PUBLIC SECTOR FINANCIAL MANAGEMENT: CONTROL

Andrew Graham
Queens University
School of Policy Studies
www.andrewbgraham.ca
Just to Recap

- Framing Financial Management
- Accounting Concepts
- Accountability and Risk
- Planning and Budgeting: Getting the Money
- Control: Spending the Money
- Control: Cash Management
- Reallocating and Budget Reductions
- Reporting and Performance Measurement
Auditor-General's Report identifies lapses in Gardens By The Bay contract controls – AG of Singapore

The Speaker’s office lacked control and oversight – AG Canada 2016

Eight years after the auditor general told the Canadian Forces to get its relocation services in line with government finance controls, the department has made strides but still has a way to go. - iPolitics

Mar 12, 2012 - Alberta's Auditor General has released a report card on financial controls at ... Northern Lakes College and Olds College all got a failing grade.
“What you don’t know can hurt you.”
Budgetary Control

- **Budget as Benchmark:**
  - Actual amounts are compared with budgeted amounts.
  - Differences between actual and budgeted amounts are referred to as budget variances.
  - Budget variances should be investigated when they are material.
BACK TO RISK
Risk Management and Control

• Why risk plays a central role
• All organizations face and manage risks
• Various types of risk
  • Performance failures: not meeting goals
  • Financial risks: funding, fraud, loss potential
  • Business complexity
  • Third party delivery
• To establish adequate control, you have to establish risk framework
Management’s Role in Risk and Control

- General Expectations
  - Clarity in objectives and program parameters
  - Identify and manage risks
  - Design, implementation and maintenance of the control structure within business processes
  - Contribute direction to identify, prioritize and review risks and controls
  - Remedy control deficiencies
- Periodically,
  - review results, reassess risks, test controls
  - confirm key controls are implemented and effective
  - maintain documentation to support this assessment
RISK - CONTROL = EXPOSURE (residual risk) → ACCEPTANCE OR ACTION
Financial Risk Considerations

- Evaluate the nature and types of errors and omissions that could occur, i.e., “what can go wrong”
- Consider significant risks common in the program/organization or have been experienced in prior years
- Information Technology risks (i.e. - access, backups, security, data integrity)
- Volume, size, complexity and homogeneity of the individual transactions processed through a given account or group of accounts (revenue, receivables)
Financial Risk Considerations

- Susceptibility to error or omission as well as manipulation or loss
- Extent of change in the policies and organization and their expected effect
- Other risks extending beyond potential material errors or omissions in the financial statements, e.g. inexperience of financial managers
- Adequacy of financial and operational information, timeliness, distribution
How To Identify Risk

- What could go wrong? How could we fail?
- What must go right to succeed?
- What decisions require the most judgment?
- What activities are most complex?
- What activities are regulated?
- On what do we spend the most money?
- How do you bill/collect related revenue?
- On what information do we most rely?
- What assets do we need to protect?
- How could someone or something disrupt our operations?
Conditions That Increase Risk

- Lack of segregation of duties
- Too much personal or implied trust
  - Approval of documents without review
  - Lack of verification of transactions after they have been entered in the system
  - Lack of reconciliations
- No follow-up when things appear questionable or not reasonable
- Lack of control over cash/petty cash
- Lack of control over purchasing of materials/supplies
- Lack of knowledge of policies and procedures
Weak Internal Controls Increase Risk Through…

- Business Interruption - system breakdowns or catastrophes, excessive re-work to correct for errors.
- Erroneous Management Decisions - based on erroneous, inadequate or misleading information.
- Fraud, Embezzlement and Theft - by management, employees, customers, vendors, or the public-at-large.
- Statutory Sanctions - penalties arising from failure to comply with regulatory requirements, as well as overt violations.
- Excessive Costs/Deficient Revenues - expenses which could have been avoided, as well as loss of revenues to which the organization is entitled.
- Loss, Misuse or Destruction of Assets - unintentional loss of physical assets such as cash, inventory, and equipment.
Control
Objectives of Internal Controls

