



## Chapter 7

### Controls

*Whatever funding model applies, there is an expectation that Parliament will adhere to the highest standards of accountability. In a number of international settings the executive has established financial accounting and reporting standards that are regarded as the gold standard and many Parliamentarians have adopted these standards for their own financial operations.*

— Commonwealth Parliamentary Association<sup>1</sup>

#### The Control Environment

The implementation of an effective system of controls over the spending of public money within the legislative branch is obviously of central importance in providing a system of best practices that will provide a degree of confidence to the public that financial stewardship is being properly practiced in the House administration.

The Terms of Reference require me to make “a determination of whether proper safeguards are in place to ensure accountability and compliance with all rules and guidelines.”<sup>2</sup> More specifically, I am directed to undertake an independent “review and evaluation of the policies and procedures for control” of the types of expenditures reviewed by the Auditor General in his report of June, 2006 respecting *Payments Made by the House of Assembly to Certain Suppliers*.<sup>3</sup>

That report observed, amongst other things, that “internal controls relating to purchases were basically non-existent,” there was a failure to comply with proper tendering guidelines, there was “inadequate documentation” provided on invoices to support which

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<sup>1</sup>Tanzania, Commonwealth Parliamentary Association, *Administration and Financing of Parliament*, (Report of a CPA Study Group, hosted by the legislature of Zanzibar), (May 25-29, 2005), p. 6.

<sup>2</sup> See Appendix 1.2, item 1(iv).

<sup>3</sup> See Chapter 1, footnote 12.

MHA the goods were purchased for, or whether payments were incorrectly charged to other parts of the House accounts, and the manner of record-keeping (involving over-writing of records respecting MHA constituency allowance payments) meant that the audit trail with respect to those matters was “effectively eliminated.”

There are multiple sources demonstrating the need for improvement of the system of controls in the House of Assembly. The above-mentioned report together with the Auditor General’s most recent annual report issued on January 31, 2007, as well as the material reviewed in Chapters 3 and 4 of this report that identified the potential for uncontrolled overspending and double billing of amounts from MHA constituency allowances are sufficient to be able to conclude that the system of controls in the House of Assembly is in need of substantial reform and enhancement.

The Terms of Reference also require me “to develop recommendations on policies and practices ... that would ensure the accountability and compliance practices employed in the House of Assembly meet or exceed the best in the country.”

This chapter will therefore focus on the type of financial policies, procedures and practices that should be adopted in the House administration to create an effective control environment. The approach taken will be to start with a discussion of the components of a general control environment. Then the focus will move to comparison of what a good control environment should be with the situation within the House of Assembly as it was at the time when this commission was appointed, leading to more recommendations, beyond those already made in Chapter 5, for improving the “tone at the top.” From there the discussion will move to a review of government accounting systems and policies, best practices from other government and industry sources, and a comparison with the policies and systems *currently* in use.<sup>4</sup> From that analysis, I will identify controls and policies that are suitable for the future operation of the House and recommend changes to ensure that “best practices” are implemented.

As a preliminary to all of this, however, I propose, to put the problem in context, to sketch out the *legislative controls* on spending money that exist in government generally and in the legislative branch in particular. A comparison between these two control regimes is instructive in itself.

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<sup>4</sup> It must be acknowledged at the outset that a number of significant and positive changes have been made in control systems in the House since early 2006, especially since the position of Chief Financial Officer was created, and filled by the present incumbent. The CFO has been working diligently to make improvements, with limited resources, to make improvements in an environment that is very fluid. It is necessary, however, to assess the current regime, even with its improvements, to determine whether further changes need to be made to ensure best practices.

## Legislative Controls on Spending of Public Money

The spending of public money in the province of Newfoundland and Labrador is governed by the *Financial Administration Act (FAA)*.<sup>5</sup> All public money over which the legislature has the power of appropriation forms the Consolidated Revenue Fund.<sup>6</sup> The Comptroller General is charged with the administration of the fund.<sup>7</sup> Both constitutionally and by statute, public money may not generally be paid out of the Consolidated Revenue Fund without legislative appropriation in the form of a “supply bill” that is passed by the House of Assembly.<sup>8</sup>

The Comptroller General is statutorily mandated to ensure, amongst other things, that “no payment of public money” is made without a legislative appropriation or is in excess of an appropriation.<sup>9</sup> He or she is required to report to the Treasury Board<sup>10</sup> any case that comes to his or her attention in which a liability has been incurred by a public officer which contravenes the *FAA*. The Comptroller General is also required to ensure that cheques are issued only in relation to expenditures for work, goods or services supplied to government where a deputy minister “or another authorized person” has certified that the work has been performed, goods supplied or services rendered or, in the case of expenditures incurred by a person while traveling on government business, that the person has certified that the expenses were incurred on government business and are in accordance with rates, amount and allowances prescribed by Treasury Board.<sup>11</sup>

A legislative appropriation is achieved by the preparation of estimates of expenditure which are submitted to the House of Assembly for debate and ultimate inclusion in a supply bill that must be enacted by the legislature. Constitutionally, only the executive can introduce a bill calling for appropriation of money in the House.<sup>12</sup> Any amendments to a money bill that would increase the amount of an appropriation may only be made with the consent of the executive.

The *FAA* provides that the total amount of money appropriated, the expenditure of which is assigned to a particular department, is to be referred to as a “Head of

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<sup>5</sup> R.S.N.L. 1990, c. F-8. See also the general discussion of this issue in Chapter 4 (Failures) under the heading “Ineffectiveness of Central Control Functions in Government.”

<sup>6</sup> S. 12

<sup>7</sup> S. 20.

<sup>8</sup> S. 22. There are some limited exceptions, such as authorizations of expenditure by way of “special warrant” in urgent or unforeseen circumstances until the legislature can deal with the matter. See s. 28.

<sup>9</sup> *FAA*, s. 29. It is also provided that no issue of public money shall be made unless the Comptroller General, or his or her designate, certifies that there is a balance available in the appropriation authorized by the legislature for the specified services in question.

<sup>10</sup> The Treasury Board is a committee of Cabinet charged, amongst other things, with financial management of the province and administrative policy and personnel management in the public service. See *FAA*, s. 6.

<sup>11</sup> S. 30.

<sup>12</sup> *Constitution Act, 1867*, Ss. 54, 90; *Newfoundland Act*, Sch., Term 3.

Expenditure.”<sup>13</sup> Thus money assigned in the estimates for expenditure by, say, the Department of Justice is a separate head of expenditure and is regulated as such. The appropriations to the House of Assembly have been treated as a separate head of expenditure for this purpose, even though the House does not easily fall within the definition of a “department” in the *FAA*.<sup>14</sup>

The *FAA* also provides that Treasury Board may, for the purpose of exhibiting in the estimates, divide a head of expenditure into “subheads,” and subheads into “subdivisions” of the subheads.<sup>15</sup> Thus, by breaking down an appropriation for a department (a “head” of expenditure) into subheads and subdivisions, Treasury Board can more tightly control the types of expenditure that can be made, since the *FAA* provides that transfers between subheads and certain subdivisions may only be made with the consent of Treasury Board.<sup>16</sup> Thus, assuming for a moment that the *FAA* applies fully to the House of Assembly, it would be possible, within the subdivision of expenditure known as “Allowances and Assistance” in the House vote, to divide House operations into constituent parts, segregating MHA allowances from other items of expenditure, and requiring expenditures on allowances to be tracked and monitored separately.<sup>17</sup> Furthermore, the Board also has authority to prescribe “the manner and form in which the accounts of the province and the several departments are to be kept.”<sup>18</sup> Thus, again, the degree of recording separate types of expenditures may be dictated by Treasury Board.

In carrying out his or her duties relating to the control of unauthorized expenditure of public money, the Comptroller General must establish a record of commitments already chargeable against each appropriation and, when a subhead or subdivision is exhausted, must not sanction any further charge against that subhead or subdivision.<sup>19</sup> Furthermore, as noted above, such a charge could not utilize funds from another subhead unless the appropriate Treasury Board-sanctioned consent was first obtained.

It is obvious that, for the Comptroller General to be able to carry out his or her statutory duties effectively, he or she must have access to documentation that can provide the justification for making an expenditure or that will be able to flag a situation that does not permit the expenditure. Accordingly, subsection 20(3) of the *FAA* provides that the Comptroller General has “free access” to the books, accounts, files, documents or other records of “a department” and is entitled “to require and receive from the officers, clerks or employees of the public service the information and explanations that he or she considers

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<sup>13</sup> Ss. 23(3).

<sup>14</sup> See ss. 2(1)(e).

<sup>15</sup> Ss. 23(4), (5).

<sup>16</sup> Ss. 28(1).

<sup>17</sup> It should be noted that this can be accomplished by having House Operations, as currently presented in the estimates, split to segregate the true operations of the House and the salary component of the MHAs from the amounts pertaining to the remaining activities of the MHAs.

<sup>18</sup> Ss. 7(1)(a).

<sup>19</sup> Ss. 27(2), (4).

necessary for the proper performance of his or her duties.” Even more important, for present purposes, is subsection 25(4) which provides:

Every application of a department for an issue of public money to defray the expenses of the services coming under its control shall be in the form, accompanied by the documents and certified in the manner that the comptroller general may require.

As well, the Treasury Board itself may also “direct a person receiving, managing or disbursing public money to keep those books, records and accounts” that the Board considers necessary.<sup>20</sup>

It is within this legal framework that the process of authorizing claims for payment and the establishment of supporting policies to enable disbursements to be issued must be developed.

### **Application of the Financial Administration Act to the House of Assembly**

Before examining actual government control and payment policies, however, it is necessary to consider the degree to which the legal framework that has been just described can be said to have application to the House of Assembly. Questions as to its applicability have generally arisen from two sources:

- the doctrine of the autonomy of the legislative branch; and
- the infelicity of the statutory language in the *FAA* which does not fit easily over the legislature, as opposed to a “department” of government.

This is an important issue, because it was used to justify a very different treatment of the House in respect of financial accountability matters after the amendments made in May of 2000 to the *Internal Economy Commission Act*. Even today, in the course of my investigations, it has become clear that there is considerable confusion in the minds of many - both politicians and officials - as to the degree to which the *FAA* applies to and, consequently, the degree to which general government policies respecting financial matters govern, House financial spending activities.

In Chapters 2, 3 and 4, references are made to the notion of legislative autonomy and how it has influenced decisions as to the manner in which House financial affairs, and other matters, have been administered. In the current context, the argument is that the legislative branch ought to be the “master in its own house” and ought not to be under the control of the executive, including its policies relating to financial control. It should have the right to

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<sup>20</sup> Ss. 7(1)(d).

develop its own policies in financial matters that may differ from those of the executive.

This argument is buttressed by the infelicity of the language of the *FAA* in its indications (or lack of indications) of its application to the legislature. I have argued in Chapter 4<sup>21</sup> that - inasmuch as the *FAA* applies to all “public money,” which forms one consolidated revenue fund that is supposed to be safeguarded and controlled by one individual (the Comptroller General), and inasmuch as the legislative branch must defray its operations out of this same fund of money - the *FAA* must, in at least some respects, apply to the House as well as to the executive. The problem, nevertheless, is that many of the specific sections of the *FAA* are drafted as applying only to a “department” which, in its definition, does not clearly encompass an anomalous body like the legislature.<sup>22</sup> If the House is not included within such language, then provisions like subsection 25(4) quoted above would not apply to enable the Comptroller General to stipulate the types of documentary backup for claims as a condition of payment of money to, or for the benefit of, the legislative branch.<sup>23</sup>

The argument based on legislative autonomy and the uncertainty, as a matter of statutory interpretation, as to the scope of the application of the *FAA* to the House is reflected in the amendments to the *Internal Economy Commission Act* in 2000. Section 7 of the *IEC Act* now provides that all amounts of money voted by the legislature with respect to estimates prepared for the House shall be paid out of the consolidated revenue fund “on the order of the commission” to defray the expenses of the House. Subsection 8(1) of that Act authorizes the IEC to “establish policies respecting documents to be supplied to the Comptroller General where an application is made for an issue of public money to defray the expenses of the House of Assembly.” Presumably, to remove any uncertainty as to whether subsection 25(4) of the *FAA* applied to the House, subsection 8(1) of the *Act* expressly excludes its potential application. Then, to make the point even clearer, subsection 8(2) provides that where the Commission “establishes policies,” documents supplied to the Comptroller General in accordance with those policies “shall be considered to fulfill all of the requirements” of the *FAA*.

