

Summary of the assessment of effectiveness of the system of internal control over financial reporting and the action plan of the Canadian International Development Agency for fiscal year 2010-2011

Annex to the Statement of Management Responsibility Including Internal Control Over Financial Reporting

Note to the reader

With the Treasury Board *Policy on Internal Control* that became effective April 1, 2009, departments are required to demonstrate the measures they are taking to maintain an effective system of internal control over financial reporting (ICFR).

As part of this policy, departments are expected to conduct annual assessments of their system of ICFR, establish an action plan to address any necessary adjustments, and to attach to their *Statements of Management Responsibility* a summary of their assessment results and action plan.

Effective systems of ICFR aim to achieve reliable financial statements and to provide assurance that:

- Transactions are appropriately authorized;
- Financial records are properly maintained;
- Assets are safeguarded from risks such as waste, abuse, loss, fraud and mismanagement; and
- Applicable laws, regulations and policies are followed.

The system of ICFR is designed to mitigate risks to a reasonable level based on an on-going process to identify key risks, to assess the effectiveness of associated key controls and adjust them as required, as well as to monitor the system in support of continuous improvement. As a result, the scope, pace and status of those departmental assessments of the effectiveness of their system of ICFR will vary from one organization to another based on risks and taking into account their unique circumstances.

It is important to note that the system of ICFR is not designed to eliminate all risks, but rather to mitigate risk to a reasonable level with controls that are balanced with and proportionate to the risks they aim to mitigate.

1. Introduction

This document is attached to the Canadian International Development Agency (CIDA)'s *Statement of Management Responsibility Including Internal Control Over Financial Reporting* for fiscal year 2010-2011. As required by the Treasury Board *Policy on Internal Control*, this document provides, for the second time, summary information on the measures taken by CIDA to maintain an effective system of internal control over financial reporting (ICFR). In particular, it provides summary information on the latest assessments conducted by CIDA during fiscal year 2010-2011, including progress, results and related action plans along with some financial highlights pertinent to understanding the control environment unique to the Agency.

1.1 Authority, Mandate and Program Activities

Detailed information on CIDA's authority, mandate and program activities can be found in the Agency's latest *Departmental Performance Report* at <http://www.acdi-cida.gc.ca/acdi-cida/ACDI-CIDA.nsf/eng/JUD-412914-HA8>, and in its latest *Report on Plans and Priorities* at <http://www.acdi-cida.gc.ca/acdi-cida/ACDI-CIDA.nsf/eng/NAD-1019143840-PV8>.

1.2 Financial highlights

Financial statements (unaudited) of the Canadian International Development Agency for the last fiscal year can be found at <http://www.acdi-cida.gc.ca/acdi-cida/ACDI-CIDA.nsf/eng/JUD-12214478-DH6>.

Financial information that is relevant to CIDA can also be found in the latest Public Accounts of Canada at http://epe.lac-bac.gc.ca/100/201/301/public_accounts_can/index.html.

For the 2010-2011 fiscal year, the financial highlights are:

- CIDA's total expenses were \$3.668 billion. Transfer payments comprised the majority (87% or \$3.192 billion), followed by salaries and employee benefits (6% or \$206 million for 1,913 employees).
- CIDA's accounts receivable amounted to \$240 million and its total revenues were \$276 million, largely stemming from a significant amount receivable from the Inter-American Development Bank (\$227 million) following its decision to convert ordinary capital equity that is subject to maintenance of value into US dollars before the end of the fiscal year.
- CIDA's prepaid expenses totalled \$210 million at March 31, while outstanding loans to developing countries and international financial institutions amounted to \$135 million, respectively comprising 15% and 10% of departmental total assets (\$1.374 billion). Cumulative investments and advances to international financial institutions were also very significant at \$6.4 billion, but their net realizable value was reduced to zero since CIDA does not anticipate recovering these investments and advances in the future.
- CIDA's accounts payable and accrued liabilities amounted to \$651 million at March 31 and comprised 84% of the Agency's total liabilities (\$772 million).
- In 2010-2011, expenses incurred directly in the field represented approximately 2% (\$91 million) of the Agency's total expenses. Field expenses are initiated and approved by CIDA staff that is located at foreign missions, while the related payments are processed and recorded by the Department of Foreign Affairs and International Trade (DFAIT) financial and administrative staff. Field expense details are transferred regularly from the

DFAIT financial system to CIDA's own financial and accounting system. CIDA will be increasing its field presence over the next three years as part of a decentralization initiative, which will have an impact on the level of field expenses incurred.

