Assessment of the Design Effectiveness of Entity Level Controls

Office of the Chief Audit Executive

February 2017

Table of Contents

Executive Summary

The objective of this engagement was to conduct an assessment of Entity Level Controls at the Department of Canadian Heritage (PCH or "the Department") in support of the Treasury Board *Policy on Internal Control* and provide an assessment of their design effectiveness.

The assessment included interviews, document review and analyses to evaluate the five components of Entity Level Controls. The five components, along with summarized findings for each component, are as follows:

1. Control Environment: PCH demonstrates their commitment to integrity through a number of activities, such as the dedicated Office of Values and Ethics, which monitors and reports on values and ethics. Oversight mechanisms are in place and are aligned with central agency requirements. In addition, as part of their internal control environment, PCH relies on third-party service providers; typically other government departments. PCH does not currently receive documentation or reporting from these providers regarding their respective internal controls assessments. As a result, PCH may not be aware of the service provider's internal control-related gaps or deficiencies that could impact the Department.

2. Risk Assessment: PCH has a Departmental Risk Profile as well as processes in place to allow for efficient and effective responses to external and internal changes. PCH would benefit from the development and implementation of a fraud risk awareness strategy, including the performance of a fraud risk assessment, to ensure that fraud risks are identified and mitigated.

3. Control Activities: PCH has developed a policy framework to support its internal control program including appropriate testing of its information technology controls. PCH's Internal Control over Financial Reporting Framework would be more comprehensive by including a description of its risk assessment methodology and all roles and responsibilities.

4. Information and Communications: PCH effectively communicates results of internal control assessments and internal audits to internal and external stakeholders. PCH would benefit from the development and implementation of an information management and information technology strategy, as well as a data warehousing strategy.

5. Monitoring Activities: PCH has developed mechanisms to report internal control deficiencies to business process owners, the Departmental Audit Committee and senior management. The Department states having informally followed up on recommendations related to internal control assessments in the past and implementation of a formal process to document results is reportedly underway.

Assessment Opinion and Conclusion

Based on the assessment findings, the Chief Audit Executive's opinion is that Entity Level Controls at Canadian Heritage are generally well designed to support the Treasury Board *Policy on Internal Control*. Opportunities for improvement exist in the following categories:

- Clarification of the roles in fraud management;
- Updating the Internal Control Framework; and
- Developing and implementing an information management and information technology strategy.

Statement of Conformance

In my professional judgment as Chief Audit Executive, this assessment was conducted in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* and with the Internal Auditing Standards for the Government of Canada, as supported by the results of the quality assurance and improvement program. Sufficient and appropriate assessment procedures were conducted, and evidence gathered, to support the accuracy of the findings and conclusion in this report. The findings and conclusion are based on a comparison of the conditions, as they existed at the time, against pre-established assessment criteria that were agreed with management and are only applicable to the entity examined and for the scope and time period covered by the assessment.

Original signed by

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With the assistance of external resources

1.0   Background

The Treasury Board *Policy on Internal Control,* effective April 1st, 2009, requires departments to develop and maintain an effective system of Internal Control over Financial Reporting to support the stewardship of public resources.

Effective systems of Internal Control over Financial Reporting aim to achieve reliable departmental financial statements and reporting while providing assurance that:

- Financial transactions are appropriately authorized;
- Financial records are properly maintained;
- Assets are safeguarded from risks such as waste, loss and mismanagement;
- Applicable policies, directives and guidelines are followed;
- Access to information systems and the data is safeguarded; and;
- The Department as a whole has a framework in place to ensure authorities are respected.

Entity Level Controls are defined as the controls that operate throughout the entire Department (both at the departmental and cost center/management unit level). This includes the "tone at the top," the organization's culture, values and ethics, governance and accountability. These controls also consider risk assessment and management, controls to monitor the results of operations, the internal audit function, the Departmental Audit Committee, and self-assessment programs. Accordingly, Entity Level Controls affect all areas of an organization's internal control framework: from the control environment to the monitoring of controls, financial management and financial reporting controls.

As of April 1st, 2017, a new *Policy on Financial Management* will replace the current *Policy on Internal Control*. The new policy will focus on internal control over financial management in addition to financial reporting. The assessment of Entity Level Controls is in line with the new policy as it focuses on internal controls over financial management as well as financial reporting.

