocations to operational units and the subsequent forecasting of expenditures. The scope of the audit included Headquarters and the following portfolios: Tax Law; Business and Regulatory Law; Public Safety, Defence and Immigration; and Aboriginal Affairs. Also included were a sample of Legal Service Units (LSUs) and regional offices as well as the Litigation Branch since the budgets of these offices are impacted by portfolio allocations.

The internal audit was conducted in accordance with the requirements of the Treasury Board (TB) *Policy on Internal Audit* and the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*. The audit team assessed the management control framework against criteria derived from the TBS 2008 *Management Accountability Framework*, as well as TBS audit guides.

In our professional judgment, sufficient and appropriate audit procedures have been conducted and evidence has been 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 of the audit, against audit criteria. It should be noted that the conclusions are only applicable to the areas examined.

EXECUTIVE SUMMARY

The main objective of this audit was to examine the adequacy of the management control framework for budgetary allocation and forecasting, including the processes and mechanisms that support planning and budgetary allocations to operational units as well as the subsequent forecasting of expenditures.

Over the last three years the Department of Justice has seen a period of substantial transformation in financial management. In October 2006, a hybrid funding model was approved that established an A-Base and cost recovery/net voting approach to funding for legal services provided to other government departments and agencies. The new approach took effect April 1, 2007 and its impact on the Department's sources of funds has been significant. More than a third of the departmental operating budget comes in the form of Net Vote Authority. In addition, other initiatives were taken to improve the stewardship of departmental financial resources. These included the increase of financial management support to heads of sectors and portfolios through financial management advisors and the introduction of the integrated business planning framework.

Furthermore, in July 2009 the Department formally announced its commitment to implementing the Chief Financial Officer (CFO) model. The CFO leads and manages the Chief Financial Officer Branch, which provides clients with accounting services, financial policy advice and guidance, maintenance and development services for financial systems, guidance and advice on corporate documents, and resource management services. The CFO Branch also provides functional guidance to financial personnel located in portfolios, sectors, and regions.

The creation of the CFO Branch has appropriately positioned the Department to address the challenges of meeting the requirements of the CFO model. While the basic architecture is rapidly being developed, the endorsement of all senior departmental management is required for successful implementation.

Overall we noted that the budgetary allocation and forecasting process within the Department is well managed. Of the observations we make in the report, three are of key significance. These

pertain to roles and responsibilities (specifically, the role of the Resource Management Division), the development of a Budget Management Framework, and financial management advisors.

Roles and Responsibilities

The role and responsibilities of the Resource Management Division need to be clearly defined and understood, in particular as they relate to the devolution of budgets in the Department (specifically, the second tier of devolution from portfolios/sectors to the regions and within sectors). We found that the extent to which the RMD can provide guidance and direction to portfolios on this budgetary devolution has not been defined. Furthermore, the RMD's role in performing a challenge function between portfolios and regions and within sectors/regions must be clarified. We found that there is a lack of consistency and standardization in how portfolios/sectors devolve their budgets.

Budget Management Framework

At the time of the audit, work was progressing well on the development of a Budget Management Framework that will provide written policies, procedures, and documented processes to manage budgetary allocation and forecasting within the Department. The Financial Planning and Reporting Section of the CFO Branch has drafted a Project Charter and completion of the Budget Management Framework is planned for September 2010. The Senior Management Board is to approve the overarching principles of the project and Fin.Com is to be periodically briefed on the development of the Framework.

The development of a Budget Management Framework is critical to ensuring sound financial and budgetary management in the Department. It is therefore important that the development of the Framework be closely monitored to ensure that it meets the timelines and goals set out in the Project Charter.

Financial Management Advisors

Key to the implementation of the CFO model is the formalization of the Financial Management Advisory (FMA) function across the Department. We found that senior management in the Department has not yet fully accepted the notion of CFO Branch financial support within the portfolios and sectors. FMAs are an essential component to providing independent financial oversight. Failure to fully adopt FMAs as conceptualized in the CFO model weakens the financial capability of portfolios and sectors, particularly in terms of addressing funding pressures, ensuring compliance with financial requirements, understanding risk, and providing financial advice. Roles and responsibilities of financial management advisors need to be defined

and the notion of CFO Branch financial support accepted within portfolios and sectors if the CFO model is to be successfully implemented.

Revenue Forecasting

Revenue forecasting is steadily improving as cost recovery matures in the Department. The RMD has recently developed draft guidelines and templates to assist direct reports on Net Vote Revenue and Net Vote Revenue Forecasting. Revenue forecasts require strong data management practices to support the departmental Salary Management System (SMS) and iCase. On average, direct reports were overall within plus or minus 8.2% of their year-end actual revenues. Given the complexity associated with forecasting revenues accurately, appropriate training should be delivered to those engaged in this exercise throughout the Department.

Expenditure Forecasting

The median accuracy rate for forecasting expenditures in 2008-09 was +/-3%. Expenditure forecasting requires that all managers review commitments and expenditures in the SMS and IFMS, make the necessary adjustments, and communicate and report on financial results through the certified Financial Situation Report (FSR). We found that not all direct reports are complying with the timelines for submitting the FSR. In 2008-09, certifications, which are attestations by ADAGs to the accuracy of the information contained in the FSR, were introduced for the first time to reinforce accountability over forecasting accuracy and timeliness. We found that in 2008-09, 35% of the FSR certifications were received after the established timeline and 6% of the FSRs were not received at all. Following the June, August, and September 2009 reporting requirements, the RMD reported that 35% of certified FSRs for the 2009-10 fiscal year had been submitted late and 3.5% of the FSRs were not submitted at all.

Devolution of Budgets

Guidelines are needed on the devolution of budgets by portfolios to the regions to ensure consistency and standardization. Each Portfolio has developed its own distinct allocation methodology for devolving funds to the regions and there is no provision in the Financial Situation Report to allow a Portfolio to identify the amount of funding held in reserve.