The result of these amendments is that the IEC is effectively a law unto itself in financial matters. Once a budgetary appropriation has been made to the House, the Comptroller General is expected to comply with an “order” of the Commission, regardless of whether there is any documentary justification provided.

It is to be noted that the exemption from the requirement to supply documentary

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<sup>21</sup> See, Chapter 4 (Failures) under the headings “Lack of Compliance Testing;” and “Effectiveness of Central Control Functions in Government.”

<sup>22</sup> Ss. 2(1) (e) defines “department” as “a department of the civil service of the province or other division, branch or part of the public service of the province.”

<sup>23</sup> Yet, ss. 25(4) of the *FAA*, which by its terms only applies to a “department,” was expressly excluded from application to the House by S.N.L. 2000, c.17, s. 2, thereby implying an assumption on someone’s part that it had prior application to the House.

support for payment orders is predicated on the Commission establishing “policies” respecting the types of documents to be supplied. The irony is that the commission’s “policy” was to declare that *no* documents need be supplied. Even if this position can be technically described as a “policy,”<sup>24</sup> it surely is not within the intent of the subsection, which, in my view, was to require the IEC, if it was not to be bound by the executive’s policies, to implement a set of alternative policies designed also to achieve accountability and control by other means. The approach taken by the IEC in eschewing the giving of *any* documentary justification to the person responsible for control of the public purse is legislative autonomy carried to the extreme. It ignores any governance concerns and certainly does not appear to be concerned with other values like accountability.

While it is true that the house administration itself still insisted on submission of documentation of sorts to support claims before it would “sign off” and submit them (without the documentation) to the Comptroller General’s office, that is not a sufficient substitute for providing justification to an external source. It negates entirely the possibility of the effective operation of internal audit controls within government. As will become apparent, the system within the House was, in any event, so dysfunctional that there were no effective controls in this area at all.

The notion of autonomy has led the Commission of Internal Economy to opt not to use the executive branch of government’s general accounting systems and policies in other areas. The result is that the two systems - executive and legislative - operated independently of each other in a number of important respects, particularly in the area of the processing of MHAs’ constituency allowance claims. While, in theory, there could be two systems operating side by side, both exhibiting proper attention to controls over spending, the situation as it developed in the House of Assembly shows what can happen where the House, having flexed its muscles by using the autonomy-card, then proceeds not to assume its concomitant responsibility to ensure accountability and implement proper alternative controls itself. Frankly, given the history of controls (or lack of them) in the House, one could be forgiven for assuming that under the present structure, if left to its own devices, the IEC would not take the necessary steps to develop the necessary sound policies to ensure accountability and control - and even if it did, there would be nothing to prevent a subsequent, differently constituted IEC from undoing any controls that were implemented.

The IEC cannot, and should not, be put in a position where it could shelter behind a distorted version of legislative autonomy to avoid the operation of the *FAA*.

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<sup>24</sup> I have suggested in Chapter 4 (Failures) that it may not.

Accordingly, I will make the following recommendation:

***Recommendation No. 39***

- (1) The Financial Administration Act should be amended to make it apply to the House of Assembly operations with respect to controls over the spending of public money;***
- (2) In particular, and for greater certainty, section 8 of the Internal Economy Commission Act should be repealed, and subsection 25(4) of the Financial Administration Act should be made applicable to the House; and***
- (3) Where it is appropriate, in legislation, to allow for any deviation from financial control policies of the executive in its application to the House, the House of Assembly Management Commission should be statutorily required to deviate only if more appropriate or efficient alternative policies are to be put in place.***

I will now turn to a consideration of the components of a good general control environment.

### **Tone at the Top - Again**

In Chapters 4 and 5,<sup>25</sup> I laid emphasis on the importance of the “tone at the top” in setting the environment in which individual responsibility and accountability can flourish. The notion of the tone at the top must also be mentioned in the current context in the more specific sense of creating a specific control environment necessary to ensure reliability of an organization’s financial systems.<sup>26</sup>

It is axiomatic that a general control environment is fundamental to the accurate recording of transactions and the preparation of reliable financial reports.<sup>27</sup> Without an

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<sup>25</sup> See Chapter 4 (Failures) under the heading “Inappropriate “Tone at the Top;”, Chapter 5 (Responsibility) under the heading “Tone at the Top.”

<sup>26</sup> In the discussion that follows I will borrow, where appropriate, from financial management theory as applied in the private sector since the Enron scandal. In my view, this has much to teach the public sector about good financial controls and accountability.

<sup>27</sup> A much more detailed discussion of the importance of a general control environment, and the various perspectives from which such an environment should be analyzed and assessed, is contained in a paper prepared for the Commission by Ernst & Young LLP entitled “Background Paper on General Control Environment” attached at Appendix 7.1 [“EY Paper”].

adequate control environment to ensure the proper recording of transactions, the resulting financial data may become unreliable and undermine both management's ability to make appropriate decisions, and can precipitate the erosion of the confidence of its stakeholders.

In order to assess the effectiveness of the internal controls in any organization, it is necessary to review and have an understanding of the controls that are in place at the top of the organization. These high-level system wide controls are sometimes referred to in financial management theory as the *entity level controls*.

Organizations have long understood the necessity for strong entity level controls. However, in light of recent corporate scandals such as Enron and WorldCom,<sup>28</sup> it became apparent that many organizations did not have effective entity level controls in place. From these failures came the requirement for organizations to document and evaluate the effectiveness of internal controls and procedures over financial reporting.

### **Entity Level Controls for the Legislature**

That entity level controls,<sup>29</sup> or “tone at the top” are extremely important for the effective operation of the overall system of internal controls within the government and the legislature cannot be overstated. Regardless of the specific controls implemented, the control environment of the legislature will never be effective without the will and commitment of the IEC and House administration to enforce entity level controls.

The administrative framework of the legislature, as it has been represented to me, is outlined in Chapter 3, Chart 3.1. Chapters 3 and 4 describe many of the facets of the administrative framework and the many failures recently identified. These failures often began as a result of entity level controls in the legislature not having received the attention they deserve, which, in turn, has resulted in failures in the House's internal control environment.

As the entity that is charged with overseeing the financial and administrative functions of the House of Assembly, the Commission of Internal Economy is the body responsible for establishing the overall control environment through its attitudes and actions supporting responsible financial governance. It is apparent to me that in recent years the tone from the IEC evidenced a level of casualness or disinterest in concentrating on compliance, transparency, and accountability to the public. This shift resulted in the creation of an environment where poor financial management thrived.

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<sup>28</sup> Enron and WorldCom were among the corporate scandals in the early 2000s which ultimately led to the implementation of new accounting and auditing rules, especially with respect to entity-level controls.

<sup>29</sup> Entity-level controls such as Control Environment; Risk Assessment; Control Activities; Information and Communications; and Monitoring are further explained in the EY Paper in Appendix 7.1.

I have previously noted that, in the past, the IEC operated in an unorganized and unstructured environment. Some of the more notable indications of this are:

- Regular meetings did not occur and minutes were not circulated in a timely manner;
- Restructuring of the constituency allowance framework occurred, and resulted in the increasing of MHA allowances without an independent commission to review their appropriateness, and also resulted in restructuring of the manner in which they were controlled and paid;
- For a number of years, a portion of MHA allowances was paid without requiring submission of supporting receipts;
- Year-end allowance adjustments were approved by the IEC and were only obliquely reported to the House;
- The Controller General was denied access to documents supporting payments of government funds;
- The compliance audit planned by the Auditor General in 2000 was cancelled and the IEC failed to act to provide a replacement;
- The IEC failed to appoint an auditor for three years, permitted one year to go unaudited, and did not perform timely follow-up with the external auditors to determine the status of outstanding audits;
- There was a lack of regular financial reporting and review: significant budgetary variances related to constituency allowances were not questioned and administrative affairs were delegated totally to the Clerk; and
- The IEC requested that the Treasury Board not be involved in analyzing and approving budgets.

To strengthen the entity level controls and the overall control environment of the House of Assembly, a number of actions should be taken. I have already mentioned some of them in Chapter 5. They include:

- The adoption of a code of conduct for the Members of the House. The guidelines in a code help to reinforce the concept of accountability that should permeate the organization and set an appropriate tone for the House.
- The imposition of individual standards of responsibility for members of the IEC.
- The statutory enumeration of the duties and responsibilities of the IEC as a body.

- The adoption of a “whistleblower” policy. The provision of a mechanism that will allow an avenue to report actions that are felt to be unethical, immoral or wrong will, again, reinforce the message that Members take their duties seriously.

In addition to the foregoing measures there are a number of other measures that can be taken to strengthen entity level controls and thereby ensure proper tone at the top. Development of an organization chart detailing the hierarchy of the legislature would assist Members and employees in understanding their roles and responsibilities as well as in highlighting any areas where segregation of duties issues might arise. Once prepared, the organizational chart should be reviewed regularly by management and updated when staffing changes occur.

Written job descriptions for all employees of the House would also assist Members and employees in understanding their roles and responsibilities. These descriptions must detail the requirements and expectations of each job and be prepared by someone who has the experience and knowledge to complete the descriptions.<sup>30</sup> Management must ensure that people meet the requirements as outlined in the descriptions, and training programs or courses should be offered to key employees to ensure that these employees are kept abreast of the latest developments in their particular field. All employees would benefit from annual evaluations, both to reinforce positive behaviour and to note any areas of improvement that may be required.

In accordance with the provisions of the *Transparency and Accountability Act*, a strategic plan for the House administration should be developed.<sup>31</sup> This plan should outline the goals of the House administration for the upcoming year as well as how the legislature plans to mitigate the risks to meet its mandate. This plan should be made available to all Members and key employees and should be reviewed each quarter for progress with updates provided to Members on an annual basis.

Information systems are expected to provide management with timely, relevant reports to be used in the overall administration of the House. The initial focus should be on the identification of financial reports necessary to assist management in the financial reporting and budgeting processes. For example, it would be helpful to develop a report that compares, on a monthly basis, each Member’s spending to date with his or her budget for the year. A new format for such a report has been drafted by the Speaker and is included in the appendices to this report.<sup>32</sup> Also contained in the same appendix is the sample form containing some suggested changes. This report should be reviewed and monitored monthly

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<sup>30</sup> Ernst & Young, LLP, *Preparing for Internal Control Reporting: A guide to Management’s Assessment Under Section 404 of the Sarbanes-Oxley Act*, (2002).

<sup>31</sup> S.N.L. 2004, c. T-8.1.

<sup>32</sup> See “Constituency Allowance Monitoring Form” in Appendix 7.2.

by each MHA and quarterly by the Clerk. Significant variances should be followed up with the particular Member and reported to the Speaker of the House.

Finally, and perhaps most importantly, management of the House - particularly the Clerk and the Chief Financial Officer - needs to champion the need for effective internal controls for the House. Regular review of the internal controls in place must occur and suggestions for improvement to current systems must be implemented in a timely manner. Key management must lead by example and set the tone at the top that internal control is important and necessary for the effective safeguarding of public funds and the operation of the House. In the past, regular reviews of the legislature's internal controls did not occur. The issue of regular review of the system of internal control will be discussed in further detail in the Management Certification section later in this chapter.<sup>33</sup>

In summary, effective entity level controls are fundamental to the overall operation of internal controls. By taking the actions outlined above, the House's entity level controls will be significantly improved and in line with best practices.<sup>34</sup>

Accordingly, I recommend

***Recommendation No. 40***

- (1) Management of the House, in particular the Clerk and the Chief Financial Officer, should implement and champion the need for effective internal controls. Regular review of the internal controls in place must occur, and suggestions for improvement to current systems must be implemented in a timely manner;***
- (2) A strategic plan for the legislature should be developed as contemplated by the Transparency and Accountability Act. This plan should outline the goals of the House administration for the upcoming year as well as how the legislature plans to mitigate the risks in meeting its mandate;***

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<sup>33</sup> See below under the heading "Quality and Risk Management".

