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DEPARTMENT OF JUSTICE CANADA

AUDIT OF COMPLIANCE WITH FINANCIAL POLICY IN DEPARTMENTAL LEGAL SERVICES UNITS

Audit Report
September 2014

Internal Audit Services

Department of Justice Canada | Ministère de la Justice Canada

Canada

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1. Executive Summary

The Department of Justice Canada (the Department) provides an integrated suite of high-quality legal advisory, litigation, and legislative services to the Minister of Justice and to all federal departments and agencies to support them in meeting the Government of Canada's policy and programming priorities and to advance the overall objectives of the Government. One way services are provided is through a network of Departmental Legal Services Units (DLSUs) and legislative Departmental Regulations Sections (DRSs) co-located with client departments and agencies, principally within the National Capital Region but also throughout the regions.

The DLSUs and DRSs employ 883 Full-Time Equivalents combined which represents 20% of the Department's workforce. The total annual expenses represent approximately 22% of the overall Departmental budget, excluding grants and contributions. In fiscal year 2013-2014, this amount consisted of $111.9 million for salaries and $1.9 million for operating and maintenance (O&M) expenses.

The Heads of most DLSUs or DRSs manage a budget from the Department and a budget from the client department. Memorandums of Understanding between the Department and client departments are in place to define accountabilities and the cost recovery rates for legal services. O&M expenses that are excluded from the cost recovery rates, such as direct O&M, are typically paid from the budget of the client department. Expenses that are included in the rates, such as training, are often initially paid by the client department and subsequently recovered from the Department in the form of an interdepartmental settlement (IS).

The audit assessed the extent to which the DLSUs and DRSs complied with financial management policy instruments of the Government of Canada and the Department.

The scope included a review of financial governance as well as a review of sample financial transactions from 2013-14. The sample of financial transactions covered at least one DLSU from each portfolio and two legislative departmental regulations sections. This included IS transactions which were primarily training expenses recovered by client departments from Justice Canada. In addition, samples of acquisition card, travel, conferences, events and training transactions were also analyzed. Contracting, as well as IS transactions involving the recovery of legal services costs by Justice Canada from client departments, were excluded from this audit.

Based on the audit findings, our opinion is that, overall DLSUs and DRSs are in compliance with financial management policy instruments of the Government of Canada and the Department. However, there are improvements that should be made with respect to the processing of IS transactions to ensure compliance with the *Financial Administration Act* and Government of Canada financial management policy instruments. The improvements that should be made are as follows:

- Develop and communicate a policy instrument to standardize how IS transactions should be processed; and,
- Include IS transactions in the Annual Account Verification Plan.

Management Response

Management is in agreement with the audit findings, has accepted the recommendations included in this report, and has developed a management action plan to address them. The management action plan has been integrated in this report.

Original signed by:

Linda Saunders
Chief Audit Executive
Department of Justice Canada

Date

2. Background

The authority for this audit is derived from the 2013-2014 to 2015-2016 Risk-based Audit Plan, which was recommended by the Departmental Audit Committee and approved by the Deputy Minister in July 2013.

The Department of Justice Canada (the Department) provides an integrated suite of high-quality legal advisory, litigation, and legislative services to the Minister of Justice and to all federal departments and agencies to support them in meeting the Government of Canada's policy and programming priorities and to advance the overall objectives of the Government. One way services are provided is through a network of Departmental Legal Services Units (DLSUs) and legislative Departmental Regulations Sections (DRSs) co-located with client departments and agencies, principally within the National Capital Region but also throughout the regions. DLSUs are organized into five portfolios: Aboriginal Affairs Portfolio (AAP); Public Safety, Defence and Immigration (PSDI); Tax Law Services (TLS); Central Agencies Portfolio (CAP); and the Business and Regulatory Law Portfolio (BRLP). The DRSs report to the Legislative Services Branch (LSB).

