



Serving
GOVERNMENT,
Serving
CANADIANS.

Final Report

2013-805

Targeted Review of Washington Operations – Foreign Military Sales Account

November 20, 2014

Office of Audit and Evaluation



TABLE OF CONTENTS

MAIN POINTS	i
INTRODUCTION	1
FOCUS OF THE TARGETED REVIEW	5
STATEMENT OF CONFORMANCE	5
OBSERVATIONS	6
OVERSIGHT	6
Oversight activities are in place and operating as intended	6
CONTROL PROCESSES	7
FMS Account control processes were not fully documented	8
Access controls in the FMS account exist and are functioning	8
Bank reconciliations are prepared, and are now being reviewed and approved	9
Appropriate segregation of duties of PWGSC-W staff is established	10
Supporting documentation is kept in the case file	11
CONCLUSION	12
MANAGEMENT RESPONSE	13
RECOMMENDATIONS AND MANAGEMENT ACTION PLAN	13
ABOUT THE TARGETED REVIEW	14

MAIN POINTS

What we examined

- i. The FMS program is a form of security assistance authorized by the United States (US) *Arms Export Control Act*, which allows the US government to sell defence articles and services to foreign countries and international organizations.
- ii. Government of Canada departments such as the Department of National Defence and the Canadian Security Establishment take advantage of the FMS program in order to obtain the necessary defence articles and services that are required to fulfill their respective mandates. Departments identify and define their operational requirements, obtain funding, and subsequently submit the procurement request to Public Works and Government Services Canada's Acquisitions Branch.
- iii. Acquisitions Branch's head office is responsible for determining purchasing strategies to acquire a wide range of technically complex systems for the land, naval and aerospace environments. This includes the acquisition of military and civilian aircraft; electronic, communication and tactical systems; security and information operation systems; armoured vehicles; and weapons, armament systems and ammunition. Acquisitions Branch, in collaboration with its client departments assesses which procurement strategy will be used. When it is determined that a military procurement will be sole sourced to the US government through the FMS program, the case is assigned to the Public Works and Government Services Canada Washington Region (PWGSC-W).
- iv. When it is determined that a military procurement will be sole sourced to the US government, the case (which is the term used in the FMS process instead of contract), is assigned to the PWGSC Washington Office (PWGSC-W). This office, located at the Embassy of Canada in Washington D.C., was established in 1951 to act as a single window for Canadian purchases under the Foreign Military Sales (FMS) program with the US government.
- v. The review was conducted to assess the oversight by PWGSC over the administration of the FMS program by PWGSC-W, as well as controls over the funds that flow through the FMS account in the US Federal Reserve Bank to pay for the purchases under the FMS program. This included the assessment of the oversight activities performed by Acquisitions Branch, and the assessment of the control activities performed by PWGSC-W over the FMS account. The review team examined information PWGSC-W reported to Acquisitions Branch, bank statements, bank reconciliations and supporting documents for the fiscal year April 1, 2013 to March 31, 2014. We also reviewed documents outside of this fiscal year to obtain an understanding of the FMS program, and to validate activities initiated subsequent to our examination phase.

Why it is important

- vi. Since PWGSC-W is the sole accredited Canadian procurement agency responsible for engaging with the US government on all contractual and administrative matters, an effective control framework is important to help ensure that PWGSC-W effectively manages the FMS account in accordance with directives and policies. Managing agreements under the FMS program requires PWGSC-W to interface with the US Department of Defense and Department of State to deliver materials and other controlled goods to Government of Canada clients. As of June 2014, PWGSC-W was managing approximately 500 cases worth close to \$4.3B.
- vii. Activities of the PWGSC-W have not yet been subject to audit or review by the Office of Audit and Evaluation. In addition, while the Office of the Auditor General has conducted four audits on military procurement since 2009 (Audit of Military Vehicles, Audit of Military Helicopters, Audit of Replacing Canada's Fighter Jets (F-35) and, National Shipbuilding Procurement Strategy), the FMS program has not been included in the scope of these audits.