**Strategic** – high-level goals and objectives, aligned with and supporting the mission.

**Operational** – effective and efficient use of resources.

**Reporting** – integrity and reliability of reporting.

**Compliance** – compliance with applicable laws and regulations.

**Stewardship** – protection and conservation of assets.
Just Who is the Controller?

<table>
<thead>
<tr>
<th>CONTROLLER</th>
<th>CONTROL SUBJECT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational Manager</td>
<td>Subordinate Units</td>
</tr>
<tr>
<td>Divisional or Senior Manager</td>
<td>Operational Manager</td>
</tr>
<tr>
<td>Corporate Manager</td>
<td>Divisional or Senior Manager</td>
</tr>
<tr>
<td>Internal Auditor</td>
<td>Operational Manager</td>
</tr>
<tr>
<td>External Auditor</td>
<td>Internal Auditor</td>
</tr>
<tr>
<td>External Auditor</td>
<td>Corporate Manager</td>
</tr>
<tr>
<td>Corporate Manager</td>
<td>Minister and/or Legislature</td>
</tr>
<tr>
<td>Corporate Manager</td>
<td>Board of Directors</td>
</tr>
<tr>
<td>Legislature</td>
<td>External Auditor</td>
</tr>
<tr>
<td>Board of Directors</td>
<td>External Auditor</td>
</tr>
</tbody>
</table>
What and Who to Control

Individual OR Organization

Before Action Ex Ante OR After Action Ex Post
The Key is to “In Control” not “Under Control”
– who is in control here and who is under control?
Just Why Control………

- Plans and execution – variability
- People are people – apply rules differently
- Events happen – change and adapt
- You’ve got to know how you are doing and be seen to know
- Due diligence – obligation to control
Just What is Control………. 

• Control is the task of ensuring that activities are providing the desired results. 
• Controlling means setting a target, measuring performance, and taking corrective action as required. 
• Control is about creating conditions that will improve the probability that desirable outcomes will be achieved.
Internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

* Committee of Sponsoring Organizations of the Treadway Commission
Put another way......

- Internal control is what we do to see that the things we want to happen will happen ...

- And the things we don’t want to happen won’t happen.
Just What is Control...........

Management control systems consist of all organization structures, processes and subsystems designed to elicit behavior that achieves the strategic objectives of an organization at the highest level of performance with the least amount of unintended consequences and risk to the organization.

Systems Theory and Management Control By: Dr. Shahid Ansari:
Some Control Triggers

- Occurrence: recorded transactions actually occurred
- Completeness: all transactions that should be recorded are
- Valuation/Accuracy: correct transaction values are recorded
- Classification: transactions are recorded in the proper account
- Authorization: recorded transactions are valid
- Cut-off: transactions are recorded in the correct accounting period
Is it Working?
- Approvals
- Reconciliation
- Physical and technical safeguarding of assets
- Segregation of duties

Identify the things that “keep me up at night”

Policies and Procedures; overall tone from Management

Communication
Just What is Control........

This is what we call a Control Framework

• All actions taken to make an organization run effectively and accomplish its goals
  • Include management’s attitude, operating style and integrity and ethical values
  • How managers communicate
  • How managers check on staff
  • Assigning responsibility for decision-making and execution
  • Establishing measurement tools
The Traditional Management Control Process

1. Identify Goals, Roles And Responsibilities
2. Establish Standards
3. Measure Performance
4. Compare to Standards
5. Take Corrective Action
Internal Control Structure

- Monitoring
  - Monthly reviews of performance reports
  - Supervisory activities

- Information and Communication
  - Purchasing limits
  - Approvals/ segregations
  - Security
  - Reconciliations
  - Proper operating & accounting procedures
  - Reporting
  - Corporate communications (e-mail, meetings)

- Control Activities
  - Based on identification & analysis of risks to achievement of objectives
  - Corporate Policies
  - Tone at the top, ethics
  - Organizational authority
  - Skilled personnel

- Risk Assessment
  - Control Environment
  - Control Activities
  - Information & Communication
  - Monitoring
Core Concept of Variance

The ability to make timely alterations guards against having to make more draconian adjustments later.
Control Process

**Plan**
- Strategic goals
- Hierarchy of goals for company
- Performance standards

**Organize**
- Assign employees jobs
- What controls used to monitor decent realized, remote operations?

**Lead**
- Lead and motivate employees
- High motivation may reduce control requirement

**Results**

**Modify strategy, goals, performance standards**

**Modify structure, reduce decentralization, less delegation, more coordination**

**Modify leadership style, use positive reinforcement, enrich jobs, etc.**

**Control**
Goals were set

- Compare results to goals and performance standards- budgets, observation, etc.
- If necessary, take corrective action.
What and why...

• Material difference between what was expected and what happened
• Basis of comparison varies: budget plan, previous year, previous time period, set standard
• Variance triggers managerial attention
Variance Analysis

- Variance analysis investigates differences (variances) between planned and actual results to help managers:
  - Prepare budgets for the coming year,
  - Control results in the current year, and
  - Valuate the performance of operating units
  - Get signals about changes in your costs, spending behaviour etc.