The DRSs and DLSUs have a combined full-time equivalent (FTE) count of approximately 883 employees which represents 20% of the Department's workforce. In addition to the Department employees, there are the support staff within the DLSUs who are employees of the client department. These support staff provide administrative services related to financial management within DLSUs. The annual expenses of both the DLSUs and the DRSs represent approximately 22% of the overall departmental budget, excluding grants and contributions. In fiscal year 2013-2014, this amount consisted of $111.9 million for salaries and $1.9 million for operating and maintenance (O&M) expenses.

The Heads of most DLSUs and DRSs manage a budget from the Department as well as a budget from the client department. Memorandums of Understanding (MOUs) between the Department and client departments are in place to define accountabilities and the cost recovery rates for legal services. O&M expenses that are excluded from the cost recovery rates, such as direct O&M (e.g., office supplies), are typically paid from the budget of the client department. Expenses that are included in the rates, such as training, are often paid by the client department and subsequently recovered from the Department in the form of an interdepartmental settlement (IS).

3. Audit Objective

The objective of this audit was to assess the extent to which DLSUs and DRSs comply with financial management policy instruments of the Government of Canada and the Department.

4. Audit Scope

The scope of this audit included the review of the financial governance in place for DLSUs and DRSs as well as a review of sample of financial transactions from 2013-2014. Based on an assessment of financial risk for each audit criteria, Appendix B outlines that at least one DLSU from each portfolio and two DRSs from the LSB were included in the scope. A sample of financial transactions from these DLSUs and DRSs that impacted the Departmental budget were selected and reviewed. The types of transactions included in an IS were primarily training expenses recovered by client departments from Justice Canada. In addition, samples of acquisition card, travel, conference, event and training transactions were also analyzed. Contracting transactions as well as IS transactions involving the recovery of legal services costs by Justice Canada from client departments were excluded from this audit as they have been identified as separate projects in the 2014-15 to 2016-17 Risk-based Audit Plan.

Appendix B provides details.

5. Audit Approach

The audit team carried out its mandate in accordance with Treasury Board's *Policy on Internal Audit* and the *Internal Audit Standards for the Government of Canada*. The audit employed various techniques including a risk assessment of the audit entity, interviews, file reviews, as well as reviews and analysis of documentation and information.

6. Findings, Recommendations and Management Action Plan

This section provides the observations and recommendations resulting from the audit work carried out. While the audit was conducted based on the lines of enquiry and audit criteria identified in the planning phase, this report is structured along the following main themes:

- *Governance;*
- *Transaction Compliance;*
- *Financial Oversight; and,*
- *Budget Management.*

For conclusions by audit criterion, please refer to Appendix A.

Based on the audit work performed and our professional judgment, the risk associated with each observation was rated using a three-point scale. The risk ranking (high, moderate, and low) is based on the level of potential risk exposure we feel may have an impact on the achievement of the Department's objectives, and is indicative of the priority Management should give to the recommendations associated with that observation. The following criteria were used in determining the risk exposure level:

High	Controls are not in place or are inadequate.
	Compliance with legislation and regulations is inadequate.
	Important issues are identified that could negatively impact the achievement of program/operational objectives.
Moderate	Controls are in place but are not being sufficiently complied with.
	Compliance with central agency/departmental policies and established procedures is inadequate.
	Issues are identified that could negatively impact the efficiency and effectiveness of operations.
Low	Controls are in place but the level of compliance varies.
	Compliance with central agency/departmental policies and established procedures varies.
	Issues identified are less significant but opportunities that could enhance operations exist.

6.1. Governance

The establishment of effective governance relies on clearly defined roles and responsibilities. Sections 5.4.9 and 5.4.13 of the Treasury Board Secretariat (TBS) *Policy on Financial Management Governance* require the establishment of clear roles and responsibilities and provision of functional guidance on financial management matters in support of appropriate stewardship of public resources and effective decision-making.

Finding 1 :	Roles and Responsibilities
Linkage to :	Governance ☒ Risk Management ☐ Control ☐

Low

MOUs are in place with all client departments included in the sample and they clearly define financial management responsibilities and accountabilities for both the client departments and the Department.

