

Report 5: July 2012

AUDIT OF THE LEGISLATIVE ASSEMBLY'S FINANCIAL RECORDS

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The Honourable Bill Barisoff
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
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Dear Sir:

As mandated under Section 11(8) of the *Auditor General Act* and Section 5 of the *Legislative Assembly Management Committee Act*, I have the honour to transmit to the Speaker of the Legislative Assembly of British Columbia this report on my Audit of the Legislative Assembly's Financial Records.

The audit results raise considerable concerns regarding the management and oversight of the Legislative Assembly's financial affairs.

The results of this audit would likely have been much more positive had the Legislative Assembly implemented the recommendations made in my Office's 2007 report on the same topic. However, because of the large number of significant and pervasive issues identified, I am unable to conclude as to whether all the amounts recorded in the Legislative Assembly's trial balance for the fiscal years ended March 31, 2009, 2010, or 2011 were correct.

Consequently, the Legislative Assembly clearly falls short of the basic accounting and financial management standards that the rest of the provincial public sector is required to meet.

I made one recommendation in this report and will monitor implementation of this recommendation as per my Office's regular follow-up process.

John Doyle, MAcc, CA
Auditor General

Victoria, British Columbia
July 2012

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In 2007, the Office of the Auditor General conducted an audit¹ on the status of the financial framework supporting the Legislative Assembly. This audit identified a number of areas for improvement such as general accounting, internal controls, data management, and public reporting.

Building on this work, and as a follow-up to the recommendations made in 2007, I conducted an audit, including testing of financial transactions, on the Legislative Assembly's financial records (specifically on the trial balance) for the three years ended March 31, 2009, 2010 and 2011. That audit is now substantially complete and the results raise significant concerns regarding the management and oversight of the Legislative Assembly's financial affairs.

Had the Legislative Assembly implemented the recommendations made in the 2007 report, the results of this most recent audit work would likely have been much more positive. Because of the large number of significant and pervasive issues identified, I am unable to conclude as to whether all the amounts recorded in the Legislative Assembly's trial balances for the years under audit were correct. Further, due to the magnitude of many of the internal control issues encountered, and the inability of the Legislative Assembly to provide timely documentation to support their financial results, I required significantly more time and resources to complete my work than I would have reasonably expected for an organization of this size.

I anticipated that the Legislative Assembly would meet the basic financial management practices and accounting standards requirements established for the rest of government. However, the Legislative Assembly is clearly falling well short of these basic expectations.

Additionally, the Legislative Assembly Management Committee, the governing body of the Legislative Assembly, appears to have had little or no involvement in either providing governance over the Legislative Assembly's financial and operational activities, or in this audit. As of the date of this report, I have not been provided the opportunity to discuss any aspect of this audit with the committee, as is typical practice, especially given the pervasive and significant nature of the issues identified.

Consistent with normal audit practices, I provided management letters, which included detailed control observations and recommendations, to the Clerk of the House and the Legislative Comptroller. These reports have also been provided to the Speaker as Chair of the Legislative Assembly Management Committee. It is my understanding that the Committee has not examined those reports.



JOHN DOYLE, MAcc, CA
Auditor General

¹ The criteria for this audit were based on the Financial Capability Model, as used by the Auditor General of Canada. For details see my report [Special Audit Report to the Speaker: The Financial Framework Supporting the Legislative Assembly](#).

In this report, I recommend that the Legislative Assembly take steps to immediately address the numerous and pervasive deficiencies reported as a result of my audit of the Legislative Assembly's financial records and my Office's 2007 Special Audit Report to the Speaker.

While the Legislative Assembly management has provided responses to my management letter recommendations, I note that their responses and proposed actions to resolve many of my recommendations are inadequate. Management has deferred resolution of a significant number of my recommendations to the Legislative Assembly Management Committee, even though the Committee does not appear to be actively involved in the Legislative Assembly's operational activities. Furthermore, many of the decisions deferred to the Committee are within the already defined authorities of Legislative Assembly staff.



John Doyle, MAcc, CA
Auditor General
July 2012

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I RECOMMEND THAT THE LEGISLATIVE ASSEMBLY:

Take steps to immediately address the numerous and pervasive deficiencies reported in my audit of the Legislative Assembly's financial records for the years ending March 31, 2009, 2010 and 2011, and in my Office's 2007 Special Audit Report to the Speaker.

