



Treasury Board and Finance

October 2017

Summary

Department

We recommend the department consistently apply its policies when recommending to Treasury Board Committee to approve a payment based on agreement request—see below.

We repeat our 2014 recommendation for the department to update and follow its enterprise risk management system by identifying, monitoring, communicating and appropriately mitigating relevant risks—see page 134.

The department has implemented our 2014 recommendations to:

- improve access controls to the information systems for tax and revenue administration—see page 135.
- appropriately approve tax refunds in accordance with legislation—see page 136.

We followed up on our 2008 and 2009 audits of CEO Selection, Evaluation and Compensation, and Executive Compensation. We are withdrawing our recommendations—see Performance Auditing page 97.

Alberta Gaming and Liquor Commission

There are no new recommendations to the Alberta Gaming and Liquor Commission in this report. The Commission has implemented our recommendation to improve its systems to manage access by external vendors to its IT systems—see Performance Audit Report, page 29.

Alberta Investment Management Corporation

There are no new recommendations to the Alberta Investment Management Corporation in this report.

ATB Financial

There are no new recommendations to ATB Financial in this report.

ATB Financial has implemented our 2013 recommendations to fix the borrower risk ratings in the banking system—see page 136.

Findings and Recommendations

DEPARTMENT

Matters from current audit

Payments Based on Agreement

Context

Members of the Legislative Assembly vote annually on the government's budget to spend in the fiscal year (the supply vote). If a government is inconsistent in its treatment of expenditures subject to a supply vote, it may deny Members of the Legislative Assembly the opportunity to challenge the government on how it's managing the economic resources entrusted to it.

Department financial reporting includes a schedule comparing the department's actual expenditures for a year to its voted budget expenditures. If a department expends beyond its approved budget, the department must fund the overspent amount (an encumbrance) by reducing its planned spending in the following year. Alternatively, the department could request Members of the Legislative Assembly to vote a supplementary estimate, providing funding for the additional spend.

Payments based on agreement are external funding agreements which are subject to a specific section of the *Financial Administration Act*¹ which exempts the funding from inclusion in a department's financial reporting and budget. Given the exemption, it is critical that the Department of Treasury Board and Finance (TBF) has accounting and budgeting policies and procedures on what qualifies as a payment based on agreement. Clear policies and procedures serve as a control to prevent departments from avoiding transparency and accountability in reporting their spending, relative to an approved budget. Within TBF, the Provincial Controller develops accounting policies while the Budget Development and Reporting (BDR) division develops budgeting policies and procedures.

The *Financial Administration Act* does not specify in detail the characteristics of a payment based on agreement, however both the TBF accounting and budget policies are consistent in requiring a payment based on agreement to have characteristics including:

- the funding must cover 100 per cent of the related cost of the product or service funded
- the department has no obligations related to the funding, other than to act as a conduit to pass the funding along to an ultimate recipient
- the funding isn't for any new or existing government programs

BDR reviews department requests to treat a funding agreement as a payment based on agreement and recommends to the Treasury Board Committee² to approve the treatment for budget purposes. BDR requires department requests be approved prior to the department signing a funding agreement in order to avoid a situation where the committee feels compelled to approve. If approved, the planned funding spend is not included in the department's annual budget supply vote.

For financial reporting purposes, an approved payment based on agreement would only require brief note disclosure of the funding agreement. The department would not record any revenue or spending of the funding in the financial statements.

In fiscal year 2017, nine departments disclosed having a payment based on agreement, with a total gross value of \$306 million.³ Of this amount, \$304 million relates to cost reimbursements to the Government of Alberta from other governments for costs incurred on their behalf. Cost reimbursements include the Department of Health for providing health services to non-Alberta residents and the Department of Agriculture and Forestry, for the delivery of fire emergency services.

Criteria: the standards of performance and control

TBF must apply its policies and procedures when recommending to Treasury Board Committee to approve a request to treat a funding agreement as a payment based on agreement.

¹ Section 25 of the *Financial Administration Act*.

² The Treasury Board Committee is a government committee usually cabinet chaired by the President of Treasury Board. The committee's role is to review and make recommendations to Cabinet on estimates as part of the budget process.

³ Advanced Education - \$123,000, Agriculture and Forestry - \$3.4 million, Education - \$167,000, Executive Council - \$1 million, Health - \$299 million, Justice and Solicitor General - \$600,000, Municipal Affairs - \$950,000, Service Alberta - \$249,000, Transportation - \$532,000.

Our audit findings

Key Finding:

Neither the Provincial Controller nor the Budget Development and Reporting division applied their policies when Treasury Board Committee approved a federal funding agreement as a payment based on agreement. Treatment as a payment based on agreement denied Members of the Legislative Assembly the opportunity to vote on accepting the required \$227 million capital spend and consider the related financial implications on current and future government operations.