What we found

- viii. Overall, we found that the oversight by PWGSC over the administration of the FMS program by PWGSC-W, as well as controls over the funds that flow through the FMS account in the US Federal Reserve Bank were sufficient and appropriate. However, we also found the bank reconciliation control could be strengthened. This control weakness was subsequently addressed in April 2014 by the Director General's, Washington Region review and approval of bank reconciliations.
- ix. We found that Acquisitions Branch's senior management provided effective oversight over PWGSC-W's management of the FMS program. Information on risks, performance and progress of FMS procurements were communicated to senior management on a consistent and regular basis to help ensure that FMS procurements adhered to Acquisitions Branch's policies, procedures and guidelines. Overall, the oversight in place helps to ensure that objectives of the program are achieved, and risks are identified, assessed and managed.
- x. We found that PWGSC-W's initial process documentation outlining the management of the FMS account was not sufficiently detailed to clearly define the key control activities of the process. Detailed process documentation clearly delineates the control activities in the management of the FMS account, and helps to ensure compliance with applicable requirements. Subsequent to our examination phase, PWGSC-W updated its process documentation to include details on the management of the FMS account. We found that the updated documentation provided sufficient detail regarding the key control activities for managing the FMS account.

2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account Final Report

- x. We found that access controls to prevent unauthorized opening and closing of the FMS account, as well as unauthorized withdrawals and deposits existed and were functioning as intended. Access controls help to ensure that the rules concerning the establishment, closure and maintenance of the FMS account as outlined in the agreement between the Canadian Department of National Defence, the US Defense Finance and Accounting Service, the Federal Reserve Bank of New York and the Bank of Canada are followed and funds are appropriately protected.
- xii. We found that sufficient controls existed to reduce the risk of banking errors, unauthorized transactions, and fraudulent activity in the FMS account. During our examination phase, bank reconciliations did not have any supervisory review or approval. Subsequent to our examination phase, we obtained evidence that the reconciliations were being reviewed and approved by the Director General, Washington Region. On-going supervisory review and approval of bank reconciliations is necessary to help ensure that the funds in the FMS account are protected, and any discrepancies are detected and resolved in a timely manner.
- xiii. Although PWGSC-W is a small office of 10 employees, we found that appropriate segregation of duties existed concerning the transfer of funds, custody of assets, recording of transactions, and reconciling activities. Proper segregation of duties reduces the opportunity of an employee processing unauthorized transactions and misappropriating funds, as well as preventing errors from occurring in the FMS account.
- xiv. We found that transactions which flow through the FMS account were appropriately documented and supported. Supporting documentation was kept on file which is important because it provides evidence, accountability and an audit trail for the transactions concerning the FMS account.

Management Response

Management has had the opportunity to review the report, and agrees with the conclusions and recommendations found therein. Management also developed a Management Action Plan to address these recommendations.

Recommendations and Management Action Plan

Recommendation 1: The Assistant Deputy Minister, Acquisitions Branch should ensure that FMS process documentation is reviewed and updated on a regular basis, and when circumstances dictate.

Management Action Plan 1: Improvements to FMS process documentation were made. This included additional oversight of the financial function and development as well as documentation / codifying of standard operating procedures for all aspects of the operations.

**2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account
Final Report**

Currently, oversight of the FMS function is led by the Director General, Washington Region; the ADM will formally delegate the responsibility to the Director General for reviewing and updating the FMS processes documentation on an annual basis, or when circumstances dictate.