<sup>34</sup> James L. Goodfellow and Alan D. Willis, *Internal Control 2006: The Next Wave of Certification, Guidance for Directors* (The Canadian Institute of Chartered Accountants, 2006).

- (3) *An organization chart, which details the hierarchy of the House administration should be developed. This chart will allow members and employees to know and understand their roles and responsibilities;***
- (4) *Job descriptions should be developed and documented for all employees of the House of Assembly. These descriptions must detail the job requirements and expectations of each job and should be written by someone who has the experience and knowledge to complete the description;***
- (5) *Management, particularly the Clerk, should ensure that people who are hired meet the job requirements as outlined in the descriptions;***
- (6) *Training programs or courses should be offered to key employees to ensure that these employees are kept abreast of the latest developments in their particular field; and***
- (7) *Management, particularly the Clerk, should develop, maintain and update as required, appropriate management information systems to assist in the financial reporting and budgeting processes, and to assist in reporting in a useful and transparent manner the spending patterns of each Member with respect to allowances and to enable significant variances to be identified and dealt with.***

### **Process and Transaction Level Controls**

The accounting policies and processes applicable to the executive branch of government are documented in the *Financial Management Circulars*, *Financial Management Handbook* and the *Financial Management Policy Manual* issued by the Office of the Comptroller General. These were reviewed to determine if they could be adopted by the legislature.

Financial management circulars are issued “to assist departments in the handling of selected financial operations,” and are designed “to clarify financial principles which are legislated by the *FAA* and by policies and procedures approved by Cabinet or Treasury Board.”<sup>35</sup> These circulars provide a description of the accounting processes in place at

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<sup>35</sup> Newfoundland and Labrador, Office of the Comptroller General, “Financial Management Circular,” (March 2003), “Introduction,” p. 1.

various governmental departments and appear to be very detailed, well written and comprehensive.

It is not practical or efficient to compare all of the government processes described in this information to best practices. I have reviewed government processes relating to budgets (referred to as estimates), purchases, payables, payments, payroll and financial reporting - the areas most used in the legislature - and compared them to best practices.

To determine what constitutes a best practice, the Commission staff reviewed control documents found on databases maintained by accounting firms such as Ernst & Young, as well as other databases. These databases are comprehensive and based upon the standards and guidelines recommended by the Canadian Institute of Chartered Accountants. As the information related to budgeting in the databases consulted was more corporate-based, a survey of the other legislatures in Canada was undertaken to obtain sufficient information on best practices from a public sector point of view.<sup>36</sup> Appendix 7.3 provides a summary of the survey results.

### **Budget Process Within Government**

As a starting point, I will discuss the components of the budget process within the executive branch of government and compare it with the existing practices of the House of Assembly and best practices from the survey noted in Appendix 7.3.

#### ***(i) Initialization of the Budget Process***

Government prepares its budget annually. At the appropriate time of the year, a request is issued for the various departments to begin the budget process, outlining the timelines for its completion or submission for approval. The Budget Division of the Financial Planning and Benefits Administration group within the Department of Finance (hereinafter referred to as the Budget Division) prepares forms and guidelines that are then provided to each department and agency. These include the projected revised estimates (a combination of actual expenses and revenues to a point in time during the year plus an estimate to the end of the year) and an estimate for the next fiscal year.

Anticipated changes to the requirements for the next fiscal year are documented. Changes can arise from past events that will not recur, or future events that are expected to occur and that have not taken place in the past. There is an expectation that the budget will be affected by program changes, pricing changes in contracts (such as union contracts with wage increases) and inflation. General guidance is given with respect to the expected outcome of the budget - in other words, the expectation to remain consistent with the

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<sup>36</sup>See Appendix 7.3 for the summary of budget responses from the “Interjurisdictional Survey” in Appendix 8.1.

previous year, or increase or decrease. Government strategic plans that have cost or revenue implications must be factored into the preparation of the estimates.

*(ii) Preparation of the Estimates*

Annually, individual departments perform a comprehensive review of the revenue and cost expectations of the programs and administrative expenditures for the next fiscal year. The account chart structure is prepared and approved by the Comptroller General. Categories of programs and activities used for the preparation of the estimates are established and approved by Treasury Board. Each monitored category is called a “vote” or “activity.” Within the votes or activities are main objects for current or capital expenditures. The votes for each department are combined to form the estimates for that department. Considerable effort at all levels of authority within the departments is expended to challenge the details of the estimates prepared.

The departmental expenditure estimate is called a Head of Expenditure<sup>37</sup> and the responsibility for preparation of the budget and monitoring of the expenditures is delegated to the Deputy Minister.<sup>38</sup> When the department is satisfied that it has adequately addressed its needs for the year and has followed the guidance given, its estimates are entered into the Oracle Financial Analyzer and, together with other analyses, are submitted to the Budget Division of the Department of Finance.

*(iii) Approval*

The Budget Division analyzes all proposed departmental expenditures within the estimates. Depending on the submissions, requests are made to refine, modify or clarify these estimates. When the Budget Division has completed its analysis, the expenditure estimates are presented to the Budget Committee, an informally structured group consisting of the Premier, key cabinet ministers and government officials, for review. Any requested revisions are made. A summarized package of information consisting of: statement 1<sup>39</sup> of the estimates summaries of decisions made by the Budget Committee; an update of the projected results for the previous year; a three-year outlook; a summary of net debt; details on revenue by source; an analysis of the previous year’s budget; revised estimates and forecasted year-end position; and a summary of outstanding request and unresolved items are then sent to the full Cabinet for its review prior to tabling in the House of Assembly. Ministers of various departments also may make appeals to Cabinet if they believe that there are expenditure requests that have been denied by the Budget Committee but which, in their

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<sup>37</sup> Newfoundland and Labrador, “Financial Management Circular” 1.010.

<sup>38</sup> See FAA, Ss. 26(1) and (2); and “Financial Management Circular” 1.010.

<sup>39</sup> Statement 1 contains the summarized details of the expenditure requests for each department or government body that requested funds for inclusion in the supply bill to be approved by the House of Assembly.

view, have a higher priority than other expenditures already approved. Cabinet then makes the final decisions on the estimates to be included in the budget presented to the House.

In the House of Assembly, questions are asked of the budget and, once answered, the budget is approved as is or with modifications. This is accomplished by the passage of a supply bill. Based on discussions with officials, rarely are any changes made to the estimates after being tabled in the House of Assembly. The Lieutenant-Governor signs a warrant after the supply bill is approved to officially provide the appropriations for government's use.<sup>40</sup>

This legislative approval process is required for all government expenditures because section 22 of the *Financial Administration Act* provides that, with a few limited exceptions, no issue of public money may be made out of the consolidated revenue fund "except under authority of the legislature." This notion, of course, is a fundamental principle of our parliamentary democracy.

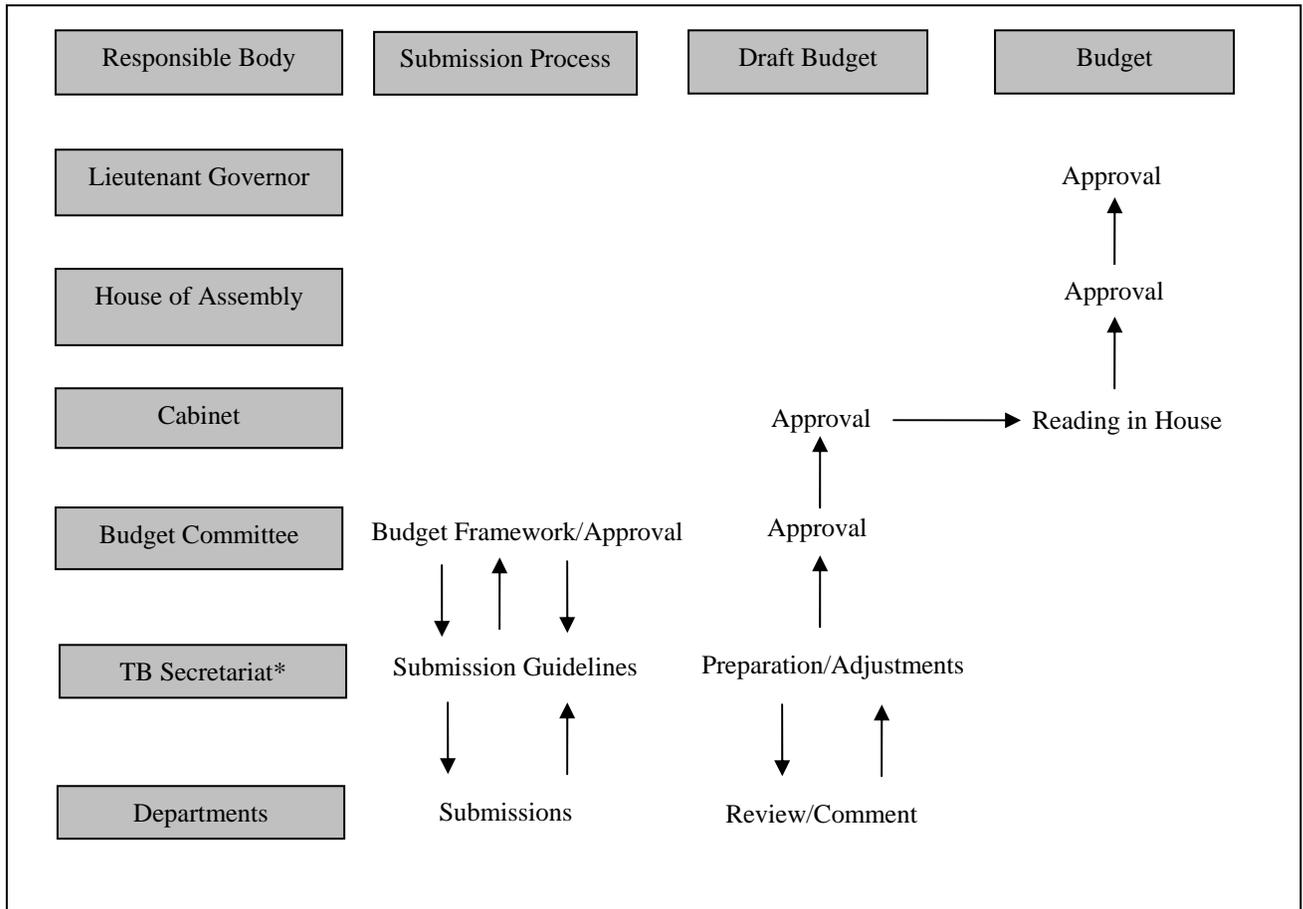
Chart 7.1 provides a diagram, last updated in March 2003, to illustrate the various stages of the preparation of the estimates.<sup>41</sup> Based on discussions with government officials, the process below remains the same today, with some modifications in the titles of the bodies performing the tasks.

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<sup>40</sup> "Financial Management Circular" 1.010.

<sup>41</sup> Financial Management Handbook of the Office of the Comptroller General, p. 30.

**Chart 7.1**



\* The functions of the Treasury Board Secretariat with respect to the budget process are now being performed by the Budget Division of the Department of Finance. As well, the Public Service Secretariat also reviews each new employment position being requested during the budget process.

**(iv) Monitoring**

After the approval of the estimates, each department enters the estimates into the government’s financial management system. The amounts entered into the financial management system are at a very detailed level - by responsibility centre and by account. Deputy Ministers<sup>42</sup> are responsible for ensuring all expenditures within their departments are appropriate, and they must certify that the government policies for purchasing, receiving goods and appropriateness of payment have been followed prior to making a request for funds to be expended.<sup>43</sup> All requests for payments are made through the Comptroller

<sup>42</sup> Or “another authorized person”: See *Financial Administration Act*, ss. 30(1).

<sup>43</sup> *FAA*, s. 30.

General's office. The Comptroller General is given the responsibility for monitoring the actual expenditures to ensure that a subdivision is not exceeded. Funds cannot be expended if there is insufficient funding available.<sup>44</sup> At the subdivision level, such monitoring is absolute, with the request for payment being denied if the account is over its limit. Below the subdivision level, monitoring can be absolute, or advisory. If it is monitored on an advisory basis and the account is over its limit but the subdivision is not, the request for payment is processed and a notification is sent.