- The Agency uses a stand-alone financial and accounting system based on the SAP application. It is critical to its operations and financial reporting capabilities, and appropriate system maintenance and monitoring practices are in place.

1.3 Service arrangements relevant to financial statements

CIDA's information technology (IT) platform, which supports its IT network and financial and accounting system, currently resides at Agriculture and Agri-Food Canada.

The Agency also relies on other organizations for the processing of certain transactions that are recorded in its financial statements:

- Public Works and Government Services Canada (PWGSC) centrally administers the payments of salaries and the procurement of certain goods and services.
- Treasury Board Secretariat provides the Agency with information used to calculate various accruals and allowances, such as the accrued employee severance benefits.
- DFAIT provides payment processing, accounting and banking services to all CIDA offices that are located within the Canadian High Commissions or Embassies abroad. DFAIT also prepares periodic financial reports for CIDA staff detailing the Agency's expenses that were incurred directly in the field.

1.4 Material changes in fiscal year 2010-2011

Apart from a change in the Chief Financial Officer (CFO), no significant departmental changes that are relevant to the Agency's financial management context and/or financial statements occurred in 2010-2011.

The CFO position was occupied by the following individuals over the course of the year:

- Mr. Jim Quinn, from April 1 to September 16;
- Ms. Sue Stimpson, from November 15 to March 31, 2011.

Other CIDA senior financial officers filled the position in an acting capacity during the two months that it was officially vacant.

2. The Agency's control environment relevant to ICFR

CIDA management recognizes the importance of setting the tone from the top to help ensure that staff at all levels understand their roles in maintaining effective systems of ICFR and are equipped to exercise these responsibilities effectively. The Agency's focus is to ensure risks are managed well through a responsive and risk-based control environment that enables continuous improvement and innovation.

2.1 Key positions, roles and responsibilities

Below are CIDA's key positions and committees with responsibilities for maintaining and reviewing the effectiveness of its system of ICFR.

President – The Agency’s President, as Accounting Officer, assumes overall responsibility and leadership for the measures taken to maintain an effective system of internal control. In this role, the President relies on the recommendations received from the Departmental Audit Committee and the advice provided by other members of the Management Board.

Chief Financial Officer (CFO) – The Agency’s CFO reports directly to the President and provides leadership for the coordination, coherence and focus on the design and maintenance of an effective and integrated system of ICFR, including its annual assessment.

Senior Managers - CIDA’s senior managers in charge of program delivery or corporate branches are also responsible for maintaining and reviewing effectiveness of the portions of the system of ICFR falling within their mandate.

Chief Audit Executive (CAE) – The Agency’s CAE reports directly to the President and provides assurance through periodic internal audits, which are instrumental to the maintenance of an effective system of ICFR.

Departmental Audit Committee (DAC) - The DAC is an advisory committee that provides objective advice to the President on the Agency’s risk management, control and governance frameworks. It is comprised of four external members and one internal member. As such, it reviews the Agency’s Corporate Risk Profile and its system of internal control, including the annual assessment and action plans relating to the system of ICFR.

Management Board - As the Agency’s central decision-making body, the Management Board reviews, approves and monitors the Corporate Risk Profile and the departmental system of internal control, including the annual assessment and action plans relating to the system of ICFR.

2.2 Key measures taken by CIDA

CIDA's control environment also includes a series of measures to equip its staff to manage risks well through raising awareness, providing appropriate knowledge and tools as well as developing skills. Examples of key measures include:

- The presence of Senior Officials responsible for Values and Ethics and for Disclosure of Wrongdoing within CIDA;
- The implementation and ongoing monitoring of an “Excellence in People Management Action Plan”;
- A section under the CFO branch that is dedicated to internal controls;
- A training program and regular communications to staff in core areas of financial management;
- The integration of previously decentralized financial officers and contracting officers under the CFO’s leadership;
- Departmental policies tailored to the Agency’s business and control environment;
- The documentation of main business processes and of the related key risks and control points to support the management and oversight of its system of ICFR;
- The constant review of IT processing systems to achieve greater security, data integrity, efficiency and effectiveness.