INTRODUCTION

1. This engagement was included in the Public Works and Government Services Canada (PWGSC) 2013-2018 Risk-Based Audit and Evaluation Plan.
2. The United States (US) government offers the Foreign Military Sales (FMS) program under the authority of the *US Arms Export Control Act*. This Act allows the US government to sell defence articles and services to foreign countries and international organizations when it formally finds that doing so will strengthen the security of the United States of America and promote international security. The FMS program is administered by the Defense Security Cooperation Agency, which is a part of the US Department of Defense.
3. Government of Canada departments such as the Department of National Defence and the Canadian Security Establishment take advantage of the FMS program in order to obtain the necessary defence articles and services that are required to fulfill their respective mandates. Departments identify and define their operational requirements, obtain funding, and subsequently submit the procurement request to the Acquisitions Branch (head office). The departments are responsible for financing purchases. Once they are satisfied with the goods or services received, clients are responsible for approving case closures.
4. Acquisitions Branch assists its client departments with identifying procurement requirements and carries out all steps in the procurement process including: identifying the goods or services to be procured; selecting the most effective procurement approach; developing appropriate procurement evaluation criteria; calling for, receiving and evaluating bids; negotiating contracts; debriefing unsuccessful bidders; and administering contracts.
5. Acquisitions Branch's head office is responsible for determining purchasing strategies to acquire a wide range of technically complex systems for the land, naval and aerospace environments. This includes the acquisition of military and civilian aircraft; electronic, communication and tactical systems; security and information operation systems; armoured vehicles; and weapons, armament systems and ammunition. Acquisitions Branch, in collaboration with the client departments assesses which procurement strategy will be used. When it is determined that a military procurement will be sole sourced to the US government through the FMS program, the case is assigned to the Public Works and Government Services Canada Washington Region (PWGSC-W).
6. PWGSC-W was established in 1951 to act as a single window for Canadian purchases under the Foreign Military Sales (FMS) program with the US government. This office is currently located at the Embassy of Canada in Washington D.C., and was set up as its own Sector of the Acquisitions Branch in 2010.

**2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account
Final Report**

7. PWGSC-W is the sole accredited Canadian procurement agency responsible for dealing with the US government on all contractual and administrative matters. This includes administrating contracts, as well as initiating the purchase for goods and services, applying for the export license, coordinating shipping and transportation, paying the invoices and retransferring the FMS procured equipment later in its lifespan if required by the client. In addition, PWGSC-W manages the FMS account, which is used to manage the financial aspects of purchases through the FMS program. This includes managing the deposits into, and payments out of the FMS account. The office is also responsible for the preparation and reconciliation of the FMS account. The departments making the purchase deposit funds into the FMS account to pay for goods or services required.

8. The financial portion of the FMS transactions flow through an account held in the Federal Reserve Bank of New York. This account was set up in 1981 and the terms and conditions of the account are outlined in an agreement signed in 1981 between the Canadian Department of National Defence, the US Defense Finance and Accounting Service, the Federal Reserve Bank of New York, and the Bank of Canada. When funds are required to pay for cases, departments making purchases make deposits into the account by electronic funds transfer, and monthly withdrawals from the account are made by the US government.

9. As of June 2014, PWGSC-W was managing approximately 500 cases worth close to \$4.3B. Approximately 99% of the cases processed through the PWGSC-W are on behalf of the Department of National Defence. Other clients include Transport Canada, the Department of Justice, and the Canadian Security Establishment (see Exhibit 1 for the roles and responsibilities of the key stakeholders in the FMS program).

**2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account
Final Report**

EXHIBIT 1

Roles and Responsibilities of Stakeholders in the FMS program

Role	Responsibilities
United States government (Department of State, Defense Security Cooperation Agency, Department of Defense, Defense Finance and Accounting Service)	<ul style="list-style-type: none"> • Offers and administers the FMS program. • Approves the sale of defence items through the FMS program. • Advises PWGSC-W of the funds required for each case, and withdraws funds from the FMS account on a monthly basis according to an agreement signed in 1981 between the Canadian Department of National Defence, the United States Defense Finance and Accounting Service, the Federal Reserve Bank of New York and the Bank of Canada. • Delivers goods and services to PWGSC-W's clients in accordance with established contracts.
Clients (i.e. Department of National Defence, Canadian Security Establishment etc.)	<ul style="list-style-type: none"> • Identifies and defines operational requirements, and submits to Acquisitions Branch (head office). • Obtains funding and develops a project plan, including substantive cost estimates and schedules, special project management needs, project phasing, maintenance support requirements, etc. • Deposits funds by electronic funds transfer to the FMS account. • Approves case closures when items are delivered as specified.
Acquisitions Branch (headquarters)	<ul style="list-style-type: none"> • Provides clients with comprehensive services for acquiring complex and commercial goods and services. • Develops purchasing strategies for leveraging military procurements. • Assists clients with identifying requirements. • Assesses which procurement strategy will be used. • Determines whether a requirement will be sole sourced through the FMS program, and allocates the procurement to PWGSC-W. • Provides strategic direction, advice, and oversight of PWGSC-W.
PWGSC-W	<ul style="list-style-type: none"> • Accredited as the sole Canadian procurement point of contact for Canadian government to American government agreements and purchases under the FMS program. • Develops purchasing strategies for leveraging military procurements. • Assists clients with identifying requirements. • Collaborates with clients and assesses which procurement strategy will be used. • Oversees and coordinates all procurement related matters for