- Variance analysis focuses on material differences to help managers correct problems and capitalize on opportunities
Investigating Budget Variances

Causes of Budget Variances
- Budget may not have been well conceived
- Conditions may have changed
- Managers may have performed particularly well or poorly
Variance Analysis Cautions

- Aggregation can hide meaningful variances and lead managers to misinterpret the condition of the organization.
- Exception Reports should be prepared for all material variances that warrant management's attention.
- Fixed costs should not result in volume variances, since they are not expected to change with volume.
## Variance Report: UK Gaming Commission

<table>
<thead>
<tr>
<th></th>
<th>2009 Actual</th>
<th>2009 Budget</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total staff costs</td>
<td>8,970,000</td>
<td>9,138,000</td>
<td>168,000</td>
</tr>
<tr>
<td>Accommodation</td>
<td>1,119,000</td>
<td>1,319,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Professional &amp; accountancy fees</td>
<td>416,000</td>
<td>976,000</td>
<td>560,000</td>
</tr>
<tr>
<td>Travelling &amp; subsistence</td>
<td>427,000</td>
<td>531,000</td>
<td>104,000</td>
</tr>
<tr>
<td>Agency and other staff costs</td>
<td>199,000</td>
<td>229,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Recruitment, training and development</td>
<td>169,000</td>
<td>310,000</td>
<td>141,000</td>
</tr>
<tr>
<td>Hospitality</td>
<td>58,000</td>
<td>119,000</td>
<td>61,000</td>
</tr>
<tr>
<td>Office services</td>
<td>921,000</td>
<td>1,086,000</td>
<td>165,000</td>
</tr>
<tr>
<td>External audit fee</td>
<td>36,000</td>
<td>45,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Internal audit costs</td>
<td>33,000</td>
<td>45,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Amounts payable to CRB</td>
<td>135,000</td>
<td>195,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Other</td>
<td>81,000</td>
<td>72,000</td>
<td>-</td>
</tr>
<tr>
<td>Total Operating Costs</td>
<td>12,564,000</td>
<td>14,065,000</td>
<td>1,501,000</td>
</tr>
</tbody>
</table>
Government of Manitoba Quarterly Variance Report

Projection of Summary Net Income/(Loss)
For the Fiscal Year Ending March 31, 2011
UNAUDITED

<table>
<thead>
<tr>
<th></th>
<th>2010/11 Third Quarter Forecast</th>
<th>2010/11 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Consolidation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Core Government</td>
<td>Core Government</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>10,496</td>
<td>10,218</td>
</tr>
<tr>
<td>Expenditure</td>
<td>10,997</td>
<td>10,755</td>
</tr>
<tr>
<td>Net Result for the Year</td>
<td>(501)</td>
<td>(537)</td>
</tr>
<tr>
<td>Transfer from/(to) Fiscal Stabilization Account</td>
<td>49</td>
<td>38</td>
</tr>
<tr>
<td>Net Income/(Loss)</td>
<td>(452)</td>
<td>(499)</td>
</tr>
</tbody>
</table>

*Includes a year-end adjustment of $37 million
Tracking Revenue: Prince George County, Maryland

<table>
<thead>
<tr>
<th>Month</th>
<th>Budget</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>July</td>
<td>$0.8</td>
<td>$0.9</td>
</tr>
<tr>
<td>August</td>
<td>$1.3</td>
<td>$1.6</td>
</tr>
<tr>
<td>September</td>
<td>$4.0</td>
<td>$3.0</td>
</tr>
<tr>
<td>October</td>
<td>$3.3</td>
<td>$3.9</td>
</tr>
<tr>
<td>November</td>
<td>$4.9</td>
<td>$6.6</td>
</tr>
<tr>
<td>December</td>
<td>$7.5</td>
<td>$7.5</td>
</tr>
<tr>
<td>January</td>
<td>$12.3</td>
<td>$10.9</td>
</tr>
</tbody>
</table>
CONTROL MECHANISMS
Tools of Control: Managing and Reporting Variance

- Internal Controls
- Accounting Controls
- Administrative Controls
Types of Control

- **Input**
  - Feedforward control
  - Anticipates problems

- **Processes**
  - Concurrent control
  - Corrects problems as they happen

- **Output**
  - Feedback control
  - Corrects problems after they occur
Tools of Control

- Audit Trail: ability to trace each transaction back to its source – protects against misuse of funds, also ensures accountability for how funds spent
- Reliable Personnel: hiring the right people, professional qualifications, training and supervision
Tools of Control