3. Assessment of CIDA's system of internal control over financial reporting

3.1 Assessment Approach

In support of the *Policy on Internal Control*, an effective departmental system of ICFR must be in place with the objectives to provide reasonable assurance that:

- Transactions are appropriately authorized;
- Financial records are properly maintained;
- Assets are safeguarded; and
- Applicable laws, regulations and policies are followed.

Over time, this includes assessment of the *design* and *operating effectiveness* of the system of ICFR, which then leads to the implementation of on-going monitoring and continuous improvement of this system.

A *design effectiveness* assessment means to ensure that key control points are identified, documented, in place and that they are balanced with and proportionate to the risks they aim to mitigate, that any weaknesses are identified and that any necessary remediation is addressed. This includes the mapping of key IT systems and business processes to the main financial records or accounts, by location as applicable.

An *operating effectiveness* assessment means that the application of key controls has been tested over a defined period, that any weaknesses are identified and that any necessary remediation is addressed.

Such testing covers all levels of departmental control, which include entity (corporate) level controls, IT general controls and business process controls.

3.2 Scope of Departmental Assessment at CIDA

To satisfy the *Policy on Internal Control*, the Agency has taken measures to assess its system of ICFR. It used its annual financial statements as a starting point to identify its main accounts or business processes.

Over a period of four years that will end on March 31, 2013, and for each of its main accounts or business processes, the Agency will have prepared system descriptions, financial control matrices, and tested the design effectiveness as well as the operating effectiveness of the key financial controls that are embedded within them. The Agency will also have identified any control weaknesses and taken appropriate corrective actions.

As at March 31, 2011, CIDA has already documented and assessed its entity (corporate) level controls and IT general controls (IT infrastructure). The Agency has also completed the documentation of financial controls that are embedded within the following significant accounts or business processes:

- Transfer payments expenses: directive contributions approach, and multilateral grants approach;
- Professional services expenses;
- Expenses incurred directly in the field at six foreign CIDA posts;

- Investments and advances to International Financial Institutions (IFIs);
- Canada Investment Fund for Africa;
- Prepaid expenses;
- General accounts payable and accrued liabilities;
- Accrued liability for matching funds programs;
- Accrued employee severance benefits;
- Gains and losses on foreign exchange;
- Contractual obligations;
- Contingent liabilities;
- Adjusting journal entries;
- Interdepartmental settlements.

The documentation exercise comprised the following steps for each of the above mentioned significant accounts or business processes:

- Gathering information pertaining to the account or process, and to risks and controls relevant to ICFR surrounding this account or process, including appropriate policies, procedures and recent internal audit results;
- Mapping out the business process with the identification and documentation of key risk and control points;
- Performing the design effectiveness testing of the business process, and starting to remediate the control weaknesses found to have them fully addressed in a timely fashion.

As well, as at March 31, 2011, CIDA had undertaken to gather information and prepare the system descriptions of the following business processes:

- Salaries and benefits expenses;
- Year-end closing and financial statement preparation;
- Events subsequent to year-end.

Lastly, as at March 31, 2011, the Agency had completed the operating effectiveness testing of the financial controls embedded within the field expenses business process at six foreign CIDA posts, also in support of its increased decentralization initiative to be implemented over the next three years. Furthermore, it had begun to test the operating effectiveness of the financial controls comprised in the following business processes managed from headquarters:

- Transfer payment expenses: multilateral grants approach;
- Professional services expenses;
- Investments and advances to IFIs;
- General accounts payable and accrued liabilities;
- Adjusting journal entries.

4. CIDA's assessment results

Based on the assessment approach described above, CIDA is developing baseline architecture of all key control points by main account and/or business process.

The Agency's assessments of entity (corporate) level controls and of IT general controls were completed in previous fiscal years. In 2010-2011, CIDA focused mainly on assessing the design effectiveness of the financial controls that are embedded within its significant accounts or business processes. It also began to test the operating effectiveness of the key controls that are comprised in a few selected business processes, for which the design assessment had already been completed.

4.1 Design effectiveness of key controls

In order to perform design effectiveness testing of the business processes that were assessed before March 31, 2011, the Agency completed all documentation of the processes and verified whether appropriate controls were in place and corresponded to actual practice. Where feasible, remediation requirements were implemented shortly after the necessary adjustments had been identified. Otherwise, management action plans either were or are currently being developed to fully address the control weaknesses within a reasonable timeframe. Design effectiveness testing also included ensuring the appropriate alignment of key controls with the risks they aim to mitigate.

