
MINISTRY OF ECONOMIC DEVELOPMENT AND TRADE

Financial Control Review

Although the Ministry of Economic Development, Trade and Tourism is now divided into the Ministry of Economic Development and Trade and the Ministry of Tourism, our review was completed prior to that division and, accordingly, reflects the timing of our work.

The overall goals of the Ministry are to help the private sector create jobs and to promote economic growth in Ontario. The Ministry's key objectives are to expand the province's economy, increase foreign and domestic investment, maintain the province's share of the world tourism market, and increase Ontario's share of the global export market.

Over the past four years, the Ministry has experienced a number of major structural changes including the amalgamation with, and separation from, the Ministry of Tourism and the devolution or wind-up of a number of agencies. There have also been significant changes in program delivery and substantial budget and staff downsizing. In addition, the Ministry became the provider of administrative services for the Ministry of Intergovernmental Affairs, and a number of financial functions will be transferred to a new central agency, the Shared Services Bureau.

The Ministry's expenditures for the 1998/99 fiscal year totalled \$161 million. These expenditures consisted of \$40 million for staff salaries and benefits, \$76 million for other direct operating expenditures such as supplies, services and equipment, and \$45 million for transfer payments and other disbursements.

REVIEW OBJECTIVES AND SCOPE

The objectives of our review were to assess the adequacy of the Ministry's financial controls, systems and procedures to ensure that expenditures were properly authorized, processed and recorded.

The criteria used to assess the financial controls were discussed with and agreed to by senior ministry management. These criteria provided a framework for our review of the Ministry's controls, systems and procedures.

Our review was performed in accordance with the standards for assurance engagements, including value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

The scope of our review, which was substantially completed in May 1999, included an examination and analysis of financial documentation and discussions with ministry staff. We also reviewed plans and reports issued by the Ministry's Audit Services Branch and, where relevant, we relied on the work ministry audit staff had performed.

OVERALL REVIEW CONCLUSIONS

The Ministry had attempted to deal with the impact of the many structural changes on financial controls and had taken steps to act on many of the issues noted. However, we found that overall financial controls were not sufficient to ensure that expenditures were properly authorized, processed and recorded, and further effort was required to address the observed weaknesses in financial controls, systems and procedures. Specifically, we noted:

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- Controls over the \$15 million spent through the Ministry's accountable advance account during the 1998/99 fiscal year were weak. As at January 31, 1999, \$475,000 worth of cheques and electronic fund transfers had been paid out but not recorded in the Ministry's financial system. In total we noted that 800 manual cheques and electronic fund transfers, totalling over \$2 million, were processed during the 1998/99 fiscal year without being promptly recorded in the financial system. In some cases, the delays between making payments and recording them in the system were six months or more. Consequently, errors and irregularities could occur and go undetected for extended periods of time.
- Controls over the cheque-signing machine were weak because one individual operated the machine and had access to the signature plate and blank cheques. This was contrary to the Ministry's policy of dual controls, which was designed to prevent any one individual from being in a position to perpetrate and conceal errors or irregularities in the normal course of their duties.
- As of March 1999, the most recent accountable advance bank reconciliation that had been completed, reviewed and approved by management was for the month of March 1998. Timely reconciliations of the bank balance to the financial accounting system and Ministry of Finance records are needed to help ensure that errors and irregularities do not go undetected.
- Controls over the authorization, processing and recording of the payroll were generally adequate although the Ministry needed to implement procedures to ensure that all changes to the payroll were accurate and complete.
- Procurement controls needed to be strengthened to ensure that purchases of goods and services are properly authorized, processed and competitively acquired in accordance with ministry policies.
- Of the 28 Finance Branch employees, 21 had the authority to enter transaction information into the financial system and approve payments. Thus, the Ministry lacked an appropriate segregation of duties as any one of these employees could independently enter transaction information and approve the processing of payments.

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- At the time of our review, \$22 million of expenditure differences between the Ministry's financial system and the Ministry of Finance's records relating to May 1998 had not been investigated and resolved.

Many of the concerns noted above had previously been brought to the attention of ministry management through the work of the Audit Services Branch. However, management had not fully addressed these concerns. Timely action by the Ministry is necessary to correct these financial control weaknesses.

DETAILED REVIEW OBSERVATIONS

ACCOUNTABLE ADVANCE ACCOUNT

The majority of the Ministry's expenditures are paid through government corporate systems operated by Management Board Secretariat (payroll) and the Ministry of Finance (other expenditures). These payments are made as instructed by the Ministry, which retains responsibility for them. The Ministry of Finance advances funds to the Ministry that are deposited under its name in a bank account called the accountable advance account.