Our review found that the 2008-09 forecast budget requirement identified in business plans was \$481.8 million, which understated actual year-end spending realized of \$488.5 million by \$6.7 million (i.e. a 98.6% accuracy rate). Part of the CFO's risk management strategy includes managing the departmental budget at the centre by using the Departmental Reserve. We found that portfolios are also risk-managing their allocation by not devolving all of their allocated

funds to the regions. As a result, the use of reserve funds for risk management is occurring at two levels: the departmental and the Portfolio.

Furthermore, there is no provision in the FSR to allow portfolios to identify the amount of funding they have held in reserve for reallocation between regions or for meeting unexpected funding pressures. The amount retained should be reflected as a separate 'contingency' line item in the FSR.

The management responses to the recommendations contained in this report were provided by the Chief Financial Officer, Chief Financial Officer Branch.

1. INTRODUCTION

1.1 Background

Financial accountability, transparency, and the stewardship of public funds are at the forefront of the Government of Canada's agenda. In 2006 the government introduced the *Federal Accountability Act*, which makes deputy heads accountable for departmental spending, and created a new Parliamentary Budget Office to support an independent analysis of the government's financial estimates.

Financial resource management processes are critical to ensuring that secured funding is consistent with a department's financial requirements to deliver on its mandate and priorities. A strong allocation and forecasting model is based on integrated processes that include planning, budget preparation, decision making, resource allocation, reporting, and forecasting revenues and expenditures. In the Department of Justice, appropriate forecasting of the financial requirements for its services is key to the Department's financial allocation process and is directly linked to the projected recovery of costs from clients for services rendered.

The Department of Justice receives funding from two sources: A-Base Authority and Net Vote Authority (NVA). A-Base funding is a source of funding for the Department, accessed through parliamentary votes¹. All sectors of the Department's operations receive a certain level of A-Base funding. Under NVA, the Department has the authority to recover the costs of providing legal services from other government departments (OGDs). NVA represents additional funding received through invoicing these OGDs for legal services, net of any A-base funding available. Once this NVA revenue is collected, the Department has the authority to increase its spending authority/cash budget by the equivalent dollar amount, as approved by Treasury Board and in accordance with TB policies.

NVA revenues account for approximately 40% of the Department's total operational funding. These revenues are a variable source of funding with 25% of the total revenues billed hourly and,

¹ Each parliamentary appropriation act consists of a number of votes. A vote is a short statute authorizing a department or agency to spend money for a specific purpose. Instead of being voted on individually, the votes or short statutes are consolidated into an appropriation act (i.e., interim supply, full supply, Main and Supplementary Estimates).

therefore, dependent upon the volume of services provided to other government departments. The remaining revenues are billed on a full-time-equivalent (FTE) basis when lawyers are primarily dedicated to a specific client. Expenditures, on the other hand, are primarily fixed, with 80% of the Department's operational expenditures linked to salaries. The mix of variable funding to fixed expenditures creates a level of spending risk that must be regularly monitored. The Department of Justice cannot exceed its legal spending authorities. Spending on operations must fall under or at funding received from both fixed A-Base funding and variable NVA revenues.

The financial resources available to the Department are significant. In the current fiscal year (2009-10), the total resources are \$924.6 million, of which \$235.1 million is from NVA funding. A-Base funding includes \$257.4 million in Vote 1 for salaries and O&M, and \$370.6 million in Vote 5 for grants and contributions. The balance of \$61.5 million relates to the Employee Benefits Plan (EBP).

The Resource Management Division (RMD) within the Chief Financial Officer (CFO) Branch is responsible for providing ongoing financial planning, analysis, and management support and advice to the Department. The RMD is headed by a Director and includes the following three sections: Financial Planning and Reporting; Liaison and Coordination Services; and Costing and Charging. The RMD is comprised of approximately 24 employees, including six financial management advisors who are located in Headquarters (HQ) portfolios and sectors and report to the Director, RMD.

1.2 Audit Objectives and Scope

The main objective of this audit was to examine the adequacy of the management control framework for budgetary allocation and forecasting including the processes and mechanisms that support a) planning, including the determination of service demands for sectors and portfolios, and b) budgetary allocations to operational units and the subsequent forecasting of expenditures.

The scope of the audit included Headquarters and the following portfolios: Tax Law; Business and Regulatory Law; Public Safety, Defence and Immigration; and Aboriginal Affairs. Also included were a sample of legal services units and regional offices as well as the Litigation Branch, since the budgets of these offices are significantly impacted by Portfolio allocations.

The audit planning and on-site examination phases were carried out between August and October 2009.

2. OBSERVATIONS – MANAGEMENT FRAMEWORK

2.1 Role and Responsibilities

The role and responsibilities of the Resource Management Division need to be clearly defined and understood.

On July 15, 2009, the Deputy Minister's Team announced the appointment of the Chief Financial Officer (CFO) responsible for leading and managing the CFO Branch, which provides clients with accounting services, financial policy advice and guidance, maintenance and development services for financial systems, guidance and advice on corporate documents (including Memoranda to Cabinet and Treasury Board submissions), and resource management services that include financial support to heads of sectors and portfolios through financial management advisors. The Branch also provides functional guidance to financial personnel located in portfolios, sectors, and regions.

In effect, the appointment of the CFO in the Department means greater stewardship over financial resources coupled with the expectation that the CFO and financial staff will play the role of a strategic business partner, providing value-added analysis and advice to the Department. Furthermore, the CFO is responsible for developing, communicating, and maintaining the departmental financial management framework, and providing leadership and oversight on the proper application and monitoring of the financial management framework across the Department.²

We found that the CFO Branch is proactively establishing its goals, vision, and role within the Department's financial community through bi-weekly teleconferences and tri-annual meetings with business managers, financial management advisors, and regional directors of Finance. The Branch is also improving and developing tools on an ongoing basis to better support financial management, particularly as it relates to the budgetary allocation and forecasting process. These include such initiatives as updating the Financial Situation Report (FSR) Manual, mapping the

² From the CFO Branch site, JUSnet.

budget allocation process, providing guidance and direction on revenue forecasting, and reconciling the Salary Management System (SMS) with expenditures.