Roles and responsibilities related to the financial management of DLSUs operations are defined in MOUs. These MOUs establish governance, rates and performance regimes that guide the relationship between client departments and the Department with respect to the demand for and provision of legal services. The MOUs formally define the scope of the work, roles and responsibilities of the Department and the client department, deliverables and expected results. A review and comparison of a sample of MOUs as well as interviews confirmed that roles and responsibilities are clearly defined and consistent in all of the reviewed agreements. DLSU Heads and staff's understanding of their financial management responsibilities was consistent with the responsibilities described in the MOUs.

6.2. Transaction Compliance

The *Financial Administration Act* (*FAA*) legislates the implementation of financial controls such as those described in Section 32 and 34 of the Act to strengthen financial expenditure controls in government. It was expected that interdepartmental settlements, travel, training, conference and acquisition card transactions were in compliance with the *FAA* and applicable policy requirements including the TBS *Directive on Account Verification* and *Directive on Expenditure Initiation and Commitment Control*.

Finding 2 :	Compliance – Interdepartmental Settlement Transactions
Linkage to :	Governance ☐ Risk Management ☒ Control ☒

Moderate

A number of IS transactions reviewed were not in compliance with applicable legislation and policy requirements. The most common non-compliance issues relate to expenditure initiation authority and *FAA* Section 34 certification.

We reviewed a sample of IS transactions from the BRLP, CAP, PSDI, and TLS portfolios and identified the following compliance issues.

<u>Section 32 & Expenditure Initiation</u>

The most critical step of the expenditure pre-approval process is comprised of two elements under the federal spending authority: expenditure initiation authority and fund commitment authority. Both elements must be performed prior to making a purchasing decision:

- Expenditure initiation authority is the authority to incur an expenditure or make an obligation to obtain goods or services that will result in the eventual expenditure of funds. This includes the decision to hire staff, to order supplies or services, to authorize travel, relocation or hospitality or to enter into some other arrangement for program purposes.

- Fund Commitment Authority (Section 32 of the *FAA*) is the authority to carry out one or more specific functions related to the control of financial commitments as required in the TBS *Directive on Expenditure Initiation and Commitment Control*. Another element of this authority is to ensure that there is a sufficient unencumbered balance available before entering into a contract or other arrangement.

The results of the file testing demonstrated that all IS transaction commitments were in place, in line with Section 32 requirements of the *FAA*. However, there was no evidence of expenditure initiation authority by a delegated individual of the Department in 50 of the 100 transactions reviewed.

Moderate

<u>Section 34</u>

Section 34 of the *FAA* requires delegated individuals to confirm and certify that work has been performed, goods supplied, or services rendered; the payee information is accurate and complete; contract or agreement terms and conditions have been met; financial coding is complete and accurate; supporting documentation is complete; and all relevant statutes, regulations, orders in council, policies and directives and other legal obligations have been complied with. The results of our file testing demonstrated that 19 of the 100 transactions did not contain a properly certified Section 34. The most frequent types of Section 34 certification errors related to not having a Section 34 certification on file or incorrect financial coding on the certification. The financial coding issues were primarily found in transactions where the travel expenses related to training were coded to a training general ledger account, instead of the travel general ledger account.

Initially the sample of IS transactions was requested through Finance and Planning Branch (FPB). A review of the files provided revealed that there was insufficient documentation to support expenditure initiation and Section 34 in the majority of the transactions. As a result, the portfolios to whom the DLSUs report were asked by FPB to provide additional documentation related to these files. IAS also provided all portfolios with a detailed itemization of outstanding items for each IS transaction sampled to allow for any available supplementary documentation to be submitted and considered for the audit. Through this review it became evident that rarely were all of the documents related to one transaction held in the same location. Various parts of the transactions were in some or all of the following locations: the Department's FPB, the portfolio ADM/ADAG's office, the DLSU or the client department's finance branch. In particular, the file review found that in 37 of the 100 transactions, there was insufficient supporting documentation (e.g., invoices) available on the IS transaction file to fully demonstrate that the work had been performed, goods supplied, or the services rendered, in accordance with Section 34.