2.0   About the Assessment

2.1   Project Authority

This assessment was requested by the Financial Management Branch and was carried out in accordance with the mid-year update of the 2016-17 to 2018-19 *Risk-Based Audit Plan* for Canadian Heritage.

2.2   Objective and Scope

The objective of this engagement was to conduct an assessment of Entity Level Controls at the Department of Canadian Heritage (PCH or "the Department") in support of the Treasury Board *Policy on Internal Control* and provide an assessment of their design effectiveness.

The scope of the assessment covered all departmental Entity Level Controls during the period of April 1st, 2015 to October 31, 2016 and was based on the *Committee of Sponsoring Organizations of the Treadway Commission framework*, known as the COSO framework.

2.3   Approach and Methodology

The assessment focused on the design effectiveness of Entity Level Controls and did not include file testing. This was achieved through the documentation of key controls followed by the evaluation of their design effectiveness. For the purpose of testing the design of controls identified, a sample of one transaction was selected to support the understanding of the control.

The key activities performed as part of this methodology included, but are not limited to:

- Review of documentation including: guidelines and procedures, previous assessments, policy and legislation relevant to the Entity Level Control business process;
- Conduct of interviews with the organization's personnel to examine processes, procedures and practices; and
- Map, in a matrix format, the key controls identified during the assessment to the Office of the Comptroller General core management controls and the *Committee of Sponsoring Organizations of the Treadway Commission Internal Control Integrated Framework*.

3.0   Findings and Recommendations

Findings are based on the evidence gathered through the interviews conducted, analyses performed and documentation reviewed for each assessment criteria. **Appendix A** provides a summary of all findings and conclusions for each of the assessment criteria. Findings of lesser materiality, risk or impact have been communicated with the auditee either verbally or in management letters.

3.1   Control Environment

The control environment was designed effectively.

The objective of the control environment is to establish and promote a collective attitude toward achieving effective Internal Control over Financial Reporting and generating reliable financial statements. The guiding principles of the control environment include:

- Demonstrating commitment to integrity and ethical values;
- Exercising oversight responsibility;
- Establishing structure, authority and responsibility;
- Demonstrating commitment to competence; and
- Enforcing accountability.

Values and Ethics

The Department of Canadian Heritage (PCH or "the Department") has demonstrated dedication to values and ethics. PCH has established the Office of Values and Ethics, which monitors on adherence to the PCH Values and Ethics Code and produces an annual report. Further, the Office has tools which foster an environment where employees can provide their opinions. For example, on a quarterly basis an employee satisfaction is measured via a survey.

The PCH Office of Values and Ethics is one of four federal government organizations which follow the guiding principles of the International Ombudsman Association. Adherence to these principles further promotes the independent, impartial and confidential nature of the Office.

Independent Oversight Responsibility - Departmental Audit Committee

Independent oversight responsibility is exercised by the Departmental Audit Committee, comprised of three external members. The Department follows the Treasury Board *Directive on Internal Auditing in the Government of Canada*, including requirements related to membership and roles and responsibilities of the Departmental Audit Committee. PCH maintains a Departmental Audit Committee Charter which specifies that the members provide objective advice and recommendations to the Deputy Minister. This includes challenge and advice regarding the sufficiency and quality of the assurance provided on the adequacy and functioning of the PCH's risk management, internal controls and governance frameworks and processes.

Work Descriptions and Organizational Charts

PCH uses generic work descriptions for non-executive positions, as standardized job descriptions are encouraged wherever possible by the Treasury Board. These descriptions include internal control-related responsibilities, financial management responsibilities and reporting relationships. As part of PCH's commitment to competency, employee training plan and performance evaluation are completed annually, and approved by supervisors. PCH has an up-to-date organizational chart which delineates responsibilities and lines of reporting within the Department. To support the departmental structure, authority and responsibility, each branch and sector within the Department maintains its own organization chart.

Accountability of Third Party Service Providers

Part of PCH's control environment includes relying on third party service providers who perform internal controls that directly affect PCH's financial information. These third party service providers, most being other government departments, are accountable for assessing their own systems of internal controls and reporting the results to their partner organizations, including PCH. However, these reports are not available despite reported PCH efforts to obtain relevant information. Reviewing the results of these assessments would provide assistance to the Department when developing its internal control risk-based plan and determining if they are able to rely on third party service providers or develop a strategy to mitigate gaps and deficiencies identified.