On a monthly basis, each department is required to complete a submission and forward it to the Budget Analyst within the Budget Division assigned to monitor the expenditures of that department. I have been told these monthly submissions are analyzed and that at the appropriations level within the budget, any material variances from budget are followed up with the department by the Budget Division.

**(v) *Transfers***

In all government departments, expenditures are monitored against the budget or estimates and, as noted above, payments cannot be made if there is insufficient funding available in the respective votes. As circumstances often change subsequent to the time the estimates are prepared, it is not unusual to require changes during the fiscal year to the overall estimates or to the allocation to the votes within the estimates. Policies are in place to provide guidance on how these transfers are to occur.

If the required additional funding is within the same department or Head of Expenditure, and within certain specified votes or activities (within "subheads" or "subdivisions" of subheads), the Deputy Ministers have been delegated authority to approve certain transfers as long as there are countervailing savings that have been identified,<sup>45</sup> and as long as they are within certain categories.<sup>46</sup> However, Deputy Ministers do not have the ultimate authority in all cases. Transfers between current and capital accounts or into salary activity accounts generally require further approval by Treasury Board or Cabinet, even if they are within the Head of Expenditure or vote.<sup>47</sup>

Funds to be transferred between Heads of Expenditure require approval in a supply bill that is approved at the Treasury Board or Cabinet level. If new money is required in a department, and the House is sitting, a new supply bill must be raised and approved in the House. If the House is not sitting, and new money is needed, authority has been delegated by Treasury Board to the Treasury Board Secretariat for the issuance of a special warrant.

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<sup>44</sup> FAA, Ss. 25(5), 29.

<sup>45</sup> See, FAA, ss. 28(1)

<sup>46</sup> Government of Newfoundland and Labrador, Office of Comptroller General, *Financial Management Policy Manual*, 2005, Policy 2.1.4.

<sup>47</sup> See Appendix 7.4 for a copy of the executive council of the Treasury Board Directive Number 97-07 which outlines the transfer of funds policy for departments.

When the House reopens, any special warrants are tabled in the House as supplemental supply bills and approved.<sup>48</sup>

As can be seen from the foregoing description, the budgetary process and the subsequent monitoring of expenditure pursuant to budgetary appropriations is quite elaborate, and is hemmed in by controls and approval requirements throughout the appropriation-spending process. The contrast with the budget process in the House is quite striking.

## **Budget Process Within the House of Assembly**

### *(i) Initialization of the Budget Process and Preparation of the Estimates*

The budgetary process of the House of Assembly does not conform in all respects with that followed by the executive branch of government. Though the House follows the overall government processes with respect to the guidelines for the initialization and preparation of the budgetary estimates, it appears, however, that in the past the preparation, documentation, analysis and review have not reflected the degree of diligence appropriate for this important financial planning and management process. One particular concern, the pattern of recurring budgetary overruns in specific accounts (most notably the allowances and assistance account) appears not to have been meaningfully addressed in the budgetary process of the House.

As was illustrated in Chapter 3, in recent years the “revised” estimates of expenditures for the fiscal year just ended have been consistently understated for the MHA allowances and assistance account. This leads to two causes for concern:

- i) It created a misleading indication of budgetary performance. The revised estimates indicated that expenditures in the current fiscal year were substantially on track. Accordingly, there was no requirement for a discussion of the variances in the budget review process.
- ii) Since the revised expenditure estimates for the current year were understated at budget time, there was no indication of the extent of the budgetary overruns on allowances and assistance when the budget was tabled in the House. With this lack of transparency, there was no basis for a timely debate on sizeable expenditure overruns in the current fiscal year that could lead to a reasonable basis for questioning the legitimacy of the estimates for the coming year. The actual expenditure overruns were not identified until the public accounts were released several months later, far removed from the profile of the budget debate.

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<sup>48</sup> See generally *FAA*, s. 28.

Clearly, greater attention should be paid to ensuring that the most accurate and up-to-date estimates possible are provided to the IEC in its deliberations on the budget. Also, it is incumbent on the IEC and the Clerk to ensure that the estimates provided to the House contain the most up-to-date and meaningful information possible to ensure that the budget is presented in a manner that fairly presents the expenditure experience and trends.

*(ii) Approval*

The process for the approval of the budgetary estimates of the House differs significantly from that applicable to the executive branch of government. The Budget Committee, Treasury Board and Cabinet are not involved in the legislative approval process. This responsibility falls under the IEC. The estimates “for the payment of the members’ salaries and other expenses of the House” are prepared by the House administrative staff on behalf of the Clerk and are presented by the Clerk to the Commission of Internal Economy for approval.<sup>49</sup> In the case of the statutory offices of the House, such as the Child and Youth Advocate and the Citizens’ Representative, a different procedure occurs. Although there are some differences in each of the pieces of legislation constituting each office, each *Act* generally requires that the hiring of staff and the payment of expenses of the office must receive the approval of the IEC.<sup>50</sup> Although most Acts do not expressly say that a formal budget must be submitted annually to the IEC,<sup>51</sup> the approval requirements in the respective legislation effectively means that is what must happen, and that, in fact, is what does occur. The Clerk, therefore, is not directly involved in the estimates preparation process for the statutory offices, except as a conduit to pass along to the IEC the estimates prepared by each office.

The only scrutiny that the estimates for the House and the statutory offices receive is that given by the IEC. In the past, there was no “professional” analysis requiring responses undertaken by the staff of the House, nor by the Budget Division of the Department of Finance, as is the case with the estimates prepared by departments in the executive branch of government. In my view, this is a serious weakness.<sup>52</sup>

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<sup>49</sup> *Internal Economy Commission Act*, s. 6.

<sup>50</sup> *Child and Youth Advocate Act*, S.N.L. 2001, c. C-12.01, Ss. 10, 11; *Citizens’ Representative Act*, S.N.L. 2001, c. C-14.1, Ss. 9, 10; *Access to Information and Protection of Privacy Act*, S.N.L. 2002, c. A-1.1, Ss. 42.6, 42.7; *Elections Act*, 1991, S.N.L. 1992, c. E-3.1, Ss. 7, 9; *House of Assembly Act*, R.S.N.L. 1990, c. H-10, s. 34. The *Auditor General Act*, S.N.L. 1991, c. 22, s. 23 does not require the approval of the IEC for hiring of staff, but does require the submission of a budget.

<sup>51</sup> Exceptions are the offices of the Chief Electoral Officer and the Auditor General; for each there is an express requirement for the annual submission of a budget. See *Elections Act*, 1991, s. 9; *Auditor General Act*, s. 33.

<sup>52</sup> I understand that during the budget process for the 2007-08 fiscal year the estimates for the statutory agencies, except that of the Auditor General, received scrutiny by the House staff.

The IEC may approve the estimates as submitted to it or may alter them. Subsection 6(3) of the *Internal Economy Commission Act* then provides:

The estimates as approved or altered by the commission shall be submitted to the minister [of Finance] and shall be laid before the House of Assembly with the other estimates for the year.

Prior to 2000, the subsection required that the estimates be submitted to the Minister of Finance “for the minister’s approval.” This phrase was removed as part of the legislative changes in 2000 giving the IEC the authority to control the audit process and the documentation that should be submitted in support of claims, as discussed earlier in this report. The intent was clear - the executive branch of government was not to have any control over what the budgetary estimates of the House and the statutory offices should contain. They were to be included in the provincial estimates and put on the floor of the House, as submitted by the IEC. Inasmuch as few changes are made to the estimates once they reach the floor of the House, the result is that whatever is submitted by the IEC will generally be approved.

The position of the IEC in this regard was reinforced by the following directive issued by the IEC at its meeting of February 26, 2003:

8. The Commission by order directed the Clerk to advise the Treasury Board Secretariat ... that no changes may be made to the Estimates without the approval of the Commission in accordance with the authority of the *Internal Economy Commission Act*.

Other directives to the same effect were also issued by the IEC from time to time in recent years, reinforcing the same position.<sup>53</sup>

The autonomy of the legislature and the concept of the supremacy of parliament are often put forward - both in this province and in other Canadian legislatures - as justifying this approach. To do otherwise could involve an interference with parliamentary privilege. There is, however, a competing constitutional principle that must be considered. It is found in section 54 of the *Constitution Act, 1867*.<sup>54</sup> It provides, in effect, that a money bill - which a supply bill to approve estimates surely is - may only be introduced into the House by the executive.<sup>55</sup> A corollary is that no amendments to a supply bill increasing expenditures may

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<sup>53</sup> *Report of Commission of Internal Economy for Fiscal Year April 1, 2001 to March 31, 2002*, pp. 13-4, March 6 meeting at minutes 1-6; and *Report of Commission of Internal Economy for Fiscal Year April 1, 2000 to March 31, 2001*, p. 9, January 3 meeting at minute 5.

<sup>54</sup> S. 54 by its terms only applies to the Parliament of Canada; however, it was made applicable to the four founding provincial legislatures by s. 90 and to Newfoundland and Labrador by Term 3 of the *Newfoundland Act*.

<sup>55</sup> In fact, s. 54 actually says that a bill for the appropriation of any part of the public revenue must be “first recommended to that House by Message of the Governor General” (the Lieutenant-Governor in the case of

be made without executive approval. Given full reign, this principle would justify the inclusion of the requirement of ministerial approval of the House estimates in subsection 6(3) of the *Internal Economy Commission Act* as it existed before 2000.

Fortunately, it is not necessary to resolve this interesting conflict of competing constitutional principles. It is sufficient to record that the executive, perhaps out of deference (not capitulation) to the idea of legislative autonomy, does not, as a general rule, question or attempt to revise the estimates that are approved by the IEC before putting them on the floor of the House. This is as it should be in most cases; however, it must be recognized that in the case of a fundamental disagreement as to the appropriateness of the IEC approved estimates, the executive could, relying on section 54, *refuse* to place the estimates in their current form before the House, thereby setting up a potential for negotiation between the two branches of government as to what would be acceptable to go into the estimates.<sup>56</sup>

Although I agree that, in principle, the budgetary process of the legislative branch should not *necessarily* be constrained by executive budgetary policy and, in particular, by directives of Treasury Board as to the types of, or limits on, expenditures that should be included in the estimates, it is nevertheless important that the process undertaken by the IEC be a thorough and analytic one. I have noted above that the process as it operated up to this year did not allow for any professional analysis of the estimates as presented. The members of the IEC can not be expected to have the necessary financial expertise to engage in a detailed technical analysis of the budget proposals. They should, however, as I have recommended in Chapter 5, have a broad governance and due diligence role in all financial matters that they may not be fully exercising now.

It becomes all the more important, therefore, that the IEC members have access to necessary financial expertise and that they be encouraged to avail of it. The Clerk must be expected to defend the estimates he or she proposes for House operations, but for him or her to be challenged, the IEC needs other analytic advice. I do not see any impediment to IEC availing of the services - in an advisory capacity - of the Budget Division of the Department of Finance for this purpose. With respect to the statutory offices, the estimates prepared for each should not go directly to the IEC for consideration, but should be first subject to analysis by the Clerk, who would then be expected to provide his or her advice to the Commission.<sup>57</sup> I say this for two reasons. First, in the revised structure of the House that I

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Newfoundland and Labrador). Since the Queen's representative takes "advice" from the executive, that effectively means that any "message" from the Lieutenant-Governor would have to be made with the approval of the executive.

<sup>56</sup> A contrary argument might be that by removing the requirement for ministerial approval from ss.6(3) of the *Internal Economy Commission Act* and requiring that the IEC estimates "*shall* be laid before the House", the executive, as the original sponsor of the *Act*, was signifying its general consent to placing all IEC estimates on the floor of the House in the form submitted. That consent was subsequently countermanded by amending legislation.

<sup>57</sup> I have been told that the Chief Financial Officer performed considerable analysis of the budgets of the applicable statutory offices during the budget process for 2007-08, and submitted such analyses to the Clerk

have recommended in Chapter 6, the Clerk should have, in relation to the statutory offices (except the office of the Auditor General), a broader and clearer role with respect to the financial and administrative policies applicable in the offices. As such, he or she should have some degree of oversight over the budgetary process in respect of those offices. Secondly, it is important that the overall budgetary requirements of the House of Assembly (including the statutory offices) as a Head of Expenditure be coordinated and considered as a whole. If the Clerk were not to have any input, even by way of advice, that goal would be frustrated.