Entity-level controls

When assessed in a previous fiscal year, the entity (corporate) level controls were judged satisfactory.

IT general controls

An assessment of IT general controls performed in a previous fiscal year concluded that weaknesses existed in the IT environment, and CIDA has already adopted appropriate measures to fully remediate most of them. In 2010-2011, the Agency continued to take remedial actions to address the remaining few weaknesses in the IT general controls, and significant progress has been reached in the following areas:

- Improved documentation and operations relating to general IT and data security; I
- Development and implementation of an information security policy; D
- More rigorous follow-ups on access to IT systems. M

In the upcoming year, CIDA has planned to keep improving the above areas, and also to further enhance the formal monitoring of IT control activities performed by third-party service providers.

Business process controls

In 2010-2011, CIDA completed the documentation and assessment of the design of financial controls that are embedded within the following significant accounts or business processes:

- Transfer payments expenses: directive contributions approach, and multilateral grants approach;
- Professional services expenses;
- Expenses incurred directly in the field at four foreign CIDA posts;
- Investments and advances to International Financial Institutions (IFIs);
- Canada Investment Fund for Africa;
- Prepaid expenses;
- General accounts payable and accrued liabilities;
- Accrued liability for matching funds programs;
- Accrued employee severance benefits;
- Gains and losses on foreign exchange;
- Contractual obligations;
- Contingent liabilities;
- Adjusting journal entries;
- Interdepartmental settlements.

The existence of relevant and strong financial controls was confirmed through the documentation and design assessment of the above significant accounts or business processes. The main control objectives pertaining to each account or business process were generally well supported by appropriate key control activities. Nonetheless, a few design improvement opportunities were identified in the following areas:

- Enhanced documentary evidence of the application of certain controls involving data reconciliations, document reviews and approvals;
- In certain sub-processes, a better sequencing of work steps to ensure that budget availability is confirmed prior to the signature of amendments to existing agreements;
- Streamlining of working tools to either facilitate data analysis or avoid duplication of effort;
- In certain sub-processes, additional analysis to ensure the accuracy and completeness of financial information;
- An improved segregation of duties within the financial system user profiles.

Where feasible, specific remediation requirements were implemented shortly after the necessary adjustments had been identified. Otherwise, management action plans either have been or are currently being developed to fully address the control weaknesses within a reasonable timeframe. A follow-up will be performed on each of the remediation measures in 2011-2012 to ensure that they are being implemented as planned.

4.2 Operating effectiveness of key controls

Design effectiveness testing remains a pre-requisite to the operating effectiveness testing of the key financial controls that are integrated to any business process. Also, whenever possible, operating effectiveness testing of controls is more efficient if performed for several business processes at the same time, as some of the key controls (for example, payment issuance controls) are common to all processes.

In 2010-2011, the Agency commenced its assessment of the operating effectiveness of key financial controls that are embedded within the following significant business processes managed from headquarters:

- Transfer payment expenses: multilateral grants approach;
- Professional services expenses;
- Investments and advances to IFIs;
- General accounts payable and accrued liabilities;
- Adjusting journal entries.

At March 31, 2011, the operating effectiveness testing of the key financial controls comprised in the above business processes had not yet been completed. The results of this assessment will therefore become available and be disclosed in the annual assessment of CIDA's system of ICFR for fiscal year 2011-2012.

Furthermore, in 2010-2011, the Agency assessed the operating effectiveness of the key financial controls that are embedded within the expenditures business process at four foreign CIDA offices. When completing operating effectiveness testing, the Agency assessed whether key controls were well functioning over a 12 month period or a specified period of time during the fiscal year based on risks.

The application of several key financial controls in the field worked effectively throughout the periods that were tested, and all transactions sampled were supported by valid and appropriate documentation. Nonetheless, improvement opportunities with regard to the operating effectiveness of certain key controls were found in the following areas:

- Sequencing and corresponding dating of approvals, to ensure that the expense and payment approvals are performed in the order prescribed by the *Financial Administration Act (FAA)*;
- Pre-payment account analyses and validations, including verification of the financial coding of expenses;
- Completeness of documentation and frequency of key financial data reconciliations;
- Full compliance of operations with the Delegation of Financial Authorities Instrument, and the related employee specimen signature cards system.