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3.2   Risk Assessment

> The risk assessment function was designed effectively and there is an opportunity to clarify the roles in fraud management.

The objective of the entity's risk assessment process is to establish and maintain an effective process to identify, analyze, and manage risks relevant to the preparation of reliable financial statements. The guiding principles of risk assessment include:

- Specifying relevant objectives;
- Identifying and analyzing risk;
- Identifying and analyzing significant change; and
- Assessing fraud risk.

Defining Objectives

PCH prepares and publishes a Corporate Risk Profile every three years. Within the Profile, PCH specifies its objectives (internal and external), which enables the identification and assessment of risks relating to these objectives.

Identifying and Assessing Risk and Change

The Corporate Risk Profile is developed by gathering input from each sector and branch, who prepare their own respective risk assessments. Environmental scans are also performed to evaluate internal and external changes and their impact on objectives and risks. The Strategic Policy, Planning and Research Branch performs an analysis of the risks and scans to determine which risks are key to the Department before presenting the results to senior management and key departmental committees.

To support risk assessment, PCH has external performance indicators, as established in the 2016 Treasury Board *Policy on Results.* These indicators intend to improve the achievement of results across government and enhance the understanding of the intended results as well as the resources used to achieve them. PCH is currently developing a process to ensure it complies with the service standards and other key performance indicators set out in the new policy.

Fraud Risk

A fraud risk assessment is key to allow the Department to consider the potential for fraud in the achievement of organizational objectives. The Department should consider various types of fraud, as well as assess incentive and pressures, opportunities, attitudes and rationalizations that may lead to fraudulent activities. The last fraud risk assessment was completed in 2012-2013. There is no evidence that fraud awareness is communicated throughout the Department. In addition, there is no documented protocol function to report fraudulent activities in case they occur.

Without a formal assessment of fraud risk, including analyses and mitigation planning, there may be increased risk of fraudulent activities occurring. Further, the lack of a protocol function for reporting fraud and lack of fraud awareness training means that employees do not have the necessary tools to identify and report potential fraudulent activities.

Recommendation:

1. *The Chief Financial Officer, in collaboration with relevant senior officials, should clarify the role for fraud management within Canadian Heritage, including the conduct of regular fraud risk assessments and the promotion of fraud awareness within the Department.*

3.3   Control Activities

Control activities were designed effectively, however the framework for Internal Control over Financial Reporting was missing key responsibilities and a risk assessment methodology.

The objective of the control activities is to serve as mechanisms for managing the achievement of an entity's objectives. The guiding principles of the control activities component include:

- Selecting and developing control activities, including general controls over technology; and
- Deploying controls through policies and procedures.

Selection and Development of Control Activities

To ensure the appropriateness of internal controls management, PCH has developed an Internal Control over Financial Reporting Framework (2015) and an annual risk-based internal control plan. The framework includes the process to identify, document and test key controls. PCH has incorporated testing of general controls over technology as part of its framework. It includes mapping key business processes to system applications, data input, data processing and calculations, output reports, and system interfaces. In addition, the framework provides a mechanism to report deficiencies to business process owners, the Departmental Audit Committee and senior management.

Policies and Procedures

The Department has implemented tools to support the Internal Control over Financial Reporting framework, which include an *Account Verification and Sampling Policy*, a *Directive on the Management of Moveable Assets*, and a *Supplementary Travel Policy – Executive and Excluded Groups*. In addition, PCH also follows and implements Treasury Board Policies including the *Policy on Internal Control* and will be implementing the new *Policy on Financial Management* in 2017.

The 2015 Internal Control over Financial Reporting framework contains the basic requirements and could be improved by adding a description of the roles and responsibilities of the financial policies and internal controls group and business process owners. In addition, the framework could benefit by including a description of the risk assessment methodology for internal controls, which will become increasingly important as the new *Policy on Financial Management* places greater emphasis on a risk-based system of internal control.

Without a risk assessment methodology and a complete description of roles and responsibilities, there is a risk that monitoring of internal controls may not be efficient and may not provide the desired or expected results.