The Resource Management Division (RMD) within the CFO Branch is responsible for providing ongoing financial planning, analysis, and management support and advice to the portfolios, sectors, and regional offices (ROs). It is also responsible for coordinating Treasury Board submissions, reviewing Memoranda to Cabinet, and liaising with the Treasury Board Secretariat (TBS). Furthermore, the RMD is responsible for the budgetary allocation and forecasting process. However, we found that its responsibilities in this regard need to be clearly and formally defined and communicated to ensure that its role is understood in the Department.

Also, a clearly defined mandate has not been established for the RMD. A well-defined and clearly communicated mandate would allow for a better understanding of RMD's purpose and role in setting the Department's "tone at the top" for sound financial management and control, financial reporting, and compliance with departmental and Treasury Board requirements.

The need for a clear definition of the RMD's responsibilities is particularly apparent when it comes to the process for devolving budgets in the Department. The RMD initiates the first level of devolution, which involves the devolution of budgets to the portfolios and sectors. This initial part of the process is clear and well understood throughout the Department. It is at the second level of devolution where the RMD's role and responsibilities require clear definition. At this second level of devolution, each portfolio/sector devolves budgets to the regions and within the sector according to its own methodology. We found that the extent to which the RMD can provide functional guidance and direction on this budgetary devolution within portfolios/sectors/regions has not been defined. The RMD also does not have a clearly defined role with respect to performing a challenge function between the portfolio and the regions and within sectors (i.e. operational level).

In consultation with the heads of portfolios/sectors, the RMD needs to establish guidelines and direction for portfolios/sectors to follow when devolving budgets. The CFO Branch is planning to implement a Budget Management Framework (see next section) that will provide written policies and procedures to clarify the roles of those involved in the budgetary allocation and forecasting process and to standardize related practices. The accountabilities that portfolios/sectors have for decisions regarding their budgets will have to be carefully considered. The Director of RMD advised the audit team that gaining acceptance of RMD's role and responsibilities for providing guidance and direction on how portfolios/sectors devolve budgets is the most difficult challenge facing RMD in developing the planned Budget Management Framework. In our view, it will require senior level direction and full consultation with portfolios and sectors if it is to be achieved.

With respect to communication of information concerning the role and responsibilities of the RMD, we found little material on the CFO Branch's Intranet site. Once the role, responsibilities, and authorities of RMD are established, the site should be developed to include this information as well as information on its policies, procedures, and guidelines. RMD management advised the audit team that, based on the priorities identified in the CFO Branch's Strategic Implementation Plan, it is examining the appropriate level of information for its Intranet site.

Recommendation and Management Response

- 1. It is recommended that the CFO, after consulting portfolio/sector/region heads, ensure that the role and responsibilities of the Resource Management Division are clearly defined and understood.**

Agreed. As part of the Budget Management Framework, roles and responsibilities of all stakeholders, including those of the Resource Management Division, will be documented. A draft policy on budget management has been developed and consultations with Directors of Business Management (formerly Business Managers), Regional Directors of Finance, and Financial Management Advisors (DBM/RDF/FMA) are under way. The Departmental Financial Management Committee (Fin.Com), which includes a representation of portfolio/sector/region heads, has agreed to act as the executive steering committee for the Budget Management Framework project and will be engaged periodically for input and recommendation of approval to Senior Management Board (SMB), currently expected for March 2011.

2.2 Budget Management Framework

The development of the Budget Management Framework needs to be closely monitored to ensure that it meets the timelines and goals set out in the Project Charter.

A Budget Management Framework links an organization's vision and its day-to-day management for budgetary allocation and forecasting through written policies, procedures, and documented processes. This essential component of sound financial and budgetary management enables employees to understand their role and responsibilities by setting out an overview of the budgetary allocation process, forecasting, and associated timelines.

In the spring 2009, outside consultants conducted a compliance assessment (gap analysis) of the Department's financial management activities. Their resulting reports identified the need to

develop a Budget Management Framework as a requirement to support the Department's financial information and reporting strategy. The CFO Branch in its Strategic Implementation Plan cited the development of such a framework as one of the key initiatives needed to better meet the requirements of internal and external financial information users.

Consequently, as a first step in the process, the Financial Planning and Reporting Section of the CFO Branch has drafted a Project Charter for the Budget Management Framework. The objective of the Framework is to document the budgetary roles and responsibilities of the Deputy Minister, the Senior Management Board, the Departmental Financial Management Committee (Fin.Com), the Chief Financial Officer, assistant deputy attorney generals (ADAGs) and assistant deputy ministers (ADMs), senior regional directors general, and directors and functional cost centre managers.

The scope of the project includes “documenting budgetary allocation and reallocation timelines/processes; preparation of communications material for the coordination of stakeholder consultations; fulfillment of standardized departmental financial practices in

- budgetary management, allocation, reallocation, and monitoring;
- financial expenditure review processes;
- financial expenditure and revenue forecast.”³

The development of the Budget Management Framework is a significant initiative and completion is planned for September 2010. The desired outcomes of the project include clearly defined financial roles and responsibilities; timely and effective budgetary management; and standardized processes, practices, and financial functions. Individuals responsible for completing various aspects of the project and timelines for completion are identified in the Project Charter. The Senior Management Board is to approve the overarching principles of the project and Fin.Com is to be periodically briefed on the development of the Framework.

The development of a Budget Management Framework is critical to ensuring sound financial and budgetary management in the Department. It is therefore important that this Framework be completed effectively and on time.

³ The Budget Management Framework, Project Charter, October 28, 2009.