The accountable advance account is used to pay for expenditures that the Ministry decides cannot be processed through the usual systems, generally because of a need for expediency. The account is intended to be used for rush payments, salary advances for new employees, employee travel expenses and petty cash fund reimbursements.

For the 1998/99 fiscal year, approximately \$15 million of payments were processed through the accountable advance account. These payments included both payroll and other expenditures. As of March 31, 1999, the Ministry had an accountable advance from the Ministry of Finance of \$1.5 million.

PAYMENT PROCESSING

Payments are made from the accountable advance account by manual or automated cheques and by electronic fund transfers. Automated cheques are printed at the Ministry's head office using data provided by the financial system. Manual cheques are prepared at head office and two other locations. At the two non-head office locations, ministry policy limits the amount for each manual cheque to \$5,000. This control limits the risks associated with errors and omissions. However, there was no maximum dollar limit for manual cheques written at head office, and there was no special approval process for large cheques, some of which exceeded \$75,000. Additionally, one of the other offices frequently exceeded its \$5,000 limit.

Another basic accounting control to help prevent errors and irregularities from occurring and going undetected is to record transactions in the financial accounting system at the time payments are made. However, we noted that a substantial number of manual cheques at all three ministry offices as well as electronic fund transfers from head office were processed well before being recorded in the system. The delays between making payments and recording them on the system were often two months, and in some cases delays were six months or more. We noted that, in total, 800 manual cheques and electronic fund transfers, totalling over \$2 million,

had been processed during the 1998/99 fiscal year well before being recorded in the financial system.

Processing payments without first recording them in the financial system increases the risk that irregularities or errors could occur and go undetected. Also, paying invoices without recording them on the financial system eliminates other controls. For example, the system has an automated edit control designed to prevent a particular supplier's invoice from being paid twice. In our expenditure sampling work, we observed that, because of a clerical error, a \$16,000 batch of invoices had been paid twice, once by manual cheques and a second time by automated cheques. Although the Ministry detected this error and recovered the double payment, such errors can be prevented by promptly recording manual payments in the financial system.

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We reviewed the Ministry's bank statement as at January 31, 1999, and observed \$475,000 worth of cheques and electronic fund transfers had been paid out but not recorded in the financial system. Ministry deposits were also often not recorded in the financial system until days or even weeks after the deposits had been made.

Recommendation

To help reduce the risk that errors or irregularities could occur and go undetected, the Ministry should:

- **establish, where necessary, and enforce maximum dollar amounts for manual cheques;**
- **record all manual cheques and electronic fund transfers in the financial system at the time the transactions are processed; and**
- **record deposits on a timely basis.**

Ministry Response

The Ministry will establish a maximum dollar limit of \$100,000 for head office manual cheques and will retain the \$5,000 maximum dollar limit for manual cheques for the two tourism attractions, Huronia Historical Parks and Old Fort William. The Ministry will also implement procedures to ensure compliance with the policies limiting dollar amounts for manual cheques.

The Ministry agrees that the manual cheques, electronic fund transfers and bank deposits were not recorded in as timely a manner as desired. This was due to heavy workload and changes in staff. Significant efforts were made to deal with this issue by year-end. The Ministry will be advising head office and tourism attractions financial staff of the importance of prompt recording of transactions, requesting that they follow established procedures, and monitoring their performance.

CHEQUE SIGNING CONTROLS

Ministry policy requires two signatures on all cheques to ensure that no one individual is in a position to perpetrate and conceal errors or irregularities in the normal course of their duties. All head office cheques are processed using a cheque-signing machine that automatically imprints two signatures on the cheques. The two signatures are reproduced by a signature plate that can be removed from the machine. The machine is designed to maintain the dual authority by requiring two individuals to unlock it before it can be used to process cheques.

We found that during business hours both keys for the cheque-signing machine were in the possession of one individual. We also found that during business hours the keys to the cheque-signing machine and some blank cheques were kept in unlocked locations. The removable signature plate was kept in the machine at all times. In 1990, the Ministry's Audit Services Branch reported this lack of segregation of duties and the associated risk of errors or irregularities. The Ministry responded that, due to compensating controls, it did not consider it necessary to implement the suggested dual controls over the cheque-signing machine.