BACKGROUND

THE LEGISLATIVE ASSEMBLY of British Columbia’s main functions are to represent the interests of British Columbians, debate and pass laws, review and approve budgets and scrutinize the policies and actions of the executive branch of government.

To accomplish this, they receive operational annual funding of approximately \$63 million. However, unlike any other government entity, the Legislative Assembly can expend funds beyond their annual funding without additional approval. Consequently, it is essential that the Legislative Assembly’s financial operations are effectively managed and monitored to ensure that public funds are used appropriately.

The Legislative Assembly’s financial operations are separate from the rest of government and administered under the guidance of the Legislative Comptroller. The Comptroller acts as the Chief Financial Officer of the Legislative Assembly and is “responsible for directly advising the Clerk of the House, the Speaker, and Members of the Legislative Assembly Management Committee regarding all matters of a financial nature, including the financial implications of planning and operational decisions.”²

The Clerk of the House has overall responsibility for “management and administrative services within the Legislative Assembly”. The Speaker, subject to any direction of the Legislative Assembly Management Committee, is responsible for the “day-to-day administration of the Legislative Assembly” and serves as Chair of the Legislative Assembly Management Committee.



² *Legislative Assembly of British Columbia 2010 Members’ Handbook* (page 36).

Governance and oversight of the Legislative Assembly is the responsibility of the Legislative Assembly Management Committee. Per section 2(1) of the Legislative Assembly Management Committee Act, the committee is composed of:

- a. the Speaker;
- b. the minister;
- c. the Government House Leader;
- d. the chair of the Government Caucus;
- e. the Opposition House Leader;
- f. the chair of the Official Opposition Caucus;
- g. one member appointed from each additional party by the members of that party; and,
- h. for each member appointed under (g) one additional government member from the Government Caucus appointed by the Government House Leader.

Some of the Legislative Assembly Management Committee's key responsibilities described in Section 3 (1) of the Legislative Assembly Management Committee Act include:

- ◆ setting policies, including financial and operational policies, for the administration of the Legislative Assembly;
- ◆ appointing, supervising and managing the staff of the Legislative Assembly;
- ◆ reviewing Vote 1 in the Legislative Assembly estimates of expenditures; and,
- ◆ engaging in other matters necessary for the efficient and effective operation and management of the Legislative Assembly.

2007 SPECIAL AUDIT REPORT TO THE SPEAKER

In 2007, my Office released Special Audit Report to the Speaker: The Financial Framework Supporting the Legislative Assembly. This audit identified a number of areas for improvement in the Legislative Assembly's financial framework. Additional details explaining the function and organizational structure of the Legislative Assembly can be found within that report.

As part of my audit of the Legislative Assembly's trial balance for the fiscal years ended March 31, 2009, 2010, and 2011, I also followed up on the 2007 report recommendations. My ongoing audit work and discussions with management indicated that no action had been taken to address any of the 2007 report recommendations. Recently, however, I received an update from the newly appointed Clerk which outlines how the Legislative Assembly will consult with the Legislative Assembly Management Committee and engage in other planned actions to address the recommendations contained in the 2007 report. (Please see Appendix A).

A **trial balance** lists the balances in all accounts (such as revenue, expense, asset, and liability accounts) at a specific date and is normally used to prepare financial statements.

AUDIT OBJECTIVE AND SCOPE

A complete set of financial statements with detailed notes is a valuable tool to evaluate and monitor an organization’s operational and financial health. Readers of an organization’s financial statements rely on external auditors to confirm the accuracy and completeness of the information contained in such financial statements.

The Legislative Assembly, however, does not produce financial statements, despite my office’s 2007 report recommendation to do so. Therefore, in the absence of financial statements, my primary objective was to audit the Legislative Assembly’s trial balance for the fiscal 2009, 2010, and 2011 years in accordance with Canadian generally accepted auditing standards.

At the request of the Speaker, I did not audit, at this time, the use of the \$119,000 annual Constituency Office Allowance provided to each Member of the Legislative Assembly, except to the extent to which it was used to pay the salaries of Constituency Office Assistants and to ensure that no more than the maximum annual allowance was paid to each Member. As discussed in the “looking ahead” portion of this report, an examination of these amounts will feature in future audits.

My secondary objective was to inform management and the Legislative Assembly Management Committee of any significant internal control deficiencies or other significant matters that came to my attention in the course of the audit. As is standard practice for financial audits, I issued management letters for each of the three fiscal years audited that include detailed observations and recommendations.