During our financial statement audit of the Department of Advanced Education, we examined a \$227 million federal grant agreement to Advanced Education to provide funding to complete certain Alberta post-secondary school capital projects by March 31, 2018. The funding, if accepted, could only be used for the capital projects. Future costs to operate the new capital projects would be a provincial responsibility. The federal government will provide the funding over three fiscal years, beginning with \$84 million in fiscal 2017. Advanced Education's approved supply vote budget for the year did not include the receipt or expenditure of this funding. In November 2016, Treasury Board Committee approved Advanced Education's request to treat the funding agreement signed in August 2016, as a payment based on agreement.

We concluded the grant funding agreement did not meet all the requirements of the TBF accounting or budgeting policies as a payment based on agreement because:

- The funding agreement only covered 50 per cent of the project costs.
- Advanced Education was responsible for monitoring completion of the projects and periodically reporting back to the federal government.
- Advanced Education will spend at least \$31 million on project costs.
- Advanced Education is liable to repay the federal government if any of the post-secondary institutions breach their responsibilities under the agreement.
- Treasury Board Committee approval as a payment based on agreement occurred three months after Advanced Education signed the funding agreement.

We observed another department receiving a similar federal capital grant with the same funding characteristics and requirements. That department did not classify the funding as a payment based on agreement, consistent with the TBF accounting and budgeting policies. That department included the revenue and expense in its financial statements and obtained a supplementary estimate from Members of the Legislative Assembly.

As a result of our examination, management of Advanced Education adjusted its accounting to record the \$84 million received and spent in its financial statements as a revenue and expense and not as a payment based on agreement. Advanced Education, however, continued to treat the funding in its schedule of actual to voted budgeted spending as a payment based on agreement. Advanced Education felt it was not appropriate to show an \$84 million overspend on its voted budget because of the Treasury Board Committee approval. Advanced Education's financial reporting at a ministry level and the Government of Alberta consolidated financial statements were not impacted.

The Provincial Controller concluded it was legally acceptable to continue to classify the funding as a payment based on agreement for budget purposes. The controller made this conclusion despite the inconsistency with the TBF budget policy and Advanced Education's adjusted treatment for accounting purposes. Advanced Education has not

included any explanation for the variance between the budgeted and actual spend in its 2017 financial reporting, 2016-2017 annual report or 2017-2018 supply vote request.

It is important to note we observed no evidence that the request by Advanced Education or Treasury Board and Finance's application of its accounting and budget policies were to intentionally manipulate department financial reporting and avoid the budgeting process. Management of Advanced Education believed it had a payment based on agreement. Advanced Education management however did not complete an analysis applying the TBF accounting and budget policies until April 2017.

Despite any misinterpretation or misapplication of the TBF accounting and budget policies by Advanced Education, BDR failed to apply its policy when recommending Treasury Board Committee approve Advanced Education's request. BDR did not require Advanced Education to complete an analysis applying the budget policy criteria before BDR recommended approval to the Treasury Board Committee. The office of the controller failed to ensure Advanced Education's treatment of the funding for accounting and budget purposes was consistent and agreed with the required criteria in the TBF accounting policy. As a result, it is not clear to users of Advanced Education's financial reporting and budget information if the \$84 million expenditure is a payment based on agreement or if future funding from the agreement should be included in Advanced Education's 2017-2018 supply vote.

RECOMMENDATION: Apply policies when recommending approval to Treasury Board Committee

We recommend that the Department of Treasury Board and Finance consistently apply its policies when recommending to Treasury Board Committee to approve a payment based on agreement request.

Consequences of not taking action

Inconsistent application of accounting and budgeting policies and procedures weaken government transparency and accountability. Users of financial and budget information will be less able to compare results, measure performance and understand if government entities are operating effectively. Budgeting processes will be less effective or bypassed and operating decisions become short-term focused rather than demonstrate the execution of long-term planning and budgeting.

Matters from prior audits

Enterprise risk management systems—recommendation repeated

Context

In 2014,⁴ we concluded that the Department of Treasury Board and Finance had not updated and followed a formal enterprise risk management system since 2011. We recommended that the department update and improve its enterprise risk management systems.

We acknowledge that the department approved its risk management framework. However, we repeat this recommendation because the department still does not have effective risk management systems three years after we made the recommendation.

⁴ *Report of the Auditor General of Alberta, October 2014, no. 22, page 194.*

Criteria: the standards of performance and control

The department should have effective risk management systems.

Our audit findings**Key Finding:**

The department does not have an effective risk management system to:

- identify, assess and evaluate strategic risks
- implement mitigation strategies
- monitor, review and report on the risks

This year, the department approved an updated risk management framework. The framework sets out who governs and oversees the department's risk management systems, the policy and principles for risk management, and performance measures to evaluate the effectiveness of the risk management systems. The department identified four key risks that it disclosed in its 2017–2019 business plan.