The audit found that one of the main reasons for the non-compliance is a lack of clarity regarding processing of IS transactions. Specifically, the Department does not have procedures concerning documentation requirements and proper evidence of approval for IS transactions. The lack of procedures contributed to inconsistent processing of IS transactions by DLSU staff. Furthermore, a lack of oversight by FPB has prevented the identification of non-compliance issues with respect to IS transactions.

Errors related to non-compliance with expenditure initiation, certification of Section 34 and coding errors result in non-compliance with the *FAA*, and central agency and departmental policies, directives and guidelines. When expenditure initiation authority and Section 34 certification are not applied there is an increased risk of paying for goods or services that the Department should not be paying for or that were not received.

Recommendation 1	**Management Action Plan**
The Deputy Chief Financial Officer should develop and communicate a policy instrument to standardize the way interdepartmental settlement transactions are processed, addressing requirements such as expenditure initiation, Sections 32 and 34 of the *Financial Administration Act* and supporting documentation.	Following the implementation of the risk-based verification and post-payment quality assurance program in December 2014, we will be in a position to determine the extent and types of procedures needed to fully meet the requirements of Expenditure Initiation and of Sections 32 and 34 of the *Financial Administration Act* for IS transactions. The policy instrument will be developed and communicated by the fall of 2015 after several quarters of data from the program

	have been examined. In the interim, the Expenditure Initiation and Sections 32 and 34 communiqué outlined in the management response to Recommendation 2 will be sent by October 31, 2014.
Office of Primary Interest :	Finance and Planning Branch
Due Date :	October 31, 2015

Finding 3 :	**Compliance – Other Transactions**
Linkage to :	Governance ☐ Risk Management ☐ Control ☒

Low

Overall, travel, conference, training, and acquisition card transactions complied with applicable legislation and policy instruments; however, opportunities for improvement exist with respect to the application of expenditure initiation for acquisition card and training transactions.

A review of travel, conference, training and acquisition card transactions from the AAP, BRLP, CAP, PSDI and TLS portfolios as well as the LSB revealed that travel and conference transactions generally complied with applicable legislative and policy requirements. That being said, legislative and policy requirements related to Expenditure Initiation and Section 34 certification were partially met for training and acquisition card transactions.

Section 32 & Expenditure Initiation

The review of training and acquisition card transactions provided evidence that the application of expenditure initiation could be improved. All of the training and acquisition card transactions were committed in the Integrated Financial and Materiel System in advance of the payment being made, in line with Section 32 of the *FAA*. However, in a significant number of training transactions, 4 of 19 (21%), and half of the acquisition card transactions, 7 of 14 (50%), expenditure initiation authority was not exercised in accordance with the TBS *Directive on Expenditure Initiation and Commitment Control*.

Interviews indicated the acquisition card transactions that did not have proper expenditure initiation authority are due to a lack of understanding of Departmental and Treasury Board Policy Instruments. For example, a blanket approval authority, using the Department form (JUS804), can be established in addition to establishing soft commitments using the Department form (JUS795e). The blanket authority is a form of expenditure initiation, as it provides an authorization by the delegated manager to continuously purchase specific commodities within an authorized price range.

The application of expenditure initiation and commitment authority is critical to ensure that total expenses for an activity do not exceed the approved budget and that the proper expenditure initiation authority has been applied in advance of program activity and related expenditures.

With respect to expenditure initiation exceptions related to training transactions, while there was evidence of approval, the approval was made after the fact or it was not dated.

Section 34 Certification

The review of training transactions indicated that in a few instances, 3 of 19 (16%), Section 34 of the *FAA* was not properly certified or there was no evidence of certification.

Certification of Section 34 is required to adequately certify that the work was performed or that the goods were supplied or services rendered in accordance with terms and conditions of an agreement or contract. The submission of invoices for payment without adequate supporting documentation could lead to payments for ineligible expenses, time delays or additional effort in determining the correctness of the payment.