**2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account
Final Report**

	<p>contracts administered through the FMS program (i.e. initiates the purchase for goods and services, applies for the export license, coordinates shipping and transportation, and retransfers procured equipment).</p> <ul style="list-style-type: none">• Ensures that client departments' deposits into the FMS account are adequate to cover the cases that are being worked on.• Ensures that payments to the United States government out of the FMS account are for the correct amount, and related to a specific case.• Reconciles the FMS account, and prepares monthly bank reconciliations.• Facilitates meetings with clients and United States interlocutors.
--	--

FOCUS OF THE TARGETED REVIEW

10. The objective of this review is to assess the oversight by PWGSC over the administration of the FMS program by PWGSC-W, as well as controls over the funds that flow through the FMS account in the US Federal Reserve Bank.
11. An audit provides a reasonable level of assurance by designing procedures so that the risk of an inappropriate conclusion being drawn based on the audit procedures performed is reduced to a low level. This includes inspection, observation, inquiry, confirmation, recalculation, re-performance and analytical procedures. A review provides a moderate level of assurance by designing procedures so that the risk of an inappropriate conclusion being drawn based on the review procedures being performed is reduced to a moderate level. These procedures are normally limited to inquiry, analytical procedures and discussion. Such risk is reduced to a moderate level when the evidence obtained enables us to conclude that the subject matter is plausible in the circumstances.
12. The focus of the review was on the management of the FMS account; the review also considered Acquisitions Branch's oversight of the FMS program. This included the assessment of the oversight activities performed by Acquisitions Branch, the assessment of the control activities performed by PWGSC-W over the FMS account, as well as a review of bank statements, bank reconciliations and supporting documents for the fiscal year April 1, 2013 to March 31, 2014.
13. More information on the targeted review objective, scope, approach and criteria can be found in the section "About the Review" at the end of the report.

STATEMENT OF CONFORMANCE

14. The targeted review conforms with the Internal Auditing Standards for the Government of Canada, as supported by the results of the quality assurance and improvement program.
15. Sufficient and appropriate review procedures have been conducted and evidence gathered to support the accuracy of the findings and conclusions in this report and to provide a moderate level of assurance. The findings and conclusions are based on a comparison of the conditions, as they existed at the time, against pre-established criteria that were agreed on with management. The findings and conclusion are only applicable to the entity examined and for the scope and time period covered by the targeted review.