Recommendation

To ensure that no one individual is in a position to perpetrate and conceal errors or irregularities in the normal course of their duties, the Ministry should ensure that:

- **the keys to the cheque-signing machine are in the possession of two different individuals;**
- **the machine is dual locked when not in use; and**
- **the signature plate, both keys and all blank cheques are kept in secure locations.**

Ministry Response

The Ministry will review existing controls over the cheque signing functions and implement procedures, including those recommended, to ensure that there is a proper segregation of duties in place.

ADVANCE ACCOUNT AGREEMENTS AND RECONCILIATIONS

Ministry of Finance policy requires a written agreement outlining the roles and responsibilities of the Ministry regarding the accountable advance account. The purpose of the agreement is to establish specific responsibilities for recording, control, reimbursement and repayment of accountable advances. Such agreements help provide the Ministry of Finance with assurance that funds advanced are properly managed and periodically reconciled. In 1993, the Ministry of Finance drafted such an agreement but the agreement was not finalized. Consequently, no requirements were in place stipulating the permissible uses for the accountable advance account or periodic reporting of account reconciliations to the Ministry of Finance.

The Ministry processed over \$15 million in payments through its accountable advance account during the 1998/99 fiscal year, which, as a percentage of total expenditures, is far

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higher than that of any other ministry. The Ministry used the account for regular payments that should have been paid through the Ministry of Finance's system.

An essential control over the accountable advance account is the preparation of monthly accountable advance account bank reconciliations. This process compares the transactions recorded on the bank statement to the payment information in the financial accounting system and reconciles the bank balance to the amount of the accountable advance. This control ensures that errors and irregularities will not go undetected. However, reconciliations were not being completed and reviewed by ministry management on a timely basis. As of March 1999, the most recent bank reconciliation that had been completed and approved by management was for the month of March 1998.

The Ministry's Audit Services Branch reported in 1997 that bank reconciliations were not being prepared and reviewed on a timely basis. Action was taken to correct this critical internal control weakness but, at the time of our review, the Ministry had not resolved the reconciliation backlog.

Recommendation

To ensure that the accountable advance account is properly managed and controlled, the Ministry should:

- **conclude a written agreement with the Ministry of Finance stipulating the permissible uses for the account and periodic reporting requirements; and**
- **ensure that monthly bank reconciliations are completed and reviewed on a timely basis.**

Ministry Response

The Ministry will follow up with the Ministry of Finance to ensure that advance account agreements are signed for each of the three ministries that receive financial services from the Finance Branch—the Ministry of Economic Development and Trade, the Ministry of Intergovernmental Affairs and the new Ministry of Tourism. The ministries were under the impression that appropriate agreements had been signed because a copy of one agreement was on file with the Ministry of Finance.

The Ministry agrees that bank reconciliations should be completed and reviewed on a timely basis. Draft bank reconciliations were completed in a timely manner. However, due to staff changes, finalization of the draft bank reconciliations had fallen behind during the summer and early fall of 1998. Finance Branch management recognized this was a problem and, in the late fall of 1998, assigned additional staff resources to finalize the reconciliations. By year-end, the reconciliations were completed and variances resolved.

For the 1999/2000 fiscal year, the Ministry will be redesigning the overall reconciliation function as part of a branch organizational review to ensure that this does not happen again.

PAYROLL EXPENDITURES

The Ministry employs about 450 full-time staff and a number of seasonal and part-time employees. Staff salaries and benefits for the year ended March 31, 1999 were \$40 million. Management Board Secretariat is responsible for the government's centralized corporate payroll system but the Ministry performs general payroll functions including the compilation and input of payroll information and the verification of payments. The Ministry is ultimately responsible for ensuring that the payroll is processed correctly.

We reviewed the procedures for the authorization, processing and recording of payroll and found that controls were generally adequate although we noted the following weaknesses that needed to be addressed:

- To ensure that all changes to the payroll are accurate and complete, the Ministry's Audit Services Branch recommended, in January 1996, that input documents be compared to output reports and that such comparisons be done by someone other than the person who input payroll change information. However, the Ministry had not implemented this control. Consequently, errors could occur and not be corrected on a timely basis.

For example, we found that an employee left the Ministry to work for another ministry in October 1998 but continued to be paid a total of \$18,000 until January 1999. The employee was not double-paid because payments from the new employer did not begin until payments from the Ministry of Economic Development, Trade and Tourism ceased. However, no journal entry had been made to recover these funds from the other ministry.