Accordingly, I will make the following recommendation:

***Recommendation No. 41***

- (1) The estimates of the House of Assembly, as approved by the House of Assembly Management Commission, should continue to be submitted to the Minister of Finance with the expectation that they be placed on the floor of the House as part of the provincial estimates without change, but recognizing that the executive may retain a residual discretion to refuse to present them in that form in exceptional cases;***
- (2) Estimates for the statutory offices should continue to be prepared by the offices concerned and presented to the Commission for approval;***
- (3) Before the Commission makes a decision on the estimates submitted by the statutory offices, it should request the Clerk to provide an analysis and commentary to the Commission on those estimates; and***
- (4) Before the Commission makes a decision on the budgetary estimates for the operation of the House prepared by the Clerk and on those prepared by the statutory offices, the Commission should avail itself of independent advice in respect of the estimates and, in particular, should submit the estimates to the Budget Division of the Department of Finance for analysis and comment.***

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prior to the presentation of those budgets to the IEC.

### ***(iii) Budget Monitoring and Financial Reporting***

With respect to budget monitoring and financial reporting, I understand from interviews with staff within the House administration that, in the past, the budgetary performance within the respective accounts relating to the House was not regularly monitored against budgeted allocations throughout the year. Regular monthly budget update reports were not provided to the Budgeting Division of the Department of Finance, despite the fact that this was the practice employed throughout the executive branch of government. There was no formal follow-up by the Budget Division in recent years (apart from telephone enquiries that indicated that generally things were “OK”). I understand that this lack of follow-up by the Budget Division on requests for information may be a further reflection of the fact that the IEC took pains to impress upon the executive branch of government that they were an autonomous body and should not be subject to interventions from Treasury Board or Finance.

The absence of an ongoing financial monitoring process in the budgetary administration of the House was likely a key explanation for why errors in posting to the accounts that occurred throughout the year went undetected. Often, the errors were not corrected until late in the fiscal year when the preparations of the year-end reports commenced (and it is not at all clear that all such posting errors were detected even during this year-end review).

### ***(iv) Account Structure and Expenditure Control Within Sub-Accounts***

In Chapter 4 I noted that the accounts of the House were structured such that only very high levels of accounts - in fact, the level of the accounts actually voted in the House - were monitored against the estimates for overspending thereby masking significantly the variances in subcategories of expenditure within each account.<sup>58</sup> This was particularly troubling with respect to the - now identified - trend in overspending with respect to constituency allowances. This, in turn, meant that over expenditures within subcategories of such accounts were likely not identified until late in the year or, even worse, not identified at all - in my view, the publicly reported account structure in the estimates should be revised to subdivide the Allowances and Assistance Account so that allowances are budgeted and reported separately from MHA salary compensation.

A further dimension of this issue relates to the lack of *individual* accounts for Members’ constituency allowances and the absence of a framework installed to control individual Members’ expenditures to the respective prescribed maximum. The significance of these issues was also highlighted in the discussion of expenditure overruns on constituency allowances and administrative deficiencies in Chapters 3 and 4.

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<sup>58</sup> See Chapter 4 (Failures) under the heading “Ineffectiveness of Central Control Functions in Government”; (i) “Inappropriate Account Structure in the Estimates.”

It has been represented to me that the concerns are in the course of being addressed. I have been told that, as of October, 2006, the House administration is utilizing the Oracle Financial Management System's discoverer tool to assist with providing periodic reports to monitor all House accounts. As well, based on recent discussions with the House staff, it appears that budget monitoring reports are now being made to the Budget Division on a regular and timely basis.

Furthermore, I understand that, as of October, 2006, the administration of the House has begun to monitor the "allowances and assistance" account by individual MHA. Each MHA account is being monitored against the maximum allowed allowance allocation for the respective constituency. I am told controls have been put in place to cap spending at the prescribed maximum. Overspending at the MHA level for their constituency allowances should not now occur as the system will not process a payment if there are insufficient funds left in any individual account.

**(v) *Transfers of Funds***

The transfer of funds from one subhead or activity to another within the House of Assembly Head of Expenditure is another area of budgets that differs from the executive branch of government. The normal requirements for approval of transfer, as set out in section 28 of the *Financial Administration Act* and in government policies, were not regarded as always applying to the House. Section 28 prescribes that "a department may, with the prior consent of [Treasury] board, where countervailing savings can be affected from other subheads of its Head of Expenditure, apply those savings to meet the excess expenditure." Section 9 of the Act provides that the Lieutenant-Governor in Council may make regulations concerning various matters within the scope of the Act. In this regard, the Lieutenant-Governor in Council issued a MC 97-0410 to provide guidance on the transfer of funds, and on June 16, 1997, Treasury Board issued a Directive Number 97-07 outlining the "Transfer of Funds Policy for Departments."<sup>59</sup> The policy provides deputy ministers with the authority to transfer funds in various types of circumstances, and prescribes other situations where approval is required by Treasury Board. Paragraph G of that policy indicates that transfers to or from an "allowances and assistance" account requires Treasury Board approval. There is no indication in the policy as to whether or not the House was considered a "department" for the purpose of the policy.

Whether legally the policy should or should not have been applied to the House may be a debatable point. The House was nonetheless very protective of its independence in relation to its spending authority. I understand that the administration processed some transfers on its own without reference to Treasury Board. However, on a number of occasions the staff of the House sought and obtained Treasury Board approval for the

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<sup>59</sup> See Appendix 7.4.

transfers. I understand from our consultation process that Treasury Board staff, based on their understanding of the principle of legislative autonomy, issued Treasury Board Authorities (“TBAs”) for the transfers, sometimes with very little information. There is little or no indication in the minutes of the IEC that transfers were authorized in advance by the IEC.

In essence, from a practical point of view it appears that the funds transfer process in the House was directed and implemented at the staff level by the Director of Financial Operations.<sup>60</sup> Even when Treasury Board authority was sought, the purpose for which the money was to be spent went largely unchallenged out of respect for the independence principle. It can be argued that, as a result of the principle of legislative autonomy, it is not appropriate to involve Treasury Board or an arm of the executive branch. However, approvals by someone other than the initiator of the transfer *must* be required.

I understand that in recent months the IEC has established a policy that all transfers of funds are to be approved by the Chief Financial Officer and the Clerk and then *ratified* by the IEC.<sup>61</sup> Similar policies occur in other legislatures across the country.<sup>62</sup> I am not convinced that this is adequate, as it would seem more appropriate to require that certain transfers, particularly those relating to the accounts currently included in allowances and assistance, and transfers across the boundaries of the statutory offices, receive *prior approval* by the IEC.

Accordingly, I recommend:

***Recommendation No. 42***

- (1) In preparing the budget for the House, the “revised” estimates for the current year, to be included with the budget for the coming year, should be based on a comprehensive analysis of expenditures to date and best estimates of expenditures for the balance of the year, and these revised estimates should be reviewed with the House of Assembly Management Commission together with an up-to-date variance analysis as an integral part of the budgetary process;***
- (2) The Commission should only approve the House estimates for submission and inclusion in the overall estimates of the Province after it completes detailed reviews of the information explaining the basis for the items making up the overall estimates;***

<sup>60</sup> The Director of Financial Operations has indicated to me that he discussed transfers of funds in advance with the Clerk.

<sup>61</sup> Letter from the Chief Financial Officer of the House of Assembly to the Deputy Minister of Finance (August 11, 2006).

<sup>62</sup> See Appendix 7.3.

- (3) *Monthly budget reports on the accounts of the House should be prepared and submitted to the Budget Division of the Department of Finance on a regular basis and along with an explanation of any significant variances. The Budget Division should provide the Clerk with any questions or comments it may have on such reports. These reports should also be provided to the Commission for review and discussion along with any questions or comments from the Budget Division;***
- (4) *Any errors identified from the monthly review of the budgets to actual expenditures should be corrected on a timely basis;***
- (5) *The Allowance and Assistance account in the Estimates of the House of Assembly should be subdivided into at least two separate accounts such that allowances are budgeted and reported separately from MHA salary compensation; and each separate account should be appropriately named in a manner that is indicative of the nature of the expenditures encompassed by each account;***
- (6) *The budgets prepared for the separate account relating to allowances should be segregated by Member and monitored accordingly;***
- (7) *A Transfer of funds policy should be developed by the House of Assembly Management Commission generally consistent with the government practice as outlined in TB Directive 97-07, except that the approval of both the Clerk and the Chief Financial Officer should be required for the transfers otherwise authorized by a deputy minister in a department. For transfers that would require Treasury Board approval in the case of a government department, the prior approval of the Commission should be required (including all transfers that involve the movement of funds in respect of salaries and allowances accounts (formerly “allowances and assistance”) and transfers across the parameters of the statutory offices); and***
- (8) *The approval of all transfers should be ratified by the Commission and clearly documented in the public minutes of the Commission.***

Beyond the broad scope of the budgetary process, there are a number of individual components within the financial management and control system that have a significant impact on the operation of the House. In particular, I will review the purchases, payables, payment and payroll processes.

### **Purchases, Payables, Payment Process Within the Executive Branch of Government**

There are a number of components essential to effective operation of the purchases, payables, payment process. The provincial policies and practices within the executive branch will first be discussed and then compared with those of the House.

#### ***(i) Initiation***

The purchase, payables, payment process in government departments is initiated in one of three ways: (i) preparation and approval of purchase requisitions; (ii) direct charges; and (iii) expense claims. It is necessary to record a few comments about each.

#### ***(a) Preparation and Approval of Purchase Requisitions***

The purchasing process commences with the necessity for goods or services. When this need arises, a purchase requisition is prepared. Depending on the dollar value of the goods or services, this requisition is then forwarded to an individual in the department that has been designated as an authorized departmental approver. It is this person's responsibility to review the requisition and to ensure that the purchase has a legitimate business purpose and is in accordance with spending authority. Once approved, the requisition is forwarded to the Government Purchasing Agency (GPA) where the purchase order and an invitation for Quote or Tender forms are created. It is the GPA's responsibility to ensure that the requisition has been forwarded by an authorized departmental approver.<sup>63</sup> If this is not the case, the requisition is sent back to the department for approval by an authorized individual.

The GPA has delegated low-dollar value purchasing authority to departments. The permanent head of the department designates those officers of a department who may acquire goods and services with low-dollar values directly from suppliers.

*Financial Management Circular 7.010* documents the government policy that recognizes the importance of the approval of purchase requisitions and the key control that purchase requisitions must be approved by authorized departmental approvers.

***(b) Direct Charges***

Direct charges include payment of invoices or transfer of funds to external parties from funding allocations that have not been previously encumbered through the purchase requisition process. Direct charges include items such as grants, allowances, payments to consultants and telephone charges.<sup>64</sup> Officials authorized to incur such expenditures must ensure that provisions have been made in the current year's approved estimates for the activity involved or that approval was granted through other legislative authority. These officials must also determine that the expenditure is a legitimate government purchase and in accordance with appropriate legislation.

*Financial Management Circular 2.075* documents the government policy for direct charges. This policy recognizes the importance of the approval of direct charges and the key control that these purchases must be in accordance with the government's spending authority.

***(c) Expense Claims***

There are a number of different steps necessary for a travel claim to be initiated and approved in the purchases, payables, payment system. A claimant must certify that the expenses claimed were incurred on government business and are in accordance with the rates, amounts, and allowances prescribed by the Treasury Board.<sup>65</sup> The purpose of the trip must be clearly indicated upon the travel claim and all supporting documentation must be attached. In each program area, a person has been delegated the authority to review the claims and the supporting documentation and approve them. Expense claims are then submitted to the department's account division where they are reviewed for compliance with the rules and receive final approval for payment.

***(ii) Request for Tenders and Purchase of Goods***

After the initiation of the purchase, the next part of the purchases, payables, payment process is to send out a request for tender or, depending on the dollar value of the purchase, to obtain three quotations. This step in the process ensures the most competitive pricing is obtained and gives all vendors equal opportunity to provide the goods and services.<sup>66</sup> Once the winning tender or quotation is selected, the purchase order is prepared, entered into the government's Financial Management System (FMS) to "encumber" (i.e. commit) the funds, and the purchase is made.