OBSERVATIONS

OVERSIGHT

Oversight activities are in place and operating as intended

16. Oversight is a governance function provided by senior management relating to the appropriate operation of a program. Senior management oversight activities help ensure that business activities are undertaken appropriately and are in line with an organization's objectives, and in compliance with the relevant policies, laws and regulations. For the FMS program, oversight by Acquisitions Branch's senior management includes oversight of the risks in the FMS procurement process, and adherence with applicable policies and processes, as well as risks created by issues, delays and emerging priorities.
17. Effective oversight helps to ensure that appropriate FMS procurement decisions are made. It also ensures that PWGSC-W follows Acquisitions Branch's policies and procedures in the delivery of procurements through the FMS program.
18. We expected Acquisitions Branch's senior management to provide oversight of PWGSC-W's activities in the FMS program. We also expected PWGSC-W to communicate regular information on risks, performance and progress to Acquisitions Branch's senior management for consideration and approval.
19. We found the Assistant Deputy Minister and the Associate Assistant Deputy Minister, Acquisitions Branch provided oversight and strategic direction, and were accountable for the successful delivery of the FMS program. The Director General, Washington Region adequately discharged her responsibility for operational duties and the implementation of the FMS program.
20. Acquisitions Branch's headquarters requested information from PWGSC-W on the risks, performance and progress of FMS procurements on a regular and consistent basis. These reporting requirements included: a monthly Operational Opportunities Report; updates on cases over \$1M; and weekly updates on priorities and challenges to the Assistant Deputy Minister and the Associate Assistant Deputy Minister, Acquisitions Branch. These requirements had clearly defined objectives and outlined the information requested to be sent to Acquisitions Branch's senior management.
21. The Operational Opportunities Report submitted to Acquisitions Branch's senior management was used to provide senior management with a three month forward planning snapshot of upcoming contracting activities for discussion and decision making. We reviewed an Operational Opportunities Report prepared by PWGSC-W which provided detailed information on 5 cases (two new cases and three amendments), each with a value of over \$1M. Information included a description of each case, the case value, as well as comments on the status of the case. We were

2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account Final Report

informed that after review and approval from the Director General, Washington Region, each Operational Opportunities Report is provided to the Assistant Deputy Minister, Acquisitions Branch for review and approval. The Assistant Deputy Minister, Acquisitions Branch follows up with the Director General on any concerns or issues.

22. The Delegation of Authority for procurements under the FMS program described in the Supply Manual states that for procurements up to \$25M the Assistant Deputy Minister or Director General or Manager, Acquisitions Branch approval is required. For procurements over \$25M, Treasury Board approval is required. We identified an additional control whereby procurements over \$1M are approved by the Assistant Deputy Minister, Acquisitions Branch. A notification sent from the Policy, Risk, Integrity and Strategic Management Sector in August 2013, and again in April 2014, specified that prior to the awarding of all procurement contracts, amendments and options which were \$1M or above, contracting officers must receive clearance for release from the office of the Assistant Deputy Minister, Acquisitions Branch. We reviewed several emails concerning new cases and amendments over \$1M from the Director General, Washington Region to both the Assistant Deputy Minister and the Associate Assistant Deputy Minister, Acquisitions Branch for review and approval. We also reviewed the corresponding emails expressing approval and clearance for release from the Associate Assistant Deputy Minister, Acquisitions Branch.
23. In addition to the oversight controls identified above, weekly email updates concerning PWGSC-W's priorities and challenges were sent from the Director General, Washington Region to the Assistant Deputy Minister and Associate Assistant Deputy Minister, Acquisitions Branch. The Assistant Deputy Minister and Associate Assistant Deputy Minister, Acquisitions Branch follow up with the Director General on any concerns or issues. We reviewed four updates which contained information about PWGSC-W's priorities, issues and concerns for the upcoming week, as well as a debrief of activities for the prior two weeks.
24. Based on our findings, PWGSC-W provided sufficient information to Acquisitions Branch's senior management to allow it to provide effective oversight over PWGSC-W's administration of the FMS program. This oversight helped ensure that: FMS procurements adhered to Acquisitions Branch's policies, procedures and guidelines; objectives were achieved; and risks were identified, assessed and managed.

CONTROL PROCESSES

25. Controls are any actions taken by management or other parties to manage risks that may impede the achievement of established objectives. For the FMS account, the established objective is the proper administration and safeguarding of funds that flow through the account.

26. We expected PWGSC-W to have the following control activities in place to reduce the risks relating to banking errors, unauthorized transactions, and fraudulent activity associated with the management of the FMS account:

- Control processes are documented;
- Access controls are functioning;
- Bank reconciliations of the FMS account are prepared, reviewed and approved on a regular basis by appropriate personnel;
- Duties are appropriately segregated (i.e. transfer of funds, custody of assets, recording of transactions and reconciliation activities); and
- Transactions are appropriately documented and supported.