- In order to ensure that the biweekly payroll is reasonable, the Ministry should compare the pay list to the expected pay prior to approving the payroll for processing. This control is designed to identify unreasonable payments. For example, we noted that in March 1999 an employee was paid for 152 hours of work during a two-week period when that employee had worked 94 hours. The employee was overpaid \$2,000 for that two-week period. In June 1999, the Ministry initiated action to recover this overpayment.
- To help ensure the accuracy of salaries and employee benefits, ministry policy requires prompt reconciliation of the payroll and benefits with the amounts recorded in Ministry of Finance records. In January 1996, the Ministry's Audit Services Branch expressed concern that important pay and benefits accounts were not being reconciled to Ministry of Finance records on a timely basis. At the time of our audit, we noted that the reconciliation of pay and benefits information was still not being performed on a timely basis. For example, as of January 1999, a report for the month of May 1998 showed unreconciled pay and benefit differences of over \$1 million.

Recommendation

To ensure that the payroll is accurate, the Ministry should:

- **check input documents to output reports and ensure that this check is done by someone other than the person who enters payroll change information;**

- compare the pay-list to the expected pay and follow up on any significant differences prior to approving the payroll for processing; and
- promptly investigate and resolve any discrepancies between the pay and benefits accounts and Ministry of Finance records.

Ministry Response

The Ministry, together with the Shared Services Bureau, will review the current responsibilities and procedures for payroll reconciliation to strengthen this function and take appropriate action.

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OTHER EXPENDITURES

PROCUREMENT PRACTICES

For the 1998/99 fiscal year, Ministry expenditures were \$121 million for direct operating expenditures such as supplies, services and equipment, and for transfer payments and other disbursements.

The Ministry has established policies designed to ensure that payments are made correctly and that purchases of goods and services are properly approved and acquired at competitive prices. The program areas typically prepare requisitions for proposed purchases and forward them to the Finance Branch for approval. Depending on the cost and the type of acquisition, a competitive selection process and a formal contract may be required. Subsequent to purchasing goods and services, the program areas verify that the purchases have been received and that the invoices have been calculated correctly. The invoice is then forwarded to the Finance Branch for payment.

We reviewed a sample of ministry purchases and found that adequate controls were not in place to ensure that purchases of goods and services were properly authorized, processed and competitively acquired, in accordance with ministry policies. For over 60% of the purchases we reviewed, we noted weaknesses in the procurement process. For example:

- The Ministry paid an agency over \$5 million to place advertisements with television stations. The Ministry had not completely checked the agency's billing to ensure that all advertising paid for had actually been obtained. We also noted that certain eligible discounts had not been taken.
- Our review indicated that certain ineligible costs had not been questioned by the Ministry prior to paying an agency \$400,000 to perform media relations work. We also noted that the Ministry processed these payments without having on hand information that was needed to ascertain whether the cost calculations were correct.
- An advertising agency billed the Ministry for work amounting to \$475,000 even though the required contracts had not been entered into and purchase order approval had not been received from the Finance Branch.
- Without going through the required competitive selection process, the Ministry paid \$70,000 to a vendor to subcontract editorial services.

Recommendation

To ensure that payments are processed accurately and that the risks of errors and irregularities are minimized, the Ministry should:

- **thoroughly check the accuracy of invoices, verify that goods and services have been received and obtain all discounts; and**
- **require that all payments be supported by evidence of compliance with the Ministry's mandatory competitive acquisition and approval policies.**

Ministry Response

The Ministry agrees with the recommendation and will:

- ***review our procurement policies and procedures;***
- ***review the feasibility of taking discounts in view of the government's 30-day payment policy and possible savings;***
- ***ensure all ministry staff receive an update of these policies and procedures;***
- ***provide training to ministry staff on procurement;***
- ***monitor procurement practices across the Ministry to ensure compliance with ministry policies and procedures; and***
- ***in cases of non-compliance, follow up with management.***

COMPUTER PROCESSING CONTROLS

The Ministry's financial system records all budget and expenditure information and is used to inform the Ministry of Finance regarding the payment of invoices. Ministry policy requires all transaction information to be entered into its financial system and held in suspense until subsequently approved for payment by a separate entry into the system. The computer processing controls associated with the financial system are designed to prevent anyone from independently initiating and approving transactions. The processing controls are intended to provide an adequate segregation of duties and, to maintain accountability, include a record of the individuals who approved payments. The purchasing function also is to be segregated from payment processing.

Of the 28 employees in the Finance Branch, 21 had the authority both to enter transaction information into the financial system and to approve payments. Therefore, the Branch lacked an appropriate segregation of duties since any one of these employees could independently enter transaction information and trigger the payment of invoices. Also, the system did not record the identities of staff who approved transactions for payment.