Recommendation:

2. *The Chief Financial Officer should update the framework for Internal Control over Financial Reporting to include the risk assessment methodology and complete roles and responsibilities. This includes putting in place a follow-up strategy to ensure that recommendations are implemented in accordance with planned actions and timelines.*

3.4 Information and Communications

> Processes and controls related to information and communications were designed effectively with the exception of the implementation of an information technology and information management strategy, including a department-wide data warehousing strategy.

The objective of the information and communication system is to ensure that information relevant to the preparation of reliable financial statements and the maintenance of internal controls and records is identified, captured, and communicated to the appropriate individuals on a timely basis. The guiding principles of the information and communications component include:

- Communicating internally and externally
- Using relevant information

Internal and External Communications

PCH effectively communicates results of internal control and internal audit assessments to internal stakeholders. Results of internal control assessments are reported through the Departmental Performance Report as well as in the Financial Statements and the Annex to the Statement of Management Responsibility. Results of internal audits are reported and published on PCH's Web site. The Departmental Audit Committee is well informed of the results of the work performed by the Internal Audit function and are provided information on a timely basis.

Relevant Information

To support decision-making and the functioning of internal control, relevant information is generated from the financial system. PCH is currently in the process of implementing a document management system, GCDocs, which will strengthen the credibility and reliance of information used to support financial management and decision-making.

Information Management and Technology Strategy

An integrated information technology and information management strategy is key to align technology acquisitions and data management/warehousing with PCH's organizational strategies, objectives, and risks. PCH is in the early stages of developing a strategy aligned with the broader digital transformation of the organization, however it is incomplete and not implemented. In addition, information is stored on several databases within the Department, but there is no data warehousing strategy. PCH has performed data warehousing feasibility assessments for specific projects, however there is no overall Departmental strategy or assessment.

Without a department-wide strategy for information management and information technology, including data warehousing, the Department does not have an assessment of the information management and information technology "as-is" state, which will better help identify and define future needs. As a result, there is a risk that information technology investments are not aligned with strategies, objectives, and risks. Furthermore, there is a risk that investment decisions are not fully supported by detailed analyses and thoroughly researched options.

Recommendation:

3. *The Chief Information and Transformation Officer should develop an Information Management and Information Technology Strategy that encompasses the digital transformation of the Department. This includes extending the current data warehousing strategies in place to the Department as a whole.*

3.5 Monitoring Activities

> Monitoring activities were designed effectively at PCH, however, the process to follow-up on recommendations stemming from internal control assessments is not in place.

The objective of monitoring is to detect and remediate control deficiencies throughout the entire system of Internal Control over Financial Reporting. The guiding principles of the monitoring activities component include:

- Conducting ongoing and/or separate evaluations; and
- Evaluating and communicating deficiencies.

Evaluations and Communication

As part of their monitoring approach, results of both PCH internal control and internal audit assessments are communicated to stakeholders on a timely basis, who are responsible for taking corrective action. Letters of recommendations are provided to business process owners who have the responsibility to develop management action plans for each recommendation. Results of internal control assessments and internal audits are shared with senior management in Executive Committee meetings and at Departmental Audit Committee meetings. Executive and Audit Committee members act as a challenge function and provide comments on recommendations and resulting action plans.

Internal audit recommendations are followed-up twice a year by the Office of the Chief Audit Executive to ensure they are resolved in accordance with planned actions and timelines. The results are presented to the Departmental Audit Committee.

The Financial Policies and Internal Controls division has created a recommendation follow-up template and has reportedly followed-up informally on recommendations. Without documented results, this limits the Department's ability to monitor the implementation of recommendations in a timely manner and in accordance with the business process owners' management action plan. This observation is addressed via Recommendation # 2 in Section 3.3 of this report, in conjunction with the framework for Internal Control over Financial Reporting.

4.0 Conclusion

The objective was to provide an assessment of the effectiveness of the design of the Department's entity level controls for management. Based on the assessment findings, the Chief Audit Executive's opinion is that Entity Level Controls at Canadian Heritage, comprising of all five components of the *Committee of Sponsoring Organizations of the Treadway Commission* Framework, are generally effectively designed and implemented to support the Treasury Board *Policy on Internal Control* and the upcoming *Policy on Financial Management*. Opportunities exist to clarify the role in fraud management, update the Internal Controls Framework and implement an Information Management and Information Technology Strategy.

Appendix A – Assessment Scale and Results Summary

The conclusions reached for each of the criteria used in the assessment were developed according to the following definitions.