The **Constituency Office Allowance** is paid annually to MLAs in order to run the day to day operations of their respective constituency offices, to a maximum of \$119,000.

AUDIT CONCLUSION

There are significant deficiencies in the financial control and governance of the Legislative Assembly’s financial affairs. As a result, I am unable to conclude if the Legislative Assembly’s trial balance financial information is fairly stated for any of the years audited.



KEY FINDINGS

Inadequate Internal Controls

Effective internal controls help safeguard entity assets and ensure that financial records are free from misstatement due to fraud or error.

During my audit I determined that internal control deficiencies were so serious and pervasive that I was unable to conclude whether the Legislative Assembly’s trial balance for the years ended March 31, 2009, 2010, and 2011 were fairly stated.

To illustrate the financial impact of these internal control deficiencies, my audits of the three fiscal years ended March 31, 2009, 2010, and 2011 identified a cumulative total of approximately \$1.3 billion in adjustments. While this “absolute” total (debits plus credits) of adjustments netted out to a much smaller impact on the Legislative Assembly’s trial balance, the magnitude of the total set of entries I identified as being required in this audit was unexpected for an organization of this size.

I also noted two instances where expenses were intentionally reclassified from one fiscal year to another to ensure that expenses were within budget.

Because of these control deficiencies, I assessed the control environment as ineffective. Consequently, there is a significant risk that the numbers in the Legislative Assembly’s trial balance are not accurate.

Some examples of the types of control deficiencies identified include:

- ◆ *Lack of Bank Reconciliations*

A monthly bank reconciliation is a widely used control procedure that provides an opportunity to verify regular cash transactions and to detect unusual, incorrect, or inappropriate cash transactions.

During my audit, I noted that the Legislative Assembly had not prepared bank reconciliations for several years, and had only started to perform bank reconciliations when preparing for the start of my March 31, 2009 trial balance audit. That first bank reconciliation, prepared by Legislative Assembly staff, identified that the Legislative Assembly’s financial records had not initially recorded over \$1 million in expenses paid out in a previous year.

I also found that the bank reconciliations prepared after I started my audit were not prepared in a standard format. As a result, the Legislative Assembly’s March 31, 2011 bank reconciliation did not identify that there was a difference between the \$133 million overdraft bank balance per the legislative assembly’s trial balance records and the actual bank balance on that day of \$0, per their monthly bank statement. This discrepancy was due to the fact that the Legislative Assembly was not recording the deposit of annual appropriations received. (See related discussion below.)

Internal Controls

Internal controls are accounting procedures and systems designed to ensure the accuracy of information within an organization’s accounting records and the safeguarding of its resources.

♦ *Lack of Management Oversight*

Segregation of duties is an internal control concept designed to prevent errors or fraudulent transactions that could arise when a single person has the ability to initiate, record, and approve a transaction. For example, separating tasks such as the purchase of, and payment for goods or services, helps prevent an individual from ordering items for personal use with public funds.

During my audit, I observed that the Legislative Assembly does not have adequate segregation of duties in relation to several key activities, including purchasing and receiving goods or services, accounts payable, payroll, and preparation and review of journal entries.

While it is not unusual for an organization of the Legislative Assembly's size to have challenges achieving adequate segregation of duties, I found that the Legislative Assembly does not have the necessary oversight procedures in place to compensate for its inadequate segregation of duties.

♦ *Lack of Supporting Documentation for Expenses*

To ensure that funds are used appropriately, expensed amounts should be supported by documents such as receipts. This is a standard business procedure.

During my audit, I noted that the Legislative Assembly, which pays the Members of the Legislative Assembly's travel credit card balances, was consistently unable to provide documentation to support Members' travel expenses. Adequate supporting documentation is necessary to confirm the validity of claimed expenses and should have been obtained prior to paying these amounts. The lack of adequate documentation greatly impedes the comptroller's ability to verify payments, as required under the Members' handbook. I note that my audit procedures were confined to the accounting records maintained by the Legislative Assembly itself.

♦ *Lack of Disclosure of Members' Payments*

To ensure transparency and accountability of payments made to Members of the Legislative Assembly, compensation provided to Members should be disclosed in the B.C. Public Accounts.

During my audit I noted that approximately \$2 million in Transitional Assistance payments made to former Members were misclassified and not included in publically disclosed "Members' Compensation" totals. These payments were paid to Members who had either completed a term in parliament and decided not to run again or were defeated in the 2009 general election.