The Ministry requires purchases over \$200 to be made using purchase orders to provide evidence of approval for the goods ordered and details that can be matched to the goods received. The financial system can match invoices to purchase orders but this edit check can be bypassed at the option of the individual who enters the invoice information. Also, four employees could both approve purchase orders and enter invoice information into the system.

Thus, the Ministry lacked segregation of duties between the purchasing and payments functions.

Recommendation

In order to provide adequate computer processing controls over the payment of expenditures, the Ministry should:

- **limit the number of staff who have the authority to enter transaction information and approve payments, and ensure that no one individual has the authority to do both;**
- **keep a systems log of the individuals who approve each transaction;**
- **require management approval to process invoices that cannot be matched to purchase orders; and**
- **ensure an adequate segregation of duties between the purchasing and payment processing functions.**

Ministry Response

The Ministry agrees that there should be adequate computer processing controls over the payment of expenditures. The Ministry will review the feasibility of modifying the financial system as recommended and, where costs are prohibitive, compensating measures will be implemented to ensure that adequate controls are in place.

RECONCILIATIONS WITH MINISTRY OF FINANCE RECORDS

Monthly reconciliations between the Ministry's financial system and Ministry of Finance records serve to ensure that all transactions recorded in the Ministry's system are accurate and complete, and also help to identify any errors and omissions on a timely basis.

The Ministry had not completed monthly reconciliations of its financial system to Ministry of Finance records since March 31, 1998. In January 1999, we reviewed partial reconciliations for subsequent months and noted that significant discrepancies still needed to be investigated and resolved. For example, for the month of May 1998, there were still \$22 million of expenditure differences between the Ministry's system and Ministry of Finance records that needed to be followed up and resolved.

The Ministry's Audit Services Branch had informed ministry management of the lack of timely reconciliations in February 1997. The Ministry indicated to us that action had been taken to bring the reconciliations up to date and that, by June 1999, it expected to complete the reconciliations for the months of April 1998 to March 1999. However, in order to function effectively, reconciliations need to be performed on a timely basis rather than once a year

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Recommendation

To ensure that all transactions recorded in the Ministry's financial system are accurate and complete, the Ministry should:

- perform monthly reconciliations of its financial system to Ministry of Finance records; and
- follow up on and resolve any differences on a timely basis.

Ministry Response

The Ministry agrees that reconciliations should be completed promptly and variances resolved in a timely manner.

Due to staff changes, the reconciliation function had fallen behind during the summer and early fall of 1998. Branch management recognized this was a problem, and in late fall, assigned additional staff resources to bring the reconciliations up to date. By February 1999, reconciliations were completed up to September 1998, and variances were being resolved. By year-end, the reconciliations were completed up to March 1999, and variances resolved prior to the close of books for the 1998/99 fiscal year.

For the 1999/2000 fiscal year, the Ministry will be redesigning the reconciliation function as part of the branch organizational review to ensure that this does not happen again.

GENERAL FINANCIAL CONTROLS

STAFFING

The Ministry's Finance Branch has a complement of 28 employees. The Branch is responsible for a number of financial control functions including processing payments, managing the accountable advances account, approving purchase orders, preparing monthly financial statements and budgeting.

As of May 1999, nine of the 28 branch employees were in temporary or acting positions, including jobs responsible for key financial controls such as the preparation of reconciliations. Further, due to the staffing situation, a number of staff were working significant amounts of overtime. Also, in September 1997, the Ministry's Audit Services Branch expressed concerns about the lack of staff continuity in the Finance Branch.

Recommendation

In order to ensure that key financial control activities are performed on a timely basis by well trained and knowledgeable staff, the Ministry should review the staffing of the Finance Branch.

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Ministry Response

As noted previously, the Ministry has undergone significant downsizing and major organizational restructuring over the past four years which has resulted in constant changes and workload pressures for the Branch. In addition, there has been a lack of continuity in several key functions in the Branch due to staff changes. It needs to be recognized that, within these operating constraints, the Branch staff have worked extremely hard to provide ongoing financial services and maintain adequate financial controls and procedures.

At the same time, the Ministry is committed to strengthening the capabilities of the Branch and has taken steps to address these issues. On an interim basis, management has brought in additional staff to support key functions such as reconciliation and purchasing. To address these issues over the longer term, the Ministry has initiated a review of the Branch to ensure timely financial services to its clients and appropriate financial controls. The review will address organizational design, staffing needs, training and re-engineering/streamlining.