CONCLUSION	DEFINITION
Well Controlled	Well managed, no material weaknesses noted; and effective.
Controlled	Well managed and effective. Minor improvements are needed.
Moderate Issues	Requires management focus (at least one of the following criteria are met): ▪ Control weaknesses, but exposure is limited because likelihood of risk occurring is not high. ▪ Control weaknesses, but exposure is limited because impact of the risk is not high.
Significant Improvements Required	Requires immediate management focus: At least one of the following three criteria are met: ▪ Financial adjustments material to line item or area or to the Department. ▪ Control deficiencies represent serious exposure. ▪ Major deficiencies in overall control structure.

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The table below includes the elements of the *Committee of Sponsoring Organizations of the Treadway Commission* (COSO) framework that were assessed for design effectiveness. The summary results reports on the number of control activities, for each element, which were rated as having "passed."

COSO FRAMEWORK		SUMMARY RESULTS	REPORTING STRATEGY
Control environment			
1	Demonstrates commitment to integrity and ethical values	8/8	
2	Exercises oversight responsibility	6/6	
3	Establishes structure, authority and responsibility	5/5	Report observation and management letter
4	Demonstrates commitment to competence	5/5	Management letter
5	Enforces accountability	5/5	
Risk Assessment			
6	Specifies relevant objectives	9/10	Report observation and recommendation 2 - ICFR
7	Identifies and analyzes risk	2/2	
8	Assesses fraud risk	0/2	Recommendation 1 - Fraud
9	Identifies and analyzes significant change	3/3	
Control Activities			
10	Selects and develops control activities	5/6	Report observation, management letter and recommendation 2 - ICFR
11	Selects and develops general controls over technology	3/4	Recommendation 3 - IT
12	Deploys through policies and procedures	4/4	
Information and Communications			
13	Uses relevant information	3/4	Report observation and recommendation 3 - IT
14	Communicates internally	6/6	
15	Communicates externally	2/2	
Monitoring Activities			
16	Conducts ongoing and/or separate evaluations	4/4	
17	Evaluates and communicates deficiencies	4/4	Recommendation 2 - ICFR

Appendix B – Management Action Plan

Recommendations	Management Assessment and Actions	Responsibility	Target Date
1. The Chief Financial Officer, in collaboration with relevant senior officials, should clarify the role for fraud management within Canadian Heritage, including the conduct of regular fraud risk assessments and the promotion of fraud awareness within the Department.	Agreed. The Department is committed to demonstrating personal and professional integrity and recognizes the importance of strengthening the processes related to fraud management. The Chief Financial Officer will engage with relevant senior officials to clarify the roles and responsibilities with regards to fraud management.	Chief Financial Officer	October 2017
	The departmental fraud risk assessment will be updated to consider the potential for fraud in the achievement of organizational objectives (e.g. real property and grants and contributions). A fraud awareness strategy will be developed and implemented.	To be determined based on role for fraud management	April 2018

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Recommendations	Management Assessment and Actions	Responsibility	Target Date
2. The Chief Financial Officer should update the framework for Internal Control over Financial Reporting to include the risk assessment methodology and complete roles and responsibilities. This includes putting in place a follow-up strategy to ensure that recommendations are implemented in accordance with planned actions and timelines.	Agreed. The Financial Policies and Internal Controls division is currently working on revising and implementing policy instruments related to the new Policy on Financial Management. Additionally, the framework for internal controls is being updated to include the methodology for risk assessment, to further define the roles and responsibilities and to ensure compliance with the upcoming regulatory landscape.	Manager, Financial Policies and Internal Controls	June 2017
	A tool has been developed to track the recommendations related to the results of the internal control reviews. A follow-up strategy is being created in order to report on the status of Management Action Plans.	Manager, Financial Policies and Internal Controls	April 2017
3. The Chief Information and Transformation Officer should develop an Information Management and Information Technology Strategy that encompasses the digital transformation of the Department. This includes extending the current data warehousing strategies in place to the Department as a whole.	Agreed. In addition to the annual Information Management and Information Technology plans submitted to the Treasury Board Secretariat in accordance with the *Policy on Information Management* and the *Policy on the Management of Information Technology*, the Chief Information and Transformation Officer will develop an Information Management and Information Technology Strategy to enable and support the digital transformation of the department.	Chief Information and Transformation Officer	September 2017