FMS Account control processes were not fully documented

27. We expected to find documentation relating to the management of the FMS (Federal Reserve Bank) account. We found that PWGSC-W had a documented process map of the procurement process for the FMS program (including activities of the client and Acquisitions Branch's headquarters), but it did not detail the activities of PWGSC-W concerning the FMS account. We performed a walk-through of the process, and reviewed documentation which supported that several activities such as bank reconciliations were being performed but were not identified on the process map.

28. The available process documentation on managing the FMS account did not detail all of the activities of the Manager, Finance and Systems who was responsible for the financial administration of the FMS cases processed through the FMS account. In July 2014, subsequent to our examination phase, PWGSC-W prepared and completed a process document detailing the control activities of the FMS account. We determined it to be sufficient as it provided adequate details to manage the FMS account.

29. Documented control processes assist an organization in maintaining a strong system of internal controls over the FMS account as they: clearly delineate the control activities to be performed in the management of the FMS account; help ensure compliance with applicable requirements; aid in the orientation of new employees; and help ensure that duties are outlined in the event of employee departures.

Access controls in the FMS account exist and are functioning

30. There are access controls embedded in the process to prevent unauthorized opening and closing of the FMS account, as well as unauthorized deposits and withdrawals (drawdown) which flow through the account. An agreement signed in 1981 between the Canadian Department of National Defence, the US Defense Finance and Accounting Service, the Federal Reserve Bank of New York and the Bank of Canada established the rules which govern these aspects of the FMS account.

31. Per the agreement, only after signature from the above-mentioned four parties would an FMS account be opened. Concerning account closure, the FMS account would only be closed upon receipt by the Federal Reserve Bank of New York of authenticated requests of both the US Defense Finance and Accounting Service and the Bank of Canada.
32. The agreement stipulates that all payments pertaining to FMS cases shall be deposited into the FMS account. It also stipulates that withdrawals from the account shall only be made on authenticated instructions from the US Security Assistance Accounting Centre which receives direction from the US Defense Finance and Accounting Service.
33. To obtain assurance regarding the existence of the access controls, we examined four bank statements to determine if deposits and withdrawals were appropriate in relation to the controls identified above. Our examination of four monthly bank statements for the months of May, July, September and December 2013, included 45 deposits into the FMS account and four withdrawals from the FMS account (i.e. only one withdrawal from each bank statement per month).
34. We found that the deposits were made to the FMS account by electronic funds transfer from the client requesting the FMS good or service under the FMS program. Each month, the US government informed PWGSC-W of the amount required for the active FMS cases. Subsequently, PWGSC-W advised clients of the required funds for the month, and the clients transferred the money directly to the FMS account. We also found that for the four bank statements chosen, the only withdrawals from the FMS account were made by the US government as stipulated in the agreement.
35. Based on our findings, access controls existed and were functioning as intended to prevent unauthorized opening and closing of the FMS account, as well as deposits and withdrawals which flow through the account. At no point in the deposit process did PWGSC-W employees have access to the funds being deposited. These access controls help to ensure that the rules governing the establishment, closure and maintenance of the FMS account outlined in the agreement are followed, and ensure that funds in the FMS account are appropriately safeguarded.

Bank reconciliations are prepared, and are now being reviewed and approved

36. We observed that the key control to mitigate the risks of banking errors, unauthorized transactions and fraudulent activity was the monthly bank reconciliation, prepared by the Manager, Finance and Systems within PWGSC-W. To assess the sufficiency of the bank reconciliation process in relation to the risks identified above, we reviewed four bank statements from the Federal Reserve Bank of New York and reconciliations for the months of May, July, September and December 2013.