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<sup>63</sup> "Financial Management Circular" 7.010.

<sup>64</sup> "Financial Management Circular" 2.075.

<sup>65</sup> See *FAA*, ss. 30(1) (b).

<sup>66</sup> "Financial Management Circulars" 1.020 and 2.075.

*Financial Management Circulars* 1.020 and 2.075 provide references to government policies in place that recognize the importance of the tendering process and the need for taxpayers to receive value for money.

**(iii) *Receipt of Goods and Completion of the Receiving Report***

The next step in the purchasing process occurs when the goods are received from the supplier. The individual responsible for receiving the goods must ensure that the goods shipped are appropriate and in the correct quantity.<sup>67</sup> The individual should document this information on a receiving report maintained as part of the purchasing process.

**(iv) *Receipt of Invoice and Payment Processing***

Once the goods or services have been received, the payment process begins. Involved in the payment process are three people - the certifier, the enterer and the approver. When the invoice is received from the supplier, the next step is to determine if certification for payment is required. The certification for invoice payments is usually delegated to managers or directors. Certification is necessary when the invoice is not supported by a receiving report, the invoice does not agree with the terms of the contract, or the invoice is for advance payment that is specified in the contract.<sup>68</sup> Individual invoice certification is not required when there is a supporting purchase order and a receiving report, or when the payment is for utility bills of a recurring nature. The certifier is not usually involved in the purchase process or the invoice payment process. This supports the segregation of duties function.

Next, the enterer ensures that the payment documentation has been certified for payment, if applicable, and that all documentation is complete. From here, the information is entered into the accounts payable system in the government's FMS.<sup>69</sup> The department's accountant or accounting manager authorizes the enterer to input the payment information into the FMS system.

After all pertinent information is entered the final payment processing step is the approval of payment requests. The approver must ensure that the amounts represent valid charges against public funds and that the expense is in compliance with the *Financial Administration Act* and in accordance with the estimates.<sup>70</sup> Once the approver is satisfied that these criteria are met, the invoice is approved for payment.

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<sup>67</sup> "Financial Management Circular" 2.150.

<sup>68</sup> Ibid.

<sup>69</sup> "Financial Management Circular" 2.

<sup>70</sup> "Financial Management Circular" 2.150.

*Financial Management Circular 2.150* documents the government policy that stresses the importance of the segregation of duties.

### **Purchases, Payables, Payment Process Within the House of Assembly**

In the past, much of the government's purchases, payables, payment process was not followed in the House of Assembly. In relation to purchase initiation, no policy existed to require a review of the purchases of the legislature to ensure they were in compliance with the government policies and procedures as issued by the Government Purchasing Agency. As a result, funds could be encumbered without receiving the appropriate approvals and could lead to purchases with no legitimate business purpose. Additionally, as the government's process of tendering or receiving of three quotations was not always followed in the House, it is difficult to ascertain whether the legislature received competitive prices for its purchases.<sup>71</sup>

In relation to the payment portion of the processing of invoices or expense claims, government policy was again not followed in the House. The most significant difference related to a lack of the segregation of duties function among the accounting staff in the House. By not having separate employees perform the certifier, enterer and approver roles during payment processing, the same person was able to approve purchase orders and also the payments of corresponding invoices.<sup>72</sup> As a result of these incompatible functions, purchases did not receive an appropriate level of scrutiny and the legislature's assets were left open to misappropriation.

From discussions the commission staff have had with current members of the House administration, I am satisfied that they acknowledge that these deficiencies occurred and indicate that a review of the requisition and purchasing component of the process will occur. I am now told by the House administrative group that as of October 2006 they have implemented the government's policy on purchases, payables and payment to ensure that the House's requisitioning and purchasing activities are in accordance with legislation and the policies and procedures issued by the Government Purchasing Agency.

With respect to the segregation of duties issues, four clerk positions have been added to the House administration in recent months (three as full-time temporary hires and one seconded from another government department). Currently, the roles of certifier, enterer and approver as outlined in the executive branch of government's policy have been adopted in the House. However, no review of the purchases, payables and payment system in place

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<sup>71</sup> Discussion with the Chief Financial Officer of the Newfoundland and Labrador House of Assembly (January 2007).

<sup>72</sup> Ibid.

within the statutory offices has occurred to date.<sup>73</sup> Included in Appendix 7.5 is a summary of the steps for the purchases, payables, payment process. It describes the “what could go wrong” scenarios and the controls required to prevent such things from occurring.

## **Expense Claims**

Although expense claims are a subset of the purchase, payables, payment system, I believe, as a result of the significant issues that have been identified as a result of the Auditor General’s comments on overpayments and double billings, they require additional focus.

As is evident from the discussion in Chapters 3 and 4, the House of Assembly did not in the past follow government policy in relation to expense claims. One of the most significant weaknesses in the expense claim process relate to supporting documentation. In many instances, Members were permitted to submit expense reports without supporting documentation. Thus, verification that the expense had actually occurred was not possible. For a long time there were no formal rules in the House in relation to the types of documentation required to support expenses. As a result, when support was included it was often incomplete and consisted of a variety of documents, itemized restaurant receipts, credit card slips, cancelled cheques, invoices, faxes, and the like.<sup>74</sup>

As expense reports made their way into the purchases, payables, payment system, many of the deficiencies as discussed above for the other types of items processed through the purchases, payables, payment system would also occur. Most notable is the lack of segregation of duties that often resulted in expense reports being processed and paid without receiving the proper scrutiny by House staff. The fact that employees and elected officials were not required to list each item on the expense claim, but rather permitted to group expenses together into one line on the claim, significantly increased the amount of time required to process claims and hindered the review process. A shortage of staff in the House further exacerbated the problems, often resulting in expense claims being rushed through the system without appropriate review to allow Members to receive their payments in a timely manner. The approval structure of the House administrative group also contributed to the problems, as a subordinate often approved data entered into the FMS by a superior. In addition, as outlined in Chapter 3, an electronic approval of the request for payment was often performed at a different location without any supporting documentation being available for review.

Double billing and double payment are other matters that have received significant media coverage recently, and I have mentioned these issues in Chapters 3 and 4. The Auditor General has indicated that he has seen instances of elected officials claiming expenses more than once, or double billing. To illustrate, a Member may have lunch at a local restaurant.

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<sup>73</sup> Ibid.

<sup>74</sup> Ibid.

The Member pays with a credit card and receives two receipts for the credit card purchase: one itemized listing of the items ordered and one slip that shows the approval for the purchase and required signature. As the rules in relation to documentation were not specific, either of these slips would have sufficed as supporting documentation for expense claim purposes. Different documents could therefore be used to support more than one claim for the same expense. Furthermore a Member may have expensed meals for a particular day as well as claimed a per diem amount on another expense report. While this could occur accidentally, through inadvertence, it is possible that the action could be taken with the intention of asset misappropriation. Another example relates to travel. A Member could fly to his or her district and expense the airfare. On another claim, the Member could expense the mileage required to drive to the district. These examples are just some of the ways that the assets of the government are open to misappropriation, as the opportunity exists to either accidentally or intentionally claim the expense twice.

A related concept to double billing is double payment. If the duplicate expenses that are claimed are paid twice because the controls within the House do not identify the double billing, double payment occurs and the person receives two payments for the one expense.

Commission research and discussions with House staff indicate that a number of controls processes have recently been initiated that may effectively counteract these weaknesses. Most notably, a series of detailed rules and procedures were issued on July 6, 2006, by the IEC.<sup>75</sup> It is noted that a rule has been implemented that all expense claims must include supporting documentation.<sup>76</sup> Expense claims submitted without appropriate support are to be rejected and processed only when documentation has been included. Furthermore, as of January 4, 2007, only original receipts showing that the payment has been made will be accepted.<sup>77</sup> Photocopies of receipts, faxed invoices, cancelled cheques, or itemized restaurant bills alone are no longer accepted as supporting documentation.

With the addition of two new clerks in the purchases, payables, payment process there will be more time available to spend on the review of expense claims to ensure they are properly reviewed and supporting documentation attached. With all of the recent attention on expense claims and the allegations of double billing, I have been advised a group of staff have been dedicated to expense claim review. This should permit the appropriate level of segregation of duties and make it more difficult for unsupported claims to be processed. I also understand that a new approval structure has been implemented with approvals being given by a person more senior than the enterer and certifier.

Another safeguard added to this process is the implementation of a new expense claim form. This form requires expenses to be itemized. This allows for an easier review of

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<sup>75</sup> Letter from the Speaker of the House of Assembly to the IEC, (July 6, 2006).

<sup>76</sup> Ibid.

<sup>77</sup> Memo from the Speaker of the House of Assembly to all MHAs, entitled "Documentation to be Submitted with Constituency Allowance Claims," (January 4, 2007). This memo was subsequently ratified by the IEC; see "Draft Minutes of the Internal Economy Commission," January 9, 2007 meeting at minute 10.

the expense claims as the reviewers can quickly assess the adequacy of the supporting documentation. In addition, I have been advised that employees and elected officials have been notified that only claims filed on the new forms will be accepted.<sup>78</sup>

The tightening of policy to allow only original documentation showing that payment has occurred should be sufficient to prevent most types of double billing within the House.<sup>79</sup> Presently, the House has implemented a process whereby once an expense report is received from a Member, a detailed review of this Member's previous expense reports occurs. This review focuses on ensuring that per diems have not been claimed on days when other meals expenses have been claimed, or that travel costs such as airfare and mileage are not claimed for the same trip. This review also checks dates of expense claims and supporting documentation and searches for past expenses for the same or similar dollar amounts and explanations. Although this is a significant improvement in the controls over expense reporting, it is very labour-intensive and requires a large number of staff. As it is manually performed, the opportunity for inadvertent human error is still present. As an interim control, it is felt that this exhaustive review is appropriate to ensure expense claims are supported and are for legitimate business purposes.

To reduce the potential for errors of any kind to occur and to improve the efficiency of the process, a computerized expense claim process should be implemented whereby items would be entered by the employee or MHA or delegate of the MHA. As mentioned, phase two of the proposed new government expense claim process is planned to cover expense claims of the MHAs. The "Iexpenses" system can, I understand, be programmed to calculate automatically the amounts MHAs can claim for mileage, per diems and accommodations. With modifications, the system should also be able to check for dates to ensure no items are claimed twice for the same date.

Accordingly, I recommend:

***Recommendation No. 43***

***(1) The purchases, payables, payment process applicable to the executive branch of government should be adopted within the House of Assembly. Should any policy not be implemented due to particular circumstances within the House, alternate policies approved by the House of Assembly Management Commission should be implemented;***

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<sup>78</sup> See Appendix 5.4 for a copy of the new expense claim used by the House of Assembly.

<sup>79</sup> As noted in Chapters 3 and 4, there is still the very real possibility that double billing and double payment could occur if one claim is submitted to the House and another to a separate government department - *i.e.* a ministerial claim for the same expense.

- (2) *The Public Tender Act should generally apply to the House of Assembly administration and to the statutory offices, but the House of Assembly Management Commission should have the authority, by directive, to modify its application in particular cases where the differing circumstances of House administration may require modification. In such cases, however, the Commission should be required to put in place alternate and more appropriate tendering and purchasing regimes rather than simply declaring the Act's non-application;*
- (3) *A complete review of the purchases, payables, payment systems for the statutory offices should be undertaken. This review should include an analysis of whether all purchases for these offices should be centralized in the House or whether each individual office is better served by having a separate purchases department based on government policy;*
- (4) *A list of approved individuals to whom tasks within the House can be delegated should be prepared by the Clerk for circulation, and updated when staff functions change. The government policy should be reviewed to ensure that the delegation limits of the government are followed within the House;*
- (5) *A full review of the House's staffing needs should be undertaken. Presently, staff seconded from other departments resolve the segregation of duties issue on a temporary basis. It is necessary to ensure that adequate staffing is hired on a full time-basis to ensure the issue of incompatible duties does not reoccur;*
- (6) *The proposed new "Expenses" program should be implemented in the House to assist with the processing of expense reports;*
- (7) *A separate account structure within the financial management system for each MHA should be assigned to allow for monitoring expenditures against individual budgeted allowances. These accounts should be monitored at the "absolute" category so that only expenditures not over the limit are processed; and*
- (8) *The concept of on-line access to allow MHAs to review their constituency allowance expenditure information and compare it with their budgetary allocation should be examined and subsequently implemented within a reasonable period of time.*

As noted at several places in this report, the current expense claim process is further complicated by the fact that Members and Ministers use different types of expense reports for differing types and sources of expenditures, and these are submitted to two different areas within government. Members submit claims to the House, while Members who are also Ministers submit claims to both the House and their departments, depending on whether the expenditures incurred were for constituency or ministerial duties. As I have mentioned in Chapter 4, this is an area that leaves the opportunity for double billing and double payment to still occur. As long as MHAs and Ministers can submit multiple expense claims using different forms to different areas of government, and these claims are not verified against one another, it is not possible to ensure that double billing and double payments do not occur.