Recommendation and Management Response

2. **It is recommended that the CFO closely monitor the development of the Budget Management Framework to ensure it proceeds as planned and meets the objectives outlined in the Project Charter.**

Agreed. In March 2010, the CFO approved the Project Charter and project delivery timelines. In addition, Fin.Com has agreed to act as the executive steering committee and will be consulted periodically for input, approval, and/or recommendation to SMB of policies/directives/procedures. As of February 2010, five draft policies/directives/procedures on initial budget allocation, budget transfer, departmental ARLU update process, pressures review, and the overall policy on budget management, were developed and shared with the DBM/RDF/FMA community for comments. A second round of comments was conducted in June 2010, prior to continuing discussions with the executive steering committee. The Budget Management Framework is scheduled for discussion and approval at Fin.Com and SMB in 2010-11.

2.3 Financial Management Advisors

Roles and responsibilities of financial management advisors need to be defined and the notion of CFO Branch financial support accepted within portfolios and sectors if the CFO model is to be successfully implemented.

The implementation of the Chief Financial Officer (CFO) model in July 2009 brought the Department in compliance with the Treasury Board *Policy on Financial Management Governance*. The purpose of this policy is to strengthen public sector financial management by contributing to the stewardship of public resources, effective decision making, and efficient policy and program delivery. As noted in the Deputy Minister’s announcement of July 15, 2009, the CFO “will lead and manage the Chief Financial Officer Branch, which provides clients with accounting services, financial policy advice and guidance, maintenance and development services for financial systems, guidance and advice on corporate documents (including Memoranda to Cabinet and Treasury Board Submissions) and resource management services that include financial support to Heads of Sectors and Portfolios through Financial Management Advisors. The Branch also provides functional guidance to financial personnel located in Portfolios, Sectors and Regions”.

Since his appointment, the CFO has made presentations to the Senior Management Board that articulate a vision for developing financial capacity within the Department. As part of this vision, the CFO plans to address the compliance assessment reports (gap analysis) of the Department’s

financial management activities by acknowledging gaps in current practices and implementing appropriate risk mitigation strategies, including formalizing the Financial Management Advisory function across the Department. The gap analysis had identified financial management advisors (FMAs) as essential to providing independent financial management, financial oversight, and financial reporting within the portfolios and sectors.

We found that senior management in the Department has not yet fully accepted the notion of CFO Branch financial support within the portfolios and sectors. Some portfolios and sectors still do not have full-time FMAs. These are the Tax Law and the Business and Regulatory Law portfolios as well as the Deputy Minister Team, and the Policy and the Public Law sectors. Originally, in 2007-08, FMAs were funded by the portfolios and sectors as a pilot project. Beginning this fiscal year (2009-10), the FMA positions have been formally incorporated into the CFO Branch through a temporary A-Base adjustment made as part of the Fall Reserve allocation process. Permanent funding for this request will be considered as part of the Spring Reserve allocation process in 2010-11.

In those portfolios and sectors that have FMAs, we found a lack of common understanding of the FMAs' reporting relationships to the RMD and their role and responsibilities within the organization itself. The CFO model conceptualized the FMA function as providing an integral and important role in supporting the Deputy Minister and the Department in meeting their financial accountabilities. While reporting to the CFO Branch, the FMA is to provide financial advice and guidance to the ADAG and portfolio management, play a pivotal challenge role between the portfolio and the regions, participate in portfolio management meetings, and work alongside the Business Manager. The reporting relationships and the roles and responsibilities of FMAs vary and need to be clarified.

In our view, failure to fully adopt FMAs as conceptualized in the CFO model weakens the financial capability of portfolios and sectors, particularly in terms of addressing funding pressures, ensuring compliance with financial requirements, understanding risk, and providing financial advice.

Recommendation and Management Response

3. It is recommended that the CFO:

- a) **after consulting with portfolio/sector heads, ensure that the roles and responsibilities of the Financial Management Advisor function are defined;**

- b) seek the support of the Senior Management Board to ensure the successful implementation of the Financial Management Advisor function in portfolios and sectors.**

Agreed. In July 2009, as part of the Deputy Minister's announcement regarding the creation of the Chief Financial Officer Model, it was noted that a key element of the CFO implementation was formalizing the Financial Management Advisory function across the Department. Sufficient time has now elapsed to carry out an assessment of the FMA function from which the feedback will be used as the basis for improving the level of services received and for sharing of best practices. The CFO met with stakeholders (ADMs, ADAGs, Heads of Sectors, Directors of Business Management, and Financial Management Advisors) in the fall of 2009 with a goal of facilitating a common understanding of the role and responsibilities of the FMA. A report will be drafted of the assessment, discussions, and findings in effort to determine next steps and ensure successful implementation. The CFO will provide an update, including report results, of the FMA implementation to the Senior Management Board to ensure the Department's ongoing commitment to this portion of the CFO model, prior to the end of fiscal year 2010-11. Clarity around roles and responsibilities will also be incorporated as part of the CFO's roles and responsibilities project currently being undertaken by the Branch.

2.4 Revenue Forecasting

While revenue forecasting is improving as cost recovery matures in the Department, to ensure better accuracy there is a need for employees involved in the process to be properly trained.

Regular and accurate revenue forecasting is required to manage the risks associated with calculating the Net Vote Authority budget requirements and allocations, forecasting cash flow requirements, and calculating the Department's forecasted financial position.

In October 2006 a hybrid funding model was approved that established an A-Base and a cost recovery/net voting approach to funding for legal services provided to departments and agencies. The new approach took effect April 1, 2007 and its impact on the Department's sources of funds was significant with more than a third of its operating budget coming in the form of Net Vote Authority. In 2008-09 the Department collected \$200.5 million (including disbursements and excluding EBP), while forecast recoveries (including disbursements and excluding EBP) for 2009-10 were \$235.1 million.

Net Vote Authority allows the Department to recover the cost of providing legal services from client departments, but spending authority cannot be exercised until monies are deposited into the Consolidated Revenue Fund. This increases the importance of having regular and accurate revenue forecasts.

Revenue forecasts are primarily timed to occur after the end of each quarterly billing period and more frequently during the last quarter of the fiscal year. In effect, six different forecasts are required from direct reports⁴ throughout the year—at the end of July and October, mid December, and at the end of January, February, and March. We found that these timelines are being met. The Resource Management Division analyzes the information from a cash flow and spending authority perspective and presents the information to senior management.