37. We found that all four reconciliations were prepared by the Manager, Finance and Systems, and variances were followed up and resolved in a timely manner. However, we did not find any evidence of supervisory review and approval for each of the bank reconciliations.
38. We informed PWGSC-W that supervisory review of the bank reconciliations would strengthen the effectiveness of the control activity. We were informed that in April 2014, the Director General, Washington Region commenced reviewing and approving the bank reconciliations. In July 2014, subsequent to our examination, we received bank reconciliations from PWGSC-W for April to June 2014 that had evidence of review and approval by the Director General, Washington Region. This review and approval of bank reconciliations by the Director General, Washington Region was also included in the updated documented procedures that we received in July 2014.
39. Based on our findings, sufficient controls over the FMS account exist to reduce the risks of banking errors, unauthorized transactions, and fraudulent activity as bank reconciliations were prepared, and are now reviewed and approved. On-going preparation, supervisory review and approval of the FMS account bank reconciliation is necessary to help ensure that controls continue to be sufficient. Preparation, review and approval of bank reconciliations of the FMS account are important as they provide assurance that the funds in the FMS account are appropriately safeguarded, and help to detect unauthorized access and discrepancies in the account.

Appropriate segregation of duties of PWGSC-W staff is established

40. Although PWGSC-W is a small office of 10 employees, we expected the following duties to be appropriately segregated amongst employees:
- The transfer of funds to the FMS account;
 - The custody of the assets;
 - The recording of transactions; and
 - The reconciling of activities.
41. We found that the client requiring the good or service always initiated the procurement, and after the terms and conditions were accepted and authorized by the client, a Letter of Acceptance was signed by the appropriate PWGSC-W employee based on the documented Delegation of Authority. To determine if the FMS procurement was appropriately authorized, we tested a variety of 50 transactions, of which 45 required the Letters of Acceptance to be authorized and signed per the documented Delegation of Authority. 100% (45 out of 45) were appropriately approved per the Delegation of Authority. Five transactions were not included in this test as four were account withdrawals and one was an amendment (correction).
42. We found that funds were transferred directly from the clients to the FMS account. In addition, assets purchased through the FMS program were shipped as per the clients' specification included in the Letters of Acceptance. PWGSC-W employees

did not have access to the funds that were deposited in the FMS account nor did they take custody of the assets purchased.

43. We found that the duties of PWGSC-W employees were segregated during the FMS procurement process as follows:
- The Manager, FMS and Senior Contracting Officer worked with the clients on all procurement related matters such as case management and amendments.
 - The Senior Purchasing Assistant entered information, such as contract details, description, quantity, and cost from the Letter of Acceptance, into the Automated Buyer Environment (Acquisitions Branch's central procurement system).
 - The Manager, Finance and Systems ensured that funds deposited by client departments, and withdrawn by the US government from the FMS account were for the correct amount, and were cross referenced to a specific case. The monthly reconciliation of the account was also completed by the Manager.
 - The Senior Contract Specialist was responsible for all FMS related shipments exiting the US. These responsibilities included completing the export paperwork and monitoring delivery of the FMS case through closure.
44. Overall we found appropriate segregation of duties existed concerning the transfer of funds, custody of assets, recording of transactions and reconciliation activities. No employee had control of all phases of the FMS procurement. Appropriate segregation of duties reduces the opportunity of an employee processing unauthorized transactions and misappropriating funds. It also helps to prevent errors from occurring in the FMS account.

Supporting documentation is kept in the case file

45. Letters of Acceptance and confirmations of funds transferred to the FMS account supported the deposits into the FMS account. Before a case was closed, the client sent a confirmation to close the case to PWGSC-W. To determine if supporting documentation for transactions was kept in the case file, we judgementally selected 50 transactions from four bank reconciliations. In our sample of 50 transactions, we found that 49 transactions had the appropriate supporting documentation kept in the case file.
46. In the one remaining case, the missing documentation was a confirmation from the client to close a case. We were informed by PWGSC-W that the case closure was discussed at an annual reconciliation meeting with US government but minutes of the meeting were not in the case file, and could not be found by PWGSC-W employees.
47. To obtain additional information on the validity of the case closure, we reviewed the letter that PWGSC-W sent to the client requesting the additional funds to finalize and close the case. We also reviewed the clearing document from the client indicating that the funds were transferred to the FMS account and then traced this amount to the

FMS bank statement. We found that the additional information obtained supported the validity of the case closure and the missing client confirmation did not represent a significant issue.