Examining expense claim processes relating to Ministerial expenses is not, in itself, within my mandate. However, it is within my mandate to recommend best practices to ensure that proper controls over allowance claims within the House exist. The possibility of double billing by claiming the same expense within the House and also within a department is equally a problem for the House as it is for the Executive. Either way, public funds will not be protected if the issue is not addressed. It would therefore not be fulfilling my mandate if I were to ignore this potential weakness in control of expenditure of public money where money within the House budget may be inappropriately spent on a claim that may legitimately have been charged to a government department.

Inasmuch as a review of double billing practice has been undertaken by the Auditor General to ensure that past expenditures have not been billed to the House more than once, it is appropriate for a similar review to be undertaken of past ministerial billing practices so that comparisons can be made with billings within the House to ensure that double payment in such circumstances has not also occurred.

Accordingly, I recommend:

***Recommendation No. 44***

- (1) An examination should be undertaken of the reimbursement claims of Ministers and Parliamentary Assistants from the fiscal years 2000-01 to 2005-06 and a comparison be made with claims by those persons made to the House of Assembly in respect of constituency allowances to ensure that duplicate claims have not been submitted and funds administered by the House unnecessarily spent; and***

**(2) *In the future, a review should be undertaken by the House of Assembly Management Commission and the Executive Council jointly to develop claims monitoring and classification processes that will identify and control duplicate claims billing across the legislative and executive branches of government.***

## **Payroll Process in the Executive Branch of Government**

The policies and procedures of the government of Newfoundland and Labrador respecting payroll matters are outlined below:

### ***(i) Maintenance of Payroll Records***

Departments and “Central Payroll” are responsible for the maintenance of applicable payroll, accounting and statistical records for all employees. Each day, attendance and overtime records must be kept and approved. All authorized leaves must be properly authorized and supporting request forms must be kept on file to account for employee absences. Each individual department is responsible for maintaining an individual personnel file for each employee. All payroll actions, including, but not limited to new hires, transfers, promotions and terminations must have appropriate supporting documentation and authorization.

### ***(ii) Input of Payroll Data***

Each department is responsible for the proper collection and input of payroll data into the payroll system.<sup>80</sup> These responsibilities include: the validity and correctness of data keyed; payroll verification; and processing of overtime and other special payments.

All keyed data must originate from an appropriately authorized source document, such as an approved time sheet. The control of having a supervisor review and approve timesheets ensures that employees are paid only for time worked and hence protects government resources.

### ***(iii) Processing Payroll***

The government payroll is processed in the Central Payroll Department. In addition to payroll processing, Central Payroll is responsible for various functions including the

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<sup>80</sup> *Financial Management Policy Manual of the Office of the Comptroller General* (October 2005).

preparation of income tax documentation (T4s); payroll adjustments, such as raises; and various administrative functions, including reconciliations at year-end.<sup>81</sup>

*(iv) Preparation and Distribution of Payroll Cheques/Direct Deposit*

Once payroll reports are run and the payroll payments are determined, payroll cheques and direct deposits are prepared and distributed. To enable the government to take advantage of the efficiencies of utilizing one business process for its payroll system and to obtain the maximum advantage of electronic direct deposits, departments must ensure all applicable employee groups are paid by direct deposit. All other remaining groups and individuals are encouraged to use direct deposit.<sup>82</sup>

**Payroll Process within the House of Assembly**

I have been informed by the House of Assembly staff that the executive branch of government's payroll system was followed in the House with one exception: the maintenance of employee personnel files. In this instance, supporting documentation showing the authorization for new hires, transfers, promotions, terminations and raise increases were not kept in most personnel files. In fact, there were employees of the House who did not have a personnel file. Through our discussions, it was determined that new hires would often be added to the system simply by making a call to the Central Payroll Department.

I understand from the House administrative group that steps are now being taken to implement the processes applicable to the executive branch of government to ensure the completeness and accuracy of all payroll action processes in the future. I have been told that the House now prepares payroll forms in accordance with government policy. Recently, a payroll clerk with significant payroll experience was hired by the House. I understand that, since that time, all of the necessary government documents to support changes to the payroll system are used, appropriately approved, and included in the respective employee's personnel file. To date, reviews of the payroll processes in the statutory offices have not occurred.

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<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

Accordingly, I recommend:

***Recommendation No. 45***

***A full review of the payroll process in the House and statutory offices should be undertaken to determine the adequacy of the current process and to confirm that the necessary changes have been implemented to ensure that the process now followed is in accordance with government policy.***

## **Operating System Controls**

The government's operating system consists of the "central accounting systems of government, including information imported from a department into the central financial and banking systems. These systems are commonly referred to as the Financial Management System (FMS) and form the books of the Province."<sup>83</sup> Oracle Financial Applications is the financial system presently used by the government to process transactions and to maintain its accounting records.

A full review of the Oracle system is outside my mandate, inasmuch as it is a government-wide system that extends well beyond the House administration. I have nevertheless caused the system to be reviewed at a high-level to ensure that there are no obvious issues that would prevent the House from utilizing the system to enhance controls over its transactions. In conducting the general review, Commission staff have had a number of interviews with individuals within the government, and I have reviewed the Auditor General's Reports from 2000 to 2006 to ensure that no serious system matters were identified.

Oracle is a well-known and respected system, one that is used by a large number of companies and government organizations worldwide. It has been characterized in its promotional material to be "the world's most flexible and complete solution that makes the job of Finance easier."<sup>84</sup>

The House of Assembly presently accesses the Accounts Payable, General Ledger and Purchasing modules within Oracle. It would be appropriate that the House also use the fixed asset module to assist with monitoring the assets of the House and those managed by the Members, as well as the Oracle Financial Analyzer to assist with budget preparation. It will be necessary, however, that staff old and new receive proper training on the use of the

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<sup>83</sup> *Financial Management Handbook of the Office of the Comptroller General (March 2003).*

<sup>84</sup> For more information about this software, visit Oracle's website online: Oracle Financial Management Solutions <<http://www.oracle.com/applications/financial-management.html>>.

Oracle system and that a program be implemented to ensure that new staff are adequately trained when hired.

Discussions with government officials have indicated that a new system for processing travel claims called “Iexpenses” is being piloted within departments at the present time and is expected to go live before the fall of 2007. The Iexpenses module is a self-service process where each individual enters his or her own data. Controls over the amounts that can be claimed for such matters as per diems and mileage are built into the module. A second phase of the project would involve implementing this self-service expense claim preparation module within the House. I believe that it is important that this second phase proceed, and that the new rules for expenses for Members as proposed in Chapter 10 be included in the module.

The more similar the systems and controls between the executive branch of government and the House are, less confusion will exist. There will be fewer opportunities for errors to occur, and it will be less costly to manage. Specific processes and procedures should be performed within the Oracle system as opposed to current practice. No longer should it be possible for individual House staff members to conduct certain financial operations off-system, as was the previous practice with respect to tracking MHA constituency allowance expenses by the Director of Financial Operations. Controls over all data that supports the financial information in the system used in the House must be implemented.

Accordingly, I recommend:

***Recommendation No. 46***

- (1) Use of the Financial Management System in its entirety should be implemented and followed in the House of Assembly and, in particular, the Oracle Fixed Asset and Financial Analyzer modules should be extended to and used by the House;***
- (2) All staff of the House should be provided with initial and ongoing training on the Oracle system;***
- (3) If the “Iexpenses” module presently being piloted within government is deemed suitable for general government use, it should be implemented within the House as well;***

- (4) *If there are policies that are deemed inappropriate for application in the House because of differences in House administration, it should be a requirement that they be replaced by the House of Assembly Management Commission with policies that improve controls, not just provide a means of opting out of controls; and*
- (5) *Security procedures over the use of computers should be implemented to ensure that all data and information not maintained on the system be adequately controlled and protected from inappropriate access or loss, either accidental or deliberate, through the use of mandatory access restrictions, and the use of automatic backups.*

## **Quality and Risk Management**

Two additional tools not used to the appropriate extent, or not used at all within the House of Assembly that I believe will assist in quality and risk management are internal audit and management certification.

### **(i) Internal Audit**

In discussing best practices surrounding an organization's controls over its accounting processes, one cannot underestimate the importance of the involvement of an internal audit group. The internal audit function can be used to assist management and the oversight body (in the case of the House, the IEC) in the effective discharge of their responsibilities.

The purpose of internal audit is to provide analysis and recommendations on business operations and activities of a financial organization to assist management in achieving orderly and efficient conduct of business and the safeguarding of the organization's assets.

The mandate of an internal audit unit usually includes:

- evaluating the soundness and adequacy of the internal control structure
- assessing compliance with policies, procedures, laws, and regulations
- reviewing the reliability, adequacy, application of accounting, financial, and other operating controls
- verifying the existence of assets and ensuring that they are safeguarded from loss

- evaluating the economy and efficiency with which resources are used and recommending improvements in operations
- conducting special examinations and reviews as requested by management.<sup>85</sup>

There are a number of factors that will impact on the ability of an internal audit group to function effectively. Fundamentally important is appropriate support and respect for the work of the group. By having the support of an organization's top management, an internal audit group can function objectively and carry out its mandate in a meaningful fashion. The oversight board must also take an active interest in the development of the internal audit program to ensure that it meets the objectives of the organization.<sup>86</sup>

The director of internal audit must have direct access to the oversight board and report regularly to that body. Management must give priority to internal audit recommendations and this should be properly evidenced.<sup>87</sup> There should also be no constraints or restrictions placed on internal audit. The group should not have limitations on scope and therefore should have unrestricted access to all the documents, manuals, systems, staff and physical properties relevant to the audit process. Finally, it is necessary for management to ensure that the internal audit function has adequate resources. There should be well-defined policies and practices for hiring, training, evaluating and supervising staff, as required.<sup>88</sup>

The provincial government has a "Professional Services and Internal Audit Division," operated as part of the Office of the Comptroller General. Its mandate is to "provide professional services and consulting to the executive and government departments in the areas of: financial management, accounting and systems; financial policy development and implementation; financial reporting; operational support; and internal audit, in order to facilitate the efficient and effective management of programs and resources and promote accountability and quality reporting for Government."<sup>89</sup>

I am firmly of the view that an internal audit function is fundamentally important in the monitoring of controls, not only of government generally, but specifically of the House. The government of Canada<sup>90</sup> and most other provinces have an internal audit function that from time to time, performs or has the authority to perform an internal audit function within

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<sup>85</sup> The Office of Internal Audit at Kent State, online: <http://www.kent.edu/internalaudit>.

<sup>86</sup> Ernst & Young LLP, *Program Risk: The Internal Audit Blind Spot*, (2006).

<sup>87</sup> American Institute of Certified Public Accountants, *Evaluating the Internal Audit Team: Guidelines and Questions*, (New York: AICPA, 2005).

<sup>88</sup> Ibid.

<sup>89</sup> Online: Office of the Comptroller General - Professional Services and Audit Division <<http://www.fin.gov.nl.ca/comptrollergeneral/divisions/professionaldivision.html>>.

<sup>90</sup> Interview of Luc Desroches and Allan Glenns of the House of Commons, by Commission members Gail Hamilton and David Norris (October 12, 2006).

their respective legislative bodies.

Later in this report I will be recommending that the Auditor General perform compliance audits of the House on a periodic basis.<sup>91</sup> Internal audit involvement will supplement the Auditor General's presence in years in which a compliance audit is not performed.