Where feasible, specific remediation requirements were implemented shortly after the necessary adjustments had been identified. Otherwise, management action plans are being developed to fully address the control weaknesses within a reasonable timeframe. A follow-up will be performed on each of the remediation measures according to a monitoring program of CIDA's foreign offices that will be established over the next two years, to ensure that they are being implemented as planned.

5. CIDA's action plan

5.1 Progress as of March 31, 2011

During 2010-2011, CIDA has continued to make solid progress in assessing and improving its key financial controls. As of March 31, 2011, the financial controls design effectiveness testing phase has been substantially advanced with regards to significant business processes, while the operating effectiveness testing of key controls has commenced.

The financial controls documentation and design assessment phase was not completed in 2010-2011 as initially anticipated due to a revised and more integrated approach to the re-engineering of CIDA's grants and contributions processes.

Notably, and as planned in 2010-2011, the Agency reached significant progress towards fully addressing the following necessary adjustments:

- Improved documentation and operations relating to general IT and data security;
- Development and implementation of a formal information security policy;
- More rigorous follow-ups on access to IT systems.

As well, CIDA commenced or partially completed work to address the following necessary adjustments, most of which will take a few years to fully implement due to their complexity or broader scope:

- Formal monitoring of IT control activities performed by third-party service providers;
- Modifications to financial system user profiles in order to ensure a proper and full segregation of duties within these profiles;
- In certain sub-processes, a better sequencing of work steps to ensure that budget availability is confirmed prior to the signature of amendments to existing agreements;
- Enhanced documentary evidence of the application of certain controls involving data reconciliations, document reviews and approvals;
- Streamlining of working tools to either facilitate financial data analysis or avoid duplication of effort;
- In certain sub-processes, additional analysis to ensure the accuracy and completeness of financial information;
- In field operations:
 - better sequencing and corresponding dating of expenditure and payment approvals;
 - improved pre-payment account analyses and validations, including verification of the financial coding of expenses and documentation of the final spot checks;
 - enhanced documentation and frequency of key financial data reconciliations;
 - full compliance of operations with the Delegation of Financial Authorities Instrument, and the related employee specimen signature cards system

5.2 Action plan for the next fiscal year and future years

Building on progress to date, the Agency is positioned to substantially complete the assessment of its system of ICFR in 2012-2013.

By the end of 2011-2012, CIDA plans to:

- Have substantially completed the documentation of all of its remaining main accounts or significant business processes, encompassing full system descriptions, financial control matrices and design effectiveness testing of the processes. The business processes for which this work will have been completed in 2011-2012 are annual budgeting, salaries and benefits expenses, loans to developing countries and IFIs, year-end closing and financial statement preparation and events subsequent to year-end.
- Have substantially advanced the operating effectiveness testing of key controls that are embedded within significant business processes to ensure they are working effectively and constantly over time; and
- Have performed additional financial controls assessments of CIDA foreign offices, in support of the increased decentralization of Agency operations.

By the end of 2012-2013, CIDA plans to:

- Have completed the documentation of all of its remaining main accounts or significant business processes, encompassing full system descriptions, financial control matrices and design effectiveness testing of the processes. The remaining business sub-processes for which this work will have been completed in 2012-2013 are the responsive and program-based contributions approaches (which will form part of a re-engineered overall grants and contributions business process);
- Have completed the initial operating effectiveness testing of the key controls that are embedded within significant business processes to ensure they are working effectively and constantly over time, except for the overall grants and contributions business process that will just have been re-engineered;
- Again, have performed additional financial controls assessments of CIDA foreign offices, in support of the increased decentralization of Agency operations; and
- Have developed an on-going monitoring program of the effectiveness of the departmental system of ICFR. This program will support a risk-based design and operating effectiveness testing plan that identifies key controls to be tested over a defined period of time, including the selection of locations, the test-period as well as the method and frequency of testing. The program will also incorporate communications to enhance the awareness and knowledge of internal controls over financial reporting and of the associated responsibilities across the Agency.

By the end of 2013-2014, CIDA plans to:

- Have performed some operating effectiveness testing of the key controls embedded within the new overall grants and contributions business process; and
- Have implemented its on-going monitoring program of the effectiveness of the departmental system of ICFR.

CIDA is fully committed to this action plan. However, attainment of the milestones identified above will be contingent on the Agency being able to maintain its current level of resources to implement the requirements of the *Policy on Internal Control*. Any major changes to the departmental structure could certainly impact on the associated timelines. CIDA will update its action plan on an annual basis.