Significant Departures from Canadian Generally Accepted Accounting Principles

To ensure that accounting records are readily understood by all users of this information, it is important that accounting records be compiled using a standard set of accounting rules. In Canada, these “standard” rules are defined within the guidance provided by Canadian Generally Accepted Accounting Principles.

During my audit I found significant departures from Canadian Generally Accepted Accounting Principles in many important areas. The impact of these deficiencies is so significant and pervasive that, in conjunction with the poor internal controls noted above, I was unable to conclude whether the trial balances for the years audited are fairly stated.

Notable departures from Generally Accepted Accounting Principles include:

♦ *No Recognition of Appropriations*

Contributions from government, such as annual funding, should be recorded to ensure that accounting records are complete and accurate.

During my audit I noted that the Legislative Assembly maintains its own bank accounts and receives deposits each day from the Ministry of Finance to cover each payment processed through its bank account on that day. However, the Legislative Assembly accounting records did not record appropriations from, or transfers to, government. As a result, the Legislative Assembly’s financial records for its bank and appropriation accounts were materially misstated. The Legislative Assembly’s accounting records showed one bank account having an overdraft of \$133 million and the other with a positive balance of \$5.5 million. The actual balance in each account, per their monthly bank statements, was \$0.

♦ *Capitalization Errors*

Tangible capital assets such as buildings and equipment should be appropriately accounted for in order to match the expense incurred to purchase an asset with its useful life. This accounting treatment allows for better budgeting and forecasting.

During my audit I was not able to find sufficient documentation within the Legislative Assembly’s accounting records to determine whether opening capital asset balances in the trial balance were fairly stated.

Additionally, I noted that building purchases and improvements had been misclassified. However, due to the lack of adequate supporting documentation, I was not able to conclude on whether the amortization related to these purchases was fairly stated.

♦ *Lack of Inventory Records*

Recording inventory for the items sold in the Legislative Assembly's gift shop or dining room ensures that financial records, including the costs of the items sold, and profit margins are accurate. This information allows management to make timely and effective business decisions and helps ensure that Legislative Assembly assets are appropriately monitored and safeguarded.

During my audit, I noted that the Legislative Assembly has not established inventory accounts for either its dining room or gift shop. While these account balances may not be a significant dollar value themselves, their absence reduces the information available to safeguard and manage Legislative Assembly assets.

Observations on Governance

An important step in all financial audits is an assessment of the organization's control environment, including its governance and oversight procedures. This is a key part of my risk assessment for any entity and helps to determine the type and quantity of audit work necessary.

Based on my review of the Legislative Assembly's governance environment, I noted that the Legislative Assembly Management Committee has a legislated responsibility to appoint, supervise and manage staff of the Legislative Assembly, analyse the expenditures and commitments of the Legislative Assembly, and ensure the "efficient and effective operation and management of the Legislative Assembly".³ Therefore, a key role of this committee is operating as a governance and management oversight body to ensure that the Legislative Assembly's resources are properly utilized, that operations are well-managed and in compliance with all relevant legislation, and that public and stakeholder expectations around the stewardship of public monies are met.

Additionally, I noted that the Clerk has overall responsibility for management and administrative services, while the Speaker, the Chair of the Legislative Assembly Management Committee, oversees the day-to-day operations of the Legislative Assembly.

The Legislative Assembly Management Committee, the Speaker, and the Clerk, therefore, each play a significant governance role over the Legislative Assembly operations. They essentially act as a Board of Directors, Chair, and Chief Executive Officer respectively.

To meet oversight objectives, it is common practice for governing bodies to ensure that periodic financial results, as prepared by management, are reviewed and responded to in a timely manner. These periodic financial reports will typically track the organization's assets, liabilities, revenues and expenses by category so that users of this information can understand what has happened. These reports will also usually include prior period results and/or budget information and explanations for significant variances. As well, these reports will typically include explanatory notes designed to help readers understand key pieces of information being provided.

³ *Legislative Assembly Management Committee Act 3(1)(c), Act 3(1)(d) and Act 3(1)(g)*

My office's 2007 Special Audit Report to the Speaker included a recommendation that the Legislative Assembly Management Committee regularly review reports of actual to budget spending. However, during my audit I noted that Legislative Assembly management has only recently started to prepare periodic financial reports for the Legislative Assembly Management Committee's review.