Other things being equal, it appears sensible to have the existing governmental internal audit division perform the internal audit function for the legislative branch. It would likely be more cost-effective than establishing a separate group to monitor the House alone. As well, individuals within the division will understand the government's systems and policies better than ones who are not, and therefore will be able to identify differences between government and House policies and systems, if any, that may need to be questioned or changed. Drawing on the resources from a pool of individuals within the internal audit group will allow for the provision of the correct skill set to undertake a variety of types of assignments within the House, as may be required from time to time.

That said, I am concerned about the adequacy of the existing level of internal audit resources in government, as noted in Chapter 4. This leads me to have a major concern, in the present environment, about recommending that the existing internal audit division perform the internal audit function for the House. Through discussions with government officials, it has become apparent to me that the internal audit group within government no longer has sufficient staff to be able to perform its duties effectively. The group currently has three staff, compared to a staff of twenty-one in 1991. This deficiency should be rectified. Regardless of whether government plans to act to make the internal audit function effective throughout the executive branch, I believe that such a function must be available within the legislative branch. Ideally, resources should be added to the Professional Services and Internal Audit Division to allow it to provide proper internal audit functions, not only to government generally, but to the House of Assembly as well. If that does not happen, then, at the very least, sufficient resources should be made available to allow the functions to be performed within the House alone.

For the foreseeable future, due to recent allegations of the misappropriation of the legislature's assets and the need for the taxpayers of the province to regain confidence in government financial monitoring systems, I believe that a policy should be established which requires all Members' expense reports be examined by way of internal audit for appropriateness and compliance with policy.

Presently, as noted earlier, the government is in phase one of implementing the "Expenses" module of the Oracle operating system in many departments of government. This module has many built in security features and requires all supporting documentation to be included prior to processing. The module is scheduled to be added in the legislative

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<sup>91</sup> See Chapter 8 (Audit), Recommendation 52(3), (4).

branch during phase two of the government's implementation, which is expected over the next year. Once this system is implemented, the security features of the program should be reviewed in detail to determine if a full review of expense reports by internal audit will still be required.

Implementation of this policy will assist in setting the appropriate tone at the top by sending the message that non-compliance with expense policies will not be tolerated. Expense reports that appear to be in violation of the approved MHA expense policies should be brought to the attention of the Member. If there is a concern over the interpretation, the matter should be brought to the attention of the Speaker for resolution.

Accordingly, I recommend:

***Recommendation No. 47***

- (1) The financial accounts of the House of Assembly and its statutory offices should be subject to appropriate and effective internal audit processes;***
- (2) The internal audit function of the House should be performed by the Professional Services and Internal Audit Division of the Office of the Comptroller General;***
- (3) Sufficient human and financial resources should be provided to the Professional Services and Internal Audit Division to enable it to provide dedicated, appropriate and effective internal audits for the House;***
- (4) If resources are not made available to the Professional Services and Audit Division to enable it to perform, on a dedicated basis, an appropriate internal audit function for the House, sufficient resources should be forthwith made available within the House budget to enable it to perform its own internal audit function;***
- (5) At least until the new "Iexpenses" module of the Oracle operating system has been applied to the House and the security features of the module are found to be operating effectively, each MHA expense report should be examined, by way of internal audit, for appropriateness and compliance with policy;***
- (6) Any apparent violations of MHA expense policies should be brought to the attention of the Speaker and the MHA concerned, and mechanisms should be legislated whereby the Speaker can, in a fair manner and subject to appropriate appeal, investigate potential violations and make orders requiring rectification; and***

**(7) Mechanisms should also be put in place to enable an MHA who has had a claim rejected by House staff to have the matter reassessed by the Speaker.**

**(ii) Management Certification**

Recent events such as the Enron affair and the sponsorship scandal within the Government of Canada have sent taxpayers and other stakeholders in search of improved mechanisms to improve corporate governance, accountability and overall corporate responsibility.<sup>92</sup> From these events, allegations of fraud and financial statement restatements focused the public's attention on the adequacy of internal control over financial reporting. As a result, private sector certification regulations such as the *Sarbanes Oxley Act of 2002* in the United States<sup>93</sup> and the regulations issued by Canadian securities regulators<sup>94</sup> were born.

These certification regulations require senior officials of an organization, such as the chief executive officers and chief financial officers, to certify by signature that they have discharged certain responsibilities. These responsibilities include the establishing, evaluating, and monitoring of the effectiveness of internal control over financial reporting.

These certification requirements will also soon impact directly upon the government and crown corporations. In 2005, the Treasury Board of Canada Secretariat released a report that outlines the Treasury Board's views on corporate governance and a detailed plan of steps intended to improve governance for Crown corporations. Included in this plan is Measure #24, which states:

In principle, the government supports the use of a certification regime adapted to the reality of public institutions. The Treasury Board of Canada Secretariat will examine, in consultation with Crown corporations, the development of a certification regime that would be applicable to all corporations.<sup>95</sup>

Although the exact requirements of Crown certification are yet to be determined, the Treasury Board's reports have made it clear that, in future, Crown corporations will be required to complete a certification process similar to that currently in place for private entities.

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<sup>92</sup>Nancy Rector and Keith Davis, "CEO/CFO Certification for Crown Corporations: How Certification Can Enhance the Accountability of Public Sector Organizations," online: Deloitte & Touche LLP <http://www.deloitte.com/dtt/article/O,1002,sid%253D68725%2526cid%253D95172,00.html>.

<sup>93</sup> *Sarbanes-Oxley Act of 2002*, P.L. 107-204, 116 Stat 745.

<sup>94</sup> Canadian Securities Administrators, *Multilateral Instrument 52-109: Certification of Disclosures in Issuers' Annual and Interim Filings*, (March 2004).

<sup>95</sup> Canada, Treasury Board, *Review of the Governance Framework for Canada's Crown Corporations: Meeting the Expectations of Canadians*, (Ottawa: Treasury Board of Canada Secretariat, February 2005).

Effective internal control over financial reporting is, as I have stressed at other places in this report, a significant component of strong corporate governance. Through the implementation of a certification regime, both private and public organizations go a long way in restoring the trust of their stakeholders.

Accepting responsibility and ownership for overall financial management, including the system of internal controls, has existed in the United Kingdom since 1872. Since this time, accounting officers have, as I have noted in Chapter 5, had personal responsibilities for the propriety and regularity of the public finances for which they are answerable; for keeping of proper accounts; for prudent and economical administration; for the avoidance of waste and extravagance; and for efficient and effective use of all available resources.<sup>96</sup> An effective system of internal control is necessary for the accounting officer to appropriately perform this responsibility. As such, the accounting officer ensures that a sound system of internal control is maintained in the organization to support the achievement of the department's policies, aims and objectives, as well, and regularly reviews the effectiveness of that system.

My discussion of the accounting officer concept in Chapter 5 led to the conclusion that the position of accounting officer is an important means of promoting the effective operation of a system of internal controls. I recommended that the roles and responsibilities similar to those of an accounting officer in the United Kingdom be assigned to the Clerk of the House.<sup>97</sup> The notion of management certification is an important adjunct of this role.

In light of the federal Treasury Board report and Measure 24, and the need to regain public confidence in light of recent events, a certification process similar to that described should be implemented in the House. I recognize that implementation of such a process may require a significant amount of time and possibly resources. However, having this process championed by the Clerk of the House and the IEC will be instrumental in the success of any certification process.

The certification process should be completed in stages, utilizing a process similar to those undertaken by other government entities going through the process. This will allow the overall certification process to be much more manageable. These stages are:

- *Stage 1* should relate to establishing and maintaining disclosure controls and procedures. Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed under legislation is recorded, processed, summarized and reported. Once the disclosure controls and procedures are effectively designed, the Chief Financial Officer and the Clerk of the House would be required to certify, in writing, that the disclosure

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<sup>96</sup> See Chapter 5 (Responsibility) under the heading "The Clerk as Accounting Officer."

<sup>97</sup> See Chapter 5 (Responsibility), Recommendation 18.

controls are in place and operating effectively.<sup>98</sup> Certification of the disclosure controls and procedures should occur within six months of the issuance of this report.

- *Stage 2* would require the Chief Financial Officer and the Clerk to certify that they have designed a system of internal control, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with government accounting policies.<sup>99</sup> Design certification should occur within one year of the issuance of this report.
- *Stage 3* would require the Chief Financial Officer and the Clerk to certify that, based upon their most recent evaluation of internal control over financial reporting, the internal control environment is operating effectively. If significant weaknesses in the design or operation of internal controls were found during this evaluation, these items would be disclosed in the certification.<sup>100</sup> At this point, it would be necessary to consider the types of deficiencies found and whether they would be significant enough to prevent the certification that the control environment is effective. Certification that the controls are operating effectively should occur within eighteen months of the issuance of this report.

For the certification process to be successful, it is necessary to have strong support from senior management. By embracing the certification program as an opportunity to improve internal communications as well as to provide accountability for public disclosures, the program has the potential to have a positive and significant impact on the quality of reporting and internal control.<sup>101</sup>

To be successful, it is necessary for a comprehensive implementation plan to be developed. As part of this plan, it is necessary to ensure the internal control structure is built on a framework such as the model<sup>102</sup> developed by the Committee of Sponsoring Organizations of the Treadway Commission.<sup>103</sup> This model is widely used by most corporate entities as they go through the certification process.<sup>104</sup> Additionally, this implementation plan must include a comprehensive “scoping” exercise. By determining in advance which accounts and activities are significant and should be included in the review of internal

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<sup>98</sup> See Ernst & Young LLP, *Internal Control over Financial Reporting: A Summary of the Canadian Securities Administrators’ Proposed MI 52-111 and Proposed Amendments to MI 52-109*, (2005).

<sup>99</sup> Ibid.

<sup>100</sup> Ibid.

<sup>101</sup> See Rector and Davis, footnote 90.

<sup>102</sup> Ernst & Young LLP, *Preparing for Internal Control Reporting: A Guide for Management Assessment under Section 404 of the Sarbanes-Oxley Act*, 2002.

<sup>103</sup> National Commission on Fraudulent Financial Reporting, *Report of the National Commission on Fraudulent Financial Reporting* (Washington, 1987) [known as the “Treadway Commission”]

<sup>104</sup> The model is described in Appendix 7.1.

controls will allow for this process to be focused and efficient. This will reduce the cost associated with the certification process.<sup>105</sup>

Strong project management and the use of personnel with the appropriate skills and background are also key to a successful certification process. Using individuals without the appropriate skills or experience often results in inefficiencies and significant rework.<sup>106</sup> Organizations that are successful in the implementation process ensure that they have a strong plan in place with the appropriate resources available for plan implementation.

I believe that, at the conclusion of such a process, enhancements to the House's system of internal control should be significant and will result in improved process performance and better safeguarding of the House's assets.

For the House to be successful in implementing management certification within the timelines identified above, assistance should be provided by internal auditors and by other staff in the Office of the Comptroller General. Implementing the necessary controls and the monitoring programs to allow the certification to take place will require considerable effort. However, the efforts will be reduced after the system is fully up and running.<sup>107</sup>

Accordingly, I recommend:

<p><b><i>Recommendation No. 48</i></b></p> <p><b><i>(1) The Clerk and senior management in the House, with the support of the House of Assembly Management Commission, should forthwith implement a management certification process by developing processes to:</i></b></p> <p><b><i>(a) establish and maintain disclosure controls and procedures;</i></b></p> <p><b><i>(b) enable the Chief Financial Officer and Clerk to certify that they designed, or caused to be designed, a system of internal control to provide reasonable assurance regarding the reliability of financial reporting in accordance with the required policies; and</i></b></p> <p><b><i>(c) enable the Chief Financial Officer and Clerk to certify that the internal controls environment is operating effectively;</i></b></p>
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<sup>105</sup> Rector and Davis, footnote 90.

<sup>106</sup> Ibid.

<sup>107</sup> Ernst & Young LLP, *Emerging Trends in Internal Controls: Fourth Survey and Industry Insights*, (2005).

- (2) *Assistance in developing a plan of implementation should be provided from the internal auditors in the Professional Services and Internal Audit Division and by other staff in the Office of the Comptroller General; and*
- (3) *The obligation to provide the necessary certifications should be stipulated in legislation respecting the duties of the Clerk.*