48. Based on our findings, transactions that flow through the FMS account were appropriately documented and supported. Supporting documentation was kept in the procurement case files. Supporting documentation is important because it provides evidence and accountability for the transactions concerning the FMS account. It also ensures that activities are authorized, in accordance to the FMS agreement, and provides an audit trail when required.

CONCLUSION

49. Overall, we found that the oversight by PWGSC over the administration of the FMS program by PWGSC-W, as well as controls over the funds that flow through the FMS account in the US Federal Reserve Bank were sufficient and appropriate. However we found that the bank reconciliation control could be strengthened.
50. We found that Acquisitions Branch's senior management provided effective oversight over PWGSC-W's in its administration of the FMS program. Acquisitions Branch's headquarters requested and received information from PWGSC-W on risks, performance and progress of FMS procurements on a regular and consistent basis. This oversight helped ensure that: FMS procurements adhered to Acquisitions Branch's policies, procedures and guideline; risks were identified, assessed and managed; and activities in support of the FMS program were monitored.
51. We found that PWGSC had sufficient control activities in place to help reduce the risks relating to banking errors, unauthorized transactions, fraudulent activity, and inappropriate segregation of duties. During our examination phase, the available documented processes and procedures to manage the FMS account were not sufficiently detailed, and did not identify control activities. Subsequent to our examination phase, process documentation was updated and we determined that it was sufficient and included adequate details to manage the FMS account.
52. We found that access controls to prevent the unauthorized opening and closing of the FMS account, as well as the appropriateness of deposits and withdrawals which flow through the account, existed and were functioning as intended. At no point in the deposit process did PWGSC-W employees have access to the funds being deposited.
53. We found that the bank reconciliation was the key control to reduce the risks of banking errors, unauthorized transactions and, fraudulent activity. During our examination phase, we determined there was no supervisory review or approval of the bank reconciliations. In July 2014, subsequent to our examination phase, we received bank reconciliations from PWGSC-W for the months April to June 2014 that had evidence of review and approval by the Director General, Washington Region. We

determined that this control is now sufficient. On-going supervisory review is necessary to ensure that the control continues to be effective.

54. We found that although PWGSC-W is a small office of 10 employees, appropriate segregation of duties existed concerning transfer of funds, custody of assets, recording of transactions and reconciliation activities. No employee had control of all phases of the FMS procurement.
55. We found that transactions that flow through the FMS account were appropriately documented and supported. In addition, supporting documentation was kept in the case files.

MANAGEMENT RESPONSE

Management has had the opportunity to review the report, and agrees with the conclusions and recommendations found therein. Management also developed a Management Action Plan to address these recommendations.

RECOMMENDATIONS AND MANAGEMENT ACTION PLAN

Recommendation 1: The Assistant Deputy Minister, Acquisitions Branch should ensure that FMS process documentation is reviewed and updated on a regular basis, and when circumstances dictate.

Management Action Plan 1: Improvements to FMS process documentation were made. This included additional oversight of the financial function and development as well as documentation / codifying of standard operating procedures for all aspects of the operations.

Currently, oversight of the FMS function is led by the Director General, Washington Region; the ADM will formally delegate the responsibility to the Director General for reviewing and updating the FMS processes documentation on an annual basis, or when circumstances dictate.

ABOUT THE TARGETED REVIEW

Authority

This engagement was included in the Public Works and Government Services Canada (PWGSC) 2013-2018 Risk-Based Audit and Evaluation Plan.

Objective

The objective of this review is to assess the oversight by PWGSC over the administration of the FMS program by PWGSC-W, as well as controls over the funds that flow through the FMS account in the US Federal Reserve Bank.

Scope and Approach

This targeted review focused on the management of the FMS account. This included the assessment of the oversight activities