Recommendation 2	Management Action Plan
The Deputy Chief Financial Officer should re-communicate the requirements of expenditure initiation authority for both training and acquisition cards, to the delegated managers including the use of blanket pre-approvals and soft commitments for acquisition cards.	A communiqué regarding the requirements for Expenditure Initiation and Sections 32 and 34 for all types of transactions will be sent by October 31, 2014.
Office of Primary Interest :	Finance and Planning Branch
Due Date :	October 31, 2014

6.3. Financial Oversight

Financial oversight helps to strengthen public sector financial management and its leadership, thereby contributing to appropriate stewardship of public resources, effective decision-making, and efficient policy and program delivery. The TBS *Directive on Account Verification* (2009) requires that low and medium risk transactions be sampled for review and that all high risk transactions be reviewed.

Section 6.3.1.3 of the revised TBS *Directive on Account Verification* (2014) requires risk-based monitoring and statistical sampling of interdepartmental settlements that are used by the Department to reimburse or pay a client department.

Finding 4 :	**Financial Oversight (Compliance with Section 33 of the *FAA*)**
Linkage to :	Governance ☒ Risk Management ☒ Control ☒

Moderate

There is insufficient oversight of DLSUs expenditures from the FPB, with respect to interdepartmental settlements. Specifically, Section 33 verification of the *FAA* is not being performed on IS to ensure payments are made in accordance with the applicable legislation and policies.

The FPB is expected to implement oversight mechanisms to ensure DLSUs expenditures are in compliance with Section 33 of the *FAA* and the TBS *Directive on Account Verification*. The previous version of the *Directive* (2009) did not clearly identify the account verification requirements for IS transactions, and they were specifically excluded from the Department's Annual Account Verification Plan. The revised version of the *Directive on Account Verification* (2014) contains specific requirements for Section 33 of the *FAA* related to ISs.

By excluding interdepartmental settlement transactions from the Annual Account Verification Plan, the Department lacks transactional procedures and oversight to ensure that ISs have been correctly certified pursuant to Sections 32 and 34 of the *FAA*. This lack of oversight has resulted in immaterial inconsistencies amongst the client departments with respect to the recovery of expenditures from the Department, such as books, rental of space, office supplies and office equipment. Furthermore, FPB may not be able to identify and correct errors related to IS transactions such as coding errors, and/or non-delegated individuals exercising financial authority. This lack of detection and identification of errors may place the Department at risk of not complying with the TBS *Directive on Account Verification* and the *FAA*.

Recommendation 3	Management Action Plan
The Deputy Chief Financial Officer should ensure effective oversight mechanisms are in place by revising the Annual Account	The Annual Account Verification Plan has been revised to include interdepartmental settlement transactions as low risk

Verification Plan to include interdepartmental settlement transactions in the appropriate risk category.	transactions. Implementation of the Annual Account Verification Plan for risk-based verification and post-payment quality assurance of transactions is planned for December 2014.
Office of Primary Interest :	Finance and Planning Branch
Due Date :	N/A (Completed)

6.4. Budget Management

Expenditure monitoring against established budgets and financial forecasting are key processes that further support the stewardship of public funds in delivery of the organization's mandate. Section 6.2.4 of the Department's *Directive on Forecasting and Variance Analysis* requires Direct Reports to the Deputy Minister to provide the Chief Financial Officer with complete, accurate and timely financial and non-financial forecast information.

Finding 5 :	**Budget Management Practices**
Linkage to :	Governance ☒ Risk Management ☒ Control ☒

Low

Overall, budget management practices are in place to provide timely and accurate financial information for decision-making.

Forecasting and variance analysis information on expenditures is presented in the Financial Situation Report (FSR) to ensure the Department operates within its financial authorities. The FSR process is repeated nine times per fiscal year: June, August and every month thereafter.

A review of period 6 (September 2013), period 9 (December 2013) and period 12 (March 2014) FSRs for the portfolios identified in Appendix B determined that all FSRs were certified by the appropriate Direct Report. All portfolios did submit their required FSRs on time with the exception of two portfolios that were late in supplying their information for one FSR period.