- Separation of Functions: person who authorizes the expenditure should not be the person to process payment – notion of counter signatures – ensures checks and balances in the system – notion that a person should not be left to control themselves – introduces elements of a challenge function as well
Tools of Control

- Proper Authorization
  - levels of authority and matrices of delegation distribute authority for spending and decision making in the organization
  - if these are unknown or operate in parallel with informal systems, audit is impossible, so to is control of expenditures
Tools of Control

- Adequate Documentation
  - both in terms of legal requirements (legislative compliance and potential for fraud) and
  - reporting needs (accurate data)
  documentation is becoming more challenging because of computerization but, both theoretically and practically, easier
Tools of Control

Regular Reporting

• frequency and distribution of financial reports should be part of the control framework of the organization

• danger in too much information and reporting, equal problem with too little

• Monthly versus quarterly financial reports: driven by risk, intensity of management process, e.g. watching costs during downsizing, high risk times of peak expenditures may call for more reporting
# Example of a Performance Report

## Performance Report for Machinery Department, June 2000

<table>
<thead>
<tr>
<th></th>
<th>Budget</th>
<th>Actual</th>
<th>Variance</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Labor</td>
<td>$2,107</td>
<td>$2,480</td>
<td>$373 over</td>
<td>Had to put workers on overtime.</td>
</tr>
<tr>
<td>Supplies</td>
<td>$3,826</td>
<td>$4,200</td>
<td>$374 over</td>
<td>Wasted two crates of material.</td>
</tr>
<tr>
<td>Repairs</td>
<td>$402</td>
<td>$150</td>
<td>$252 under</td>
<td></td>
</tr>
<tr>
<td>Overhead (electricity, etc.)</td>
<td>$500</td>
<td>$500</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$6,835</strong></td>
<td><strong>$7,330</strong></td>
<td><strong>$495 over</strong></td>
<td></td>
</tr>
</tbody>
</table>
Tools of Control

Regular Managerial Review
- Different from reporting – calls for an active review and decision
- Regular review during management/executive committee meetings
- Need to demonstrate stewardship by non-financial managers
Tools of Control

Proper Procedures

- “By the book” procedures create compliance requirements
- Make sure you know that
  1) there is actually a book and not just someone making rules up and
  2) consequence of non-compliance and
  3) wiggle room when you need it
Tools of Control

- Adequate Determination of Risk and Risk Management Strategies
- Physical Safeguards: should be part of the control framework
- Bonding and Rotation of Duties: all of these procedures are designed to ensure against theft and having only one person with their hand on key financial processes
- Independent Check: role and use of internal or external auditors
Beyond Traditional Control:

Towards Strategic Control

Beliefs Systems

Core Values

Risks to be Avoided

Boundary Systems

Organizational Strategy

Interactive Control Systems

Strategic Uncertainty Risk

Critical Performance Variables

Diagnostic Control Systems
Boundary Controls

- Ethical Behaviour
- Strategies
- Codes of Conduct
Why Controls Do Not Always Work

- **Inadequate knowledge of policies or governing regulations.** “I didn’t know that!” “The rules were unclear.”
- **Inadequate segregation of duties.** “We trust ‘A’ who does all of those things.” “Senators approve their own expenses.”
- **Inappropriate access to assets.** Passwords shared, cash not secured...
- **Form over substance.** “You mean I’m supposed to do something besides initial/sign it?”
- **Control override.** “I know that’s the policy, but we do it this way.” “Just get it done; I don’t care how!”
- **Inherent limitations.** People are people and mistakes happen. You cannot foresee or eliminate all risk.
The Costs of Control

- Controls not costless
- Control costs can also be transferred
- Limits to managerial responsiveness
- Amount of preoccupation with process over service or results
- Excessive paper burden
- Poor assessment of risk and excessive caution
The Dysfunctional Side of Control

• Unfocused controls
  • Failure to achieve desired or intended results occur when control measures lack specificity

• Incomplete control measures
  • Individuals or organizational units attempt to look good exclusively on control measures

• Inflexible or unreasonable control standards
  • Controls and organizational goals will be ignored or manipulated
Behavioral Consequences of Controls

- Behavioral Displacement
- Gamesmanship
- Operating Delays
- Negative Attitudes
New Challenges in Control

- Extended governance of third party delivery
- Cross control systems within government and across governments
- Lack of agreement on adequate controls
- Poor understanding of risk and risk management
- Capacity to over-control through information and computer monitoring