The RMD has recently developed draft guidelines to assist direct reports on Net Vote Revenue and Net Vote Revenue Forecasting. The RMD has also developed a standardized template for forecasting revenue. Revenue forecasts require strong data management practices to support the Salary Management System and iCase. For the SMS, this includes realistic planned staffing that requires regular monitoring, discussions with managers and HR on staffing timelines and related SMS adjustments, and proper assignment of employees to cost centres. For iCase, this requires regular, timely entry of hours (timekeeping) by practitioners; regular validation of iCase hours to ensure accuracy and completeness; consistent timely correction of billing issues in iCase should timekeeping be entered incorrectly; and proper identification and treatment of non-recoverable time, including managers' time.

Revenue forecasting is steadily improving as cost recovery matures in the Department. In August 2008, the Department was forecasting annual revenues of \$242.5 million and by February 2009, the estimate was reduced to \$215.4 million. We were told that the RMD found the August forecast to be unrealistic, but that the Division's role as to how far it could challenge these numbers was not clear. At the end of the fiscal year, actual annual revenues were \$222.0 million (excluding disbursements and including EBP), a \$6.6 million increase over the February forecast.

The November forecast is the main forecast used to gauge the accuracy of the financial status of the Department as more meaningful data is available by that time of the fiscal year. In 2008-09, the discrepancy between the November forecast and year-end numbers was only \$2.48 million or 1.1%. The median accuracy for revenues, however, was +/-8.2% (i.e. on average, direct reports were overall within plus or minus 8.2% of their year-end actual revenues). We found that two direct reports were out by as much as 15%. During this same period, the RMD established a new

⁴ Direct reports are those organizations within the Department (e.g. portfolios, sectors) that report directly to the Deputy Minister.

revenue forecasting process and introduced new templates. This may have accounted for some of the discrepancy.

It is expected that during 2009-10 forecasts should be more indicative of accuracy levels as direct reports progress through the learning curve of the new process. Following the second forecasting exercise after October 2009, revenue was projected to be \$257 million (excluding disbursements and including EBP) for 2009-10, an increase of \$35 million over the previous fiscal year.

The wide discrepancy in forecasting revenues by some direct reports, the complexity associated with forecasting revenues accurately, and the importance of having meaningful and accurate data indicate the significance of appropriate training. In our view it would be beneficial for those engaged in the forecasting process to receive training on how best to use SMS and iCase data. This would ensure a standardized approach across the Department and greater reporting accuracy than has been the case to date.

Recommendation and Management Response

4. It is recommended that the CFO ensure that appropriate training is provided to departmental employees involved in the revenue forecasting process.

Agreed. Over the past year and in consultation with the Financial Reporting Working Group (formed from the DBM/RFD/FMA Committee), the RMD has produced a draft document outlining the revenue forecasting process. This document sets out the objectives, methodology, and steps to forecast revenues. Training on this particular process has been deferred, as the process and related documentation will be revised subsequent to the implementation of the Salary Forecasting Tool (SFT) in July 2010. In the interim, the draft procedure has been shared openly with the broad user community. Once updated, the procedure will be made available on the RMD website and communicated by the end of 2010-11 to Directors of Business Management, Regional Directors of Finance, and Financial Management Advisors using different means, including but not limited to one-on-one meetings with functional experts, presentations, and group discussions at national Finance meetings. Training on the revenue forecasting process will also be integrated as part of the Budget Management Framework implementation.

2.5 Expenditure Forecasting

The Department has a formal process in place to produce financial results to support managerial decision making, but not all direct reports are complying with the timelines for submitting the Financial Situation Report.

Senior management requires timely and accurate departmental financial information on expenditures to support management decision making, assure financial management accountability and transparency, and identify lapses and shortfalls so that funding can be re-directed to other priorities.

The RMD has instituted a requirement for managers to conduct reviews of financial management accountability and report on their financial results. This requirement calls for managers to review all commitments and expenditures in the SMS and IFMS, make the necessary adjustments, and communicate and report on financial results through the Financial Situation Report (FSR). This report depicts the available financial resources in terms of budgeted and actual expenditures. The FSR process is required nine times annually at the end of June, August, and every month thereafter to the end of the fiscal year. There are 19 direct reports that are required to complete and submit an FSR to the RMD. The FSR is a consolidated report that starts at the responsibility centre and then is combined at the Portfolio or sector level.

In 2008-09, certifications, which are attestations by ADAGs to the accuracy of the information contained in the FSR, were introduced for the first time to reinforce accountability over forecasting accuracy and timeliness. In terms of timeliness, the 2008-09 Year-end Financial Situation Report indicated that 35% of the FSR certifications were received after the established timeline and 6% of the FSRs were not received at all. This fiscal year (2009-10) the same trend is continuing. Meeting timelines for submitting certified FSRs continues to be a challenge in the Department, despite there being a clear reporting schedule and a Call Letter issued a week in advance of the scheduled preparation of the FSR. Following the June, August, and September 2009 reporting requirements, the RMD reported that, as was the case last fiscal year, 35% of certified FSRs were submitted late, and this fiscal year 3.5% of the FSRs were not submitted at all. Business managers indicated that it is often difficult to obtain the certifications due to Portfolio heads' schedules and travel demands.

In terms of forecasting expenditures accurately, the median accuracy rate for the Department in 2008-09 was +/-3%. This meant that on average the departmental forecast made in November, after assessing the FSRs submitted, was within plus or minus 3% of the year-end actual spending. In total, 48% of the direct reports achieved an accuracy level below +/-2%. Five direct reports achieved an accuracy level below +/-1%. For the whole year, the Department showed

overall a surplus of \$37 million or 4% of available financial resources. The financial situation at the end of 2008-09 was as follows:

March 31, 2009	Budget	Actual	Surplus
Operating Expenditures – Vote 1	\$510.3 m	\$488.5 m	\$21.8 m
Grants and Contributions – Vote 5	\$389.2 m	\$374.4 m	\$14.9 m
Total	\$899.5 m	\$862.8 m	\$36.7 m

RMD records indicate that in 2008-09 94% of the FSR certifications were received. In the case of one Portfolio, the ADAG provided a Certification; however, it was qualified in that the ADAG disclaimed any accountability or responsibility for how funds were spent in the regions.