In 2013-14, the Departmental variance target was set to 4% for period 6 in September (period 6 to period 12), and 2% for period 9 in December (period 9 to period 12). All portfolios, except one, achieved the target of 2% at period 9 for the salary and O&M combined.

7. Audit Opinion

Based on the audit findings, our opinion is that, overall DLSUs and DRSs are in compliance with financial management policy instruments of the Government of Canada and the Department. However, there are improvements that should be made with respect to IS transactions to ensure compliance with applicable financial management policy instruments. The improvements that should be made are as follows:

- Develop and communicate a policy instrument to standardize how IS transactions should be processed; and
- Include IS transactions in the Annual Account Verification Plan.

8. Statement of Conformance

In my professional judgment as Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the opinion provided and contained in this report. The extent of the examination was planned to provide a reasonable level of assurance with respect to the audit criteria. The opinion is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria that were agreed on with Management. The opinion is applicable only to the entity examined and within the scope described herein. The evidence was gathered in compliance with the Treasury Board Policy and Directive on Internal Audit. The audit conforms to the *Internal Auditing Standards for the Government of Canada,* as supported by the results of the Quality Assurance and Improvement Program. The procedures used meet the professional standards of the Institute of Internal Auditors. The evidence gathered is sufficient to provide Senior Management with proof of the opinion derived from the internal audit.

Appendix A – Audit Criteria

Based on a combination of the evidence gathered through documentation examination, analysis, transaction testing and interviews, each of the audit criteria listed below was assessed and a conclusion for the audit criteria was determined using the following definitions:

Conclusion on Audit Criteria		Definition of Opinion
1	Criteria Met – Well Controlled	Well managed or no material weaknesses noted, controls are effective.
2	Criteria Met with Exceptions – Controlled	Requires minor improvements.
3	Criteria Met with Exceptions – Moderate Issues	Requires improvements in the areas of material financial adjustments, some risk exposure.
4	Criteria Not Met – High Impact – Significant Improvements	Requires significant improvements in the area of material financial adjustments, serious risk exposure.

The following are the audit criteria and examples of key evidence and/or observations noted which were analyzed and against which conclusions were drawn. In cases where significant improvements and/or moderate issues were observed, these were reported in the audit report.

Audit Criteria	Conclusion on Audit Criteria	Examples of Key Evidence/ Observations
Line of Enquiry 1 – Financial Management Governance		
Criterion 1.1: Effective oversight mechanisms are in place that foster prudent stewardship of public resources in the delivery of the mandate of the organization.	2	Finding 1, 4
Line of Enquiry 2 – Compliance with Government of Canada and Departmental Financial Management Policy Instruments		
Criterion 2.1: Financial transactions are managed in compliance with applicable legislation and policy instruments.	3	Finding 2, 3
Criterion 2.2: Budget management practices provide timely and accurate financial information.	1	Finding 5

Appendix B – DLSU Samples by Financial Area

Portfolio	DLSU	(IS)	Acquisition Card (non-IS)	Travel, Conferences & Events (non-IS)	Training (non-IS)
AAP	Aboriginal Affairs - HQ		√	√	√
AAP	Aboriginal Affairs - BC		√	√	√
BRLP	Industry Canada	√			
BRLP	Foreign Affairs	√		√	
BRLP	Public Works and Government Services Canada	√			
BRLP	Transport Canada	√			
BRLP	Fisheries and Oceans	√			
BRLP	Health Canada	√			√
BRLP	Employment and Social Development Canada	√			
CAP	Treasury Board Secretariat	√	√	√	√
CAP	Finance	√	√	√	√
PSDI	Canada Border Services Agency	√		√	
PSDI	Canada Security Intelligence Service	√		√	
PSDI	Royal Canadian Mounted Police	√			
PSDI	Department of National Defence	√			
TLS	Canada Revenue Agency	√		√	
LSB	Transport (Departmental Regulation Section)			√	√
LSB	Health (Departmental Regulation Section)		√	√	√