Management told us that they manage risks through various informal processes. The department has not yet implemented and followed formal processes as defined in its framework. These processes include formally identifying, assessing and ranking risks, developing and implementing risk mitigation procedures, regular monitoring and evaluating programs and procedures to mitigate risks, and incorporating the processes into its business and operational planning processes.

**RECOMMENDATION: Update and follow enterprise risk management system—
recommendation repeated**

We again recommend that the Department of Treasury Board and Finance update and follow its enterprise risk management system by identifying, monitoring, communicating and appropriately mitigating relevant risks.

Consequences of not taking action

Without an effective enterprise risk management system, the department may not identify and manage its risks efficiently and effectively.

**User access controls over tax and revenue administration systems—
recommendation implemented**

Context

In 2014⁵ we recommended that the department's tax and revenue administration division improve the security of its tax and revenue information systems. The division did not document the security design, including segregation of duties for the tax and revenue information system. In addition, management could not demonstrate that access to the system was assigned appropriately.

Our audit findings

The department implemented our recommendation. We conclude, based on our assessment and testing, that management's systems to review, approve and maintain appropriate access to the tax and revenue information systems are adequately designed, implemented and operating effectively.

⁵ Report of the Auditor General of Alberta—October 2014, no. 23, page 195.

Management completed a comprehensive redesign of security access to the system. This included limiting user access in the system to those functions that employees need in order to perform their specific roles, and enforcing appropriate segregation of duties so that no employee can perform multiple and critical tasks without review from another employee. The department also implemented processes to review, approve and implement changes to the security design and to periodically review whether employees' access to the system remains appropriate.

Corporate tax refunds—recommendation implemented

Context

In 2014⁶ we recommended that the department's tax and revenue administration division approve corporate tax refund payments before they are made, in order to comply with the *Financial Administration Act*. The department pays refunds to corporations after it issues the notice of assessment or notice of reassessment. Management stated that the refunds are paid promptly to avoid or minimize any interest due on refunds. However, the required reviews and approvals occurred only after the refunds were paid.

Our audit findings

The department implemented our recommendation. Management designed and implemented systems of internal controls to approve tax refunds before they are made.

ATB Financial

New banking system—borrower risk ratings—recommendation implemented

Context

The borrower risk rating (BRR) is a rating scale from 1 to 13 that is assigned to all of ATB's non-consumer borrowers. ATB's credit department uses the non-consumer risk rating (NCRR) system to calculate ATB's BRRs for individual borrowers. The NCRR system is ATB's system of record for BRRs.

In 2013, we recommended that ATB fix the borrower risk ratings in the banking system.⁷ We noted that the banking system does not have an accurate list of BRRs for ATB's business and agriculture loans.

Our audit findings

ATB has implemented our recommendation to fix the borrower risk ratings in the banking system. ATB introduced a manual review procedure to ensure the BRR matches across the NCRR, the application for credit, and the banking system. We tested a sample of business and agriculture loans and found that the BRR does match in all three places.

⁶ *Report of the Auditor General of Alberta—October 2014*, no. 24, page 197.

⁷ *Report of the Auditor General of Alberta—October 2013*, no. 14, page 158.

Outstanding Recommendations

The following recommendations are outstanding and not yet ready for follow-up audits:

Improve ministry annual report processes—July 2012, no. 10, p. 65

We recommend that the Department of Treasury Board and Finance work with ministries to improve annual report:

- preparation processes for identifying significant performance measure variances and developing explanations for these variances for reporting
- approval processes, including senior management sign off of a summary of the year's performance measure variances and significant variance assessments

Improve performance measure reporting guidance and standards—July 2012, no. 11, p. 67

We recommend that the Department of Treasury Board and Finance improve its guidance for:

- performance measure target setting
- variance identification
- significant performance measure variance assessments and annual report explanation development
- preparing the results analysis

Department's Oversight Systems for Alberta's Public Sector Pension Plans: Policies designed to achieve plan objectives—February 2014, no. 1, p. 24

We recommend that the Department of Treasury Board and Finance set standards for the public sector pension plan boards to establish funding and benefit policies with:

- tolerances for the cost and funding components
- alignment between plan objectives and benefit, investment and funding policies
- pre-defined responses when tolerances are exceeded or objectives are not met

Department's Oversight Systems for Alberta's Public Sector Pension Plans: Risk management system—February 2014, no. 2, p. 26

We recommend that the Department of Treasury Board and Finance establish an Alberta public sector pension plan risk management system to support the minister in fulfilling his responsibilities for those plans.