The failure of some direct reports to provide current and up-to-date financial information on time makes it difficult for senior management to have accurate knowledge of the Department’s financial position, understand spending risks, and effectively seize potential spending opportunities. It also impacts the reallocation of resources and the ability to address departmental priorities and pressures in a timely manner.

Recommendation and Management Response

5. **It is recommended that the CFO bring to the attention of the Senior Management Board the requirement for all direct reports to submit certified FSRs on time in compliance with the established schedule.**

Agreed. The requirement for submission of timely Financial Situation Reports is assessed as part of the performance management appraisals for senior managers. In support of this, the RMD tracks the date of submission and reports on the results as part of the Year-End FSR presentation to Fin.Com and SMB.

2.6 Devolution of Budgets

Guidelines are needed on the devolution of budgets by portfolios to the regions to ensure consistency and standardization.

The essential management function of an operational budget is to ensure control and accountability of the source and use of funds residing at the appropriate responsibility centre. Managers of responsibility centres are trained in the requirements of the *Financial Administration Act* and have signing authority appropriate to their budgets. Once budgets are devolved to the regional responsibility centre, the respective Portfolio is responsible to not only

provide a challenge and critique function through the Financial Situation Report process, but also to reallocate surplus funds identified by responsibility centre managers to other purposes within the Portfolio or return the funds to the Departmental Reserve for reallocation.

Each legal services section within a region is a responsibility centre that has its own operational budget. Regional operational budgets are prepared annually and, when consolidated and approved by the Portfolio, form the basis of the Portfolio Business Plan submission to the Office of Strategic Planning and Performance Management (SPPM). Regional staff indicated that a great deal of time is spent planning operational budgets. Treasury Board has cited the Department as a ‘best practices model’ for its business planning process. Our review found that the 2008-09 forecast budget requirements identified in business plans⁵ was \$481.8 million, which understated the actual year-end spending realized of \$488.5 million by \$6.7 million (i.e. a 98.6% accuracy rate).

The timeliness of the devolution of budgets from the centre (RMD) to portfolios has improved considerably since 2007-08 as evidenced in the following:

Initial Budget Allocation from RMD to Portfolios	A-Base	Net Vote Authority
2007-08	April 4	Oct 10
2008-09	March 26	May 16
2009-10	March 16	March 17

It is noteworthy that the 2009-10 Budget Allocation Report, which included allocation of the A-base, Net Vote Authority, and the Spring Reserve, was approved by SMB on March 12, 2009 and allocated to portfolios by April 1, 2009, considerably earlier than in previous years.

The Corporate Financial Strategy was presented to SMB in March 2009 and was approved. This strategy included the retention of funds within the Departmental Reserve to assist in the management of the departmental budget. The Departmental Reserve, established to meet funding pressures and emerging priorities that occur throughout the year, is funded by the retention of a portion of the allocation at the beginning of the fiscal year. A formal process for calls against this Reserve are assessed and recommended by Fin.Com for SMB approval each Spring and Fall. We found that some portfolios are risk-managing their allocation by not devolving all of their allocated funds to the regions. As a result, the use of reserve funds to manage risk is occurring at two levels: the departmental and the Portfolio.

⁵ The financial requirements of business plans are based on the Budget Allocation Report (BAR) provided by RMD. The BAR is derived from the approved Annual Reference Level Update (ARLU), which presents the Department’s Estimates for the coming year.

During interviews, portfolio business managers, who interact regularly with the regional legal services sections, advised the audit team that portfolios hold back part of the funding allocation based on the specific past spending patterns of the regions. This is done to reserve funds to address emerging needs and in recognition of the fact that regional expenditure projections, especially those impacted by the timing of staffing decisions, are subject to factors beyond their control. Business managers also noted that it is easier to distribute funds toward the end of the year according to need rather than to devolve all funds to the regions and then be required to request that funding be returned if a funding pressure arises or a reallocation between regions is necessary. The FSR for September 2009 showed that, in the case of the Ontario and the British Columbia regional offices, portfolios retained \$5.44 million and \$4.53 respectively of the business plan funding requested by the legal services sections in those regions.

While the timeliness of the devolution of budgets to the regions has improved considerably, the amounts held in reserve by the portfolios continues to be a major concern of the regional responsibility centre managers. Our review disclosed that there are no formal guidelines for portfolios on how budgets should be devolved to the regions. In the absence of guidelines, each portfolio has developed its own distinct allocation approach for devolving budgets.

Recommendation and Management Response

- 6. It is recommended that the CFO, after consulting with Portfolio heads, ensure that guidelines are developed on the devolution of budgets by portfolios to the regions to ensure consistency and standardization in the process.**

Agreed. The Department has made significant progress particularly in the establishment and communication of timelines for budgetary allocations, including those from the portfolios to the regions and to other recipient organizations (i.e. Public Law Sector and Litigation Branch). As part of the Budget Management Framework, a directive on initial budget allocations has been drafted and consultation with portfolio/sector/region representatives is under way. This directive, scheduled to be completed by September 2010, is not meant to restrict portfolio/sector/region heads from making allocation decisions required to support their business needs, but will set the parameters in which they will be required to operate. This directive will seek to increase the consistency and standardization in the process for devolution of budgets by portfolios.

There is no provision in the Financial Situation Report to allow portfolios to identify the amount of funding held in reserve to address minor funding pressures.

As indicated above, portfolios are risk-managing their funding allocation by not devolving all of the budgets to the regions. If portfolios continue to be insistent that they retain a portion of the allocation to meet unexpected pressures, the amount retained should be reflected as a separate item in the FSR. This could be shown as a ‘contingency’ line item.