Furthermore, as of the date of this report, these reports have been provided only to the Speaker and not to the Legislative Assembly Management Committee. And, even if the Legislative Assembly Management Committee had been provided with the reports, the reports do not have the necessary explanatory notes to help Legislative Assembly Management Committee members understand and evaluate reported results.

Additionally, I noted that the frequency of the Legislative Assembly Management Committee meetings may not be sufficient to provide a timely overview of the Legislative Assembly's financial operations, and thereby meet its governance responsibilities, even if appropriate financial reports were made available.

The results of my audit, therefore, indicate that the Legislative Assembly Management Committee, the Speaker, and the Clerk are not effectively operating as a governance and management oversight body to ensure that the Legislative Assembly's resources are properly utilized and that its operations are well managed and in compliance with all relevant legislation and stakeholder expectations.

DURING 2012, I will expand the scope of my audit work to include all aspects of the \$119,000 Constituency Office Allowance, plus all other periodic payments Members may receive from the Legislative Assembly to run their constituency offices. This will include auditing constituency office records and payments made at constituency offices. This audit will not include Ministerial allowances.⁴ It is important to note that most of this constituency office funding goes towards wages and benefits for staff at these offices, which is administered by the Legislative Assembly, and as such, was within the scope of my work to date.

I will continue to perform annual audits of the Legislative Assembly's financial information until all significant issues identified during my audits have been satisfactorily resolved. I will then re-evaluate the need for continued direct involvement in the audit of the financial records of the Legislative Assembly.

As per the regular follow-up process in my Office, I will follow-up with the Legislative Assembly every six months on the status of their implementation of the recommendation made in this report.

⁴ Ministers receive a capital city living allowance and a travel allowance from their Ministries for travel incurred in their role as Ministers. This is in addition to the allowances received in their role as MLAs.

Status of recommendations made in the April 2007 Special Audit Report to the Speaker.

April 2007 Special Audit Report Recommendation	Status - Per the Clerk of the Legislative Assembly, January 12, 2012
<p>1. A suitable internal audit provider be engaged to examine and report periodically to senior management on the operation of financial controls across all Vote 1 expenditure areas, including constituency offices.</p>	<ul style="list-style-type: none"> ◆ At this time, I have not engaged an internal auditor. This matter could be referred to LAMC for its consideration along with my advice on the subject. Should LAMC or the Speaker agree, I will proceed with the creation of an internal audit function. OAG Update - since this response was received, the Legislative Assembly has contracted an internal audit service provider.
<p>2. Clearer procedures, policies and guidelines for financial control be put in place, covering:</p> <ul style="list-style-type: none"> ◆ types and frequency of financial procedures to be performed, and financial control reports to be produced and reviewed by the senior management team; and ◆ procedures for identifying, documenting and following up significant variances or changes to financial plans. 	<ul style="list-style-type: none"> ◆ I am working on a framework for issues that could involve LAMC. Specific items raised by the OAG are forwarded to the Clerk of the House and the Speaker and, depending upon the nature of the issue, LAMC. I will proceed with the action plan provided to your office subject to additional direction I receive from the Speaker or LAMC.
<p>3. Business Continuity and Disaster Recovery Plans covering financial systems in the Legislative Assembly be completed and periodically tested.</p>	<ul style="list-style-type: none"> ◆ This plan is proceeding and is in the custody of the Sergeant-at-Arms who will consult with the various Legislative Assembly branches. I will discuss disaster recovery for our financial system with our service provider. Once a plan is complete we will share the results with your office. It is important that any plan of this magnitude account for not only the major risks, but the size of the organization, the role of the organization, and the importance of the organization.
<p>4. Financial reporting requirements to the Legislative Assembly Management Committee be established and include regular reporting and discussions of actual to budget spending, as well as publically available audited financial statements for Vote 1.</p>	<ul style="list-style-type: none"> ◆ The Speaker receives quarterly financial reports. LAMC could receive your recommendations on both internal and external financial reporting and I undertake to work the Office of the Comptroller General with respect to moving to IFRS and PSAB standards for BC provincial government and entity sector reporting.
<p>5. A more clearly documented process be put into place for the production and approval of the annual operating and capital budget, including the respective roles of senior management and Legislative Assembly Management Committee members.</p>	<ul style="list-style-type: none"> ◆ The current budget process has been more formally structured with the assistance of a consultant. After evaluating the success of this process, I will document procedures I recommend be adopted. I also plan on making further improvements and adjustments for future budget preparation processes.