Department's Oversight Systems for Alberta's Public Sector Pension Plans: Sustainability support processes—February 2014, no. 3, p. 28

We recommend that the Department of Treasury Board and Finance:

- validate the objectives for the pension plan sustainability review with stakeholders
- evaluate and report on how each proposed change meets the objectives for the review
- cost and stress test all proposed changes to assess the likely and possible future impacts on Alberta's public sector pension plans
- conduct or obtain further analysis of the impact of proposed pension plan design changes on employee attraction and retention
- prepare a detailed implementation plan for the changes

Results analysis reporting: Guidance, training and monitoring needed—July 2014, no. 1, p. 18

We recommend that the Department of Treasury Board and Finance, working with the Deputy Ministers' Council, improve:

- the guidance and training for ministry management to identify, analyze and report on results in ministry annual reports
- processes to monitor ministry compliance with results analysis reporting standards

Economy and Efficiency of Cash Management: Evaluate cash management for efficiency and economy—February 2016, no. 8, p. 77

We recommend that the Department of Treasury Board and Finance:

- evaluate how it can use excess liquidity within government-controlled entities to reduce government debt and minimize borrowing costs, and implement mechanisms to utilize excess liquidity
- evaluate the Consolidated Cash Investment Trust Fund and pursue opportunities to increase its use or modify its current structure to ensure it remains a relevant cash management tool

Economy and Efficiency of Cash Management: Develop policies to prevent early payment of grants and an accumulation of large cash balances—February 2016, no. 9, p. 79

We recommend that the Department of Treasury Board and Finance issue policies and guidance for departments to monitor the working capital needs of government-controlled entities to ensure departments only provide cash when needed

Economy and Efficiency of Cash Management: Implement and use information technology to manage cash—February 2016, no. 10, p. 82

We recommend that the Department of Treasury Board and Finance implement an integrated treasury management system to manage treasury functions and processes, including government-wide cash pooling and management.

Economy and Efficiency of Cash Management: Use leading banking and related practices and evaluate cost benefits of bank accounts—February 2016, no. 11, p. 85

We recommend that the Department of Treasury Board and Finance work with departments to implement leading banking practices and evaluate the benefits of existing bank accounts compared to the costs of administering them, and make changes where the costs exceed the benefits.

Economy and Efficiency of Cash Management: Improve policies for payments—February 2016, no. 12, p. 86

We recommend that the Department of Treasury Board and Finance:

- periodically analyze payment data to identify non-compliance with policies and seek opportunities for improvements
- ensure that cost recoveries between government entities consider costs and benefits, and a transaction threshold

Apply policies when recommending approval for payment based on agreement requests—October 2017, Financial Statement Auditing, p. 134

We recommend that the Department of Treasury Board and Finance require the Provincial Controller and the Budget Development and Reporting division to consistently apply its policies when jointly recommending to Treasury Board Committee to approve a payment based on agreement request.

Enterprise risk management systems—October 2017, Financial Statement Auditing, p. 135 (originally October 2014, no. 22, p. 194)

We again recommend that the Department of Treasury Board and Finance update and follow its enterprise risk management system by identifying, monitoring, communicating and appropriately mitigating relevant risks.

Management has identified these recommendations as implemented—to be confirmed with follow-up audits:

Collection of outstanding corporate taxes: Maintain policies and train staff—October 2014, no. 6, p. 51

We recommend that the Department of Treasury Board and Finance:

- update and maintain its policies and procedures for tax compliance officers
- review its training program to ensure it provides relevant and ongoing training to tax compliance officers

Collection of outstanding corporate taxes: Develop internal and external performance measures and targets—October 2014, no. 7, p. 52

We recommend that the Department of Treasury Board and Finance develop comprehensive performance measures and targets for tax collections and determine which to report publicly.

Collection of outstanding corporate taxes: Improve management information and analyze data periodically—October 2014, no. 8, p. 54

We recommend that the Department of Treasury Board and Finance:

- update its management reports to include additional information on the status of tax collection files and the success of its various collection activities
- periodically analyze the characteristics of the corporate taxes outstanding to identify potential changes to legislation, policies and collections strategies
- deal with the backlog of files submitted for write-off and low value accounts

Compliance systems for unfiled corporate income tax returns—October 2015, no. 17, p. 156

We recommend that the Department of Treasury Board and Finance improve its compliance systems to deal with unfiled corporate income tax returns.

ATB Financial

The following recommendation is outstanding and not yet ready for a follow-up audit:

Payment card industry—October 2012, no. 31, p. 149

We recommend that ATB Financial put in place processes to monitor its compliance with the Payment Card Industry's requirements.

Management has identified the following recommendation as implemented—to be confirmed with a follow-up audit:

Service auditor reports—October 2014, no. 26, p. 202 (originally October 2009, p. 227)

We again recommend that ATB Financial improve its processes related to service providers by ensuring its business areas:

- receive service provider audit reports
- review service provider audit reports and assess the impact of identified internal control weaknesses
- put end-user controls in place to complement service provider controls