Recommendation and Management Response

- 7. It is recommended that the CFO ensure that, if portfolios retain funds pertaining to regional operational budgets, the FSR is amended to add a ‘contingency’ line item to show the amount of budget funds portfolios are holding in reserve.**

Agreed. Commencing in 2010-11 with the June 30th FSR, an additional line has been added to portfolio/sector/region Financial Situation Report templates to capture any contingency funds not yet distributed. An explanation and direction on the use of this ‘contingency’ line was also provided.

3. OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

The role and responsibilities of the Resource Management Division need to be clearly defined and understood.

- 1. It is recommended that the CFO, after consulting portfolio/sector/region heads, ensure that the role and responsibilities of the Resource Management Division are clearly defined and understood.....5**

Agreed. As part of the Budget Management Framework, roles and responsibilities of all stakeholders, including those of the Resource Management Division, will be documented. A draft policy on budget management has been developed and consultations with Directors of Business Management (formerly Business Managers), Regional Directors of Finance, and Financial Management Advisors (DBM/RDF/FMA) are under way. The Departmental Financial Management Committee (Fin.Com), which includes a representation of portfolio/sector/region heads, has agreed to act as the executive steering committee for the Budget Management Framework project and will be engaged periodically for input and recommendation of approval to Senior Management Board (SMB), currently expected for March 2011.

The development of the Budget Management Framework needs to be closely monitored to ensure that it meets the timelines and goals set out in the Project Charter.

- 2. It is recommended that the CFO closely monitor the development of the Budget Management Framework to ensure it proceeds as planned and meets the objectives outlined in the Project Charter.....7**

Agreed. In March 2010, the CFO approved the Project Charter and project delivery timelines. In addition, Fin.Com has agreed to act as the executive steering committee and will be consulted periodically for input, approval, and/or recommendation to SMB of

policies/directives/procedures. As of February 2010, five draft policies/directives/procedures on initial budget allocation, budget transfer, departmental ARLU update process, pressures review, and the overall policy on budget management, were developed and shared with the DBM/RDF/FMA community for comments. A second round of comments was conducted in June 2010, prior to continuing discussions with the executive steering committee. The Budget Management Framework is scheduled for discussion and approval at Fin.Com and SMB in 2010-11.

Roles and responsibilities of financial management advisors need to be defined and the notion of CFO Branch financial support accepted within portfolios and sectors if the CFO model is to be successfully implemented.

3. It is recommended that the CFO:8

- a) after consulting with portfolio/sector heads, ensure that the roles and responsibilities of the Financial Management Advisor function are defined;**
- b) seek the support of the Senior Management Board to ensure the successful implementation of the Financial Management Advisor function in portfolios and sectors.**

Agreed. In July 2009, as part of the Deputy Minister's announcement regarding the creation of the Chief Financial Officer Model, it was noted that a key element of the CFO implementation was formalizing the Financial Management Advisory function across the Department. Sufficient time has now elapsed to carry out an assessment of the FMA function from which the feedback will be used as the basis for improving the level of services received and for sharing of best practices. The CFO met with stakeholders (ADMs, ADAGs, Heads of Sectors, Directors of Business Management, and Financial Management Advisors) in the fall of 2009 with a goal of facilitating a common understanding of the role and responsibilities of the FMA. A report will be drafted of the assessment, discussions, and findings in effort to determine next steps and ensure successful implementation. The CFO will provide an update, including report results, of the FMA implementation to the Senior Management Board to ensure the Department's ongoing commitment to this portion of the CFO model, prior to the end of fiscal year 2010-11. Clarity around roles and responsibilities will also be incorporated as part of the CFO's roles and responsibilities project currently being undertaken by the Branch.

While revenue forecasting is improving as cost recovery matures in the Department, to ensure better accuracy there is a need for employees involved in the process to be properly trained.

4. It is recommended that the CFO ensure that appropriate training is provided to departmental employees involved in the revenue forecasting process.....11

Agreed. Over the past year and in consultation with the Financial Reporting Working Group (formed from the DBM/RFD/FMA Committee), the RMD has produced a draft document outlining the revenue forecasting process. This document sets out the objectives, methodology, and steps to forecast revenues. Training on this particular process has been deferred, as the process and related documentation will be revised subsequent to the implementation of the Salary Forecasting Tool (SFT) in July 2010. In the interim, the draft procedure has been shared openly with the broad user community. Once updated, the procedure will be made available on the RMD website and communicated by the end of 2010-11 to Directors of Business Management, Regional Directors of Finance, and Financial Management Advisors using different means, including but not limited to one-on-one meetings with functional experts, presentations, and group discussions at national Finance meetings. Training on the revenue forecasting process will also be integrated as part of the Budget Management Framework implementation.

The Department has a formal process in place to produce financial results to support managerial decision making, but not all direct reports are complying with the timelines for submitting the Financial Situation Report.

5. It is recommended that the CFO bring to the attention of the Senior Management Board the requirement for all direct reports to submit certified FSRs on time in compliance with the established schedule.....13

Agreed. The requirement for submission of timely Financial Situation Reports is assessed as part of the performance management appraisals for senior managers. In support of this, the RMD tracks the date of submission and reports on the results as part of the Year-End FSR presentation to Fin.Com and SMB.

Guidelines are needed on the devolution of budgets by portfolios to the regions to ensure consistency and standardization.

- 6. It is recommended that the CFO, after consulting with Portfolio heads, ensure that guidelines are developed on the devolution of budgets by portfolios to the regions to ensure consistency and standardization in the process.15**

Agreed. The Department has made significant progress particularly in the establishment and communication of timelines for budgetary allocations, including those from the portfolios to the regions and to other recipient organizations (i.e. Public Law Sector and Litigation Branch). As part of the Budget Management Framework, a directive on initial budget allocations has been drafted and consultation with portfolio/sector/region representatives is under way. This directive, scheduled to be completed by September 2010, is not meant to restrict portfolio/sector/region heads from making allocation decisions required to support their business needs, but will set the parameters in which they will be required to operate. This directive will seek to increase the consistency and standardization in the process for devolution of budgets by portfolios.

There is no provision in the Financial Situation Report to allow portfolios to identify the amount of funding held in reserve to address minor funding pressures.

- 7. It is recommended that the CFO ensure that, if portfolios retain funds pertaining to regional operational budgets, the FSR is amended to add a ‘contingency’ line item to show the amount of budget funds portfolios are holding in reserve.16**

Agreed. Commencing in 2010-11 with the June 30th FSR, an additional line has been added to portfolio/sector/region Financial Situation Report templates to capture any contingency funds not yet distributed. An explanation and direction on the use of this ‘contingency’ line was also provided.

APPENDIX A - CONTEXTUAL INFORMATION

Budget Allocation and Forecasting Process Description

The Department of Justice uses two sources of funding to deliver on its mandate: appropriated (A-Base) resources, which are accessed via parliamentary appropriation acts, and Net Vote Authority, which allows the Department to spend revenues collected for the provision of legal services to other government departments.

The Estimates process of the federal government provides the overall framework and timing cycle for the Department's budgetary process. The Department's Main Estimates identify by vote the spending authorities and amounts for the subsequent year, which Parliament will be asked to appropriate as part of an appropriation act. The culmination of the Main Estimates process is the Department's Annual Reference Level Update (ARLU). Treasury Board (TB) finalizes the ARLU exercise by approving the reference levels. Year one of the ARLU submission forms the basis of the Main Estimates submitted to Parliament.

The Supplementary Estimates process of the federal government provides for expenses that are not included in the Main Estimates and allows for adjustments occasioned by such things as the federal government budget, transfers to and from other government departments, adjustments related to the Department's allocation to specific government-wide initiatives, new TB project approvals. Three calls to the Supplementary Estimates occur each year: 'Supplementary A' (February), 'Supplementary B' (June), and 'Supplementary C' (October).

The Department is allowed to carry forward up to a maximum of 5% of its Operating (Vote 1) Main Estimates into the next fiscal year. These resources are the primary source of funds for the Departmental Reserve and are used to fund key departmental investments (i.e. IM/IT, Accommodations) and in-year pressures. To mitigate funding lapses in excess of this 5%, the Department has a Fall and Winter (as required) Reserve process for reallocating funds. This allows managers the flexibility to effectively use all their resources for evolving financial pressures while respecting their pledge to account and report on expenditures in a timely and accurate manner.

The TB *Policy on Management, Resources and Results Structure* reflects the two perceptual lenses used to view the Department's budget. The first looks at allocations related to strategic outcomes where all funds are designated against the Department Performance Activity Architecture and is the perspective for the Annual Confirmation of Reference Levels. The second perspective relates allocations to the Department's organizational structure and ties allocations to specific programs that the Department undertakes.

The Department's ARLU is centrally managed by the Resource Management Division and is based upon the results of recent Treasury Board submissions and Government decisions on reductions. This information forms the basis for the notional departmental Budget Allocation Report (BAR), which identifies the Direct Report level distribution of these same resources, prior to departmental allocation/reallocation decisions. The notional BAR is used to inform Part Two of the direct reports' business plans and is the basis upon which direct reports develop their expenditure plans for the next fiscal year.

The Department has established a formal process for calls against funds held in the Reserve that are made in the Spring and Fall (Winter as required) of the year. Reserve requests from direct reports for funds are submitted to the Department's Financial Management Committee (Fin.Com). As the total of the funding requests typically exceed the Reserve funds available, Fin.Com prepares and recommends a prioritized list of the submissions for SMB approval.

Based on the information captured in the business plans and Spring Reserve requests, the CFO Branch annually develops a departmental Financial Strategy to inform discussions with Fin.Com and SMB. This Financial Strategy is a consolidation of the A-Base allocation, Net Vote Authority allocation, and Spring Reserve allocation processes and is approved prior to the beginning of the fiscal year. This allows the Department to allocate approximately 99% of departmental resources to program areas prior to the beginning of the fiscal year. Approximately 1% is retained to deal with funding pressures and emerging priorities, which must be dealt with internally during the year, and to mitigate the risks regarding the management of the NVA regime.

The Department has a two-tiered approach to allocating resources to direct reports. First, A-Base, Net Vote Authority, and Spring Reserve allocations to the portfolios and sectors are made prior to the beginning of the fiscal year by the Resource Management Division within the CFO Branch in accordance with the Financial Strategy approved by the SMB. Subsequently, portfolios allocate resources to regions, Litigation Branch, and Public Law Sector based on their respective business process.

The Department's financial management position is assessed through the certified financial situation reports (FSR) received from the direct reports, which are prepared in June, August, and each month thereafter. Each FSR shows the operating budgets of the direct reports, with the actual expenditures to date as well as commitments and forecasted expenditures for the remainder of the fiscal year.

APPENDIX B – AUDIT METHODOLOGY

The criteria for the audit were based on the *Guidance on Assessing Control* issued by the Criteria of Control Board (CoCo) of the Canadian Institute of Chartered Accountants, the TBS *Management Accountability Framework* (MAF), and other TBS guidance on auditing management frameworks.

In conducting this audit the audit team:

- prepared a detailed audit program with criteria;
- interviewed the following stakeholder groups:
 - CFO, including staff of the Chief Financial Officer Branch;
 - Portfolio and Sector management (ADAG, Deputy ADAG, business managers, and FMAs);
 - regional directors and directors of Finance.
- reviewed the following:
 - business plans, previous audits, MOUs, CFO Branch reports, and written procedures;
 - policies and procedures of Treasury Board and CFO Branch;
 - Estimates, Spring and Fall Reserve, and business planning documents as well as the Minister's Budget Briefing Notes;
 - internal reporting procedures aimed at providing Justice Canada management and clients with timely and accurate information on budgetary allocation and forecasting;
 - budget-related minutes of Fin.Com and SMB committees and selected TB submissions requesting additions to the departmental budget.

The audit was undertaken in a manner consistent with the TB *Policy on Internal Audit* and related guidelines and procedures, and with generally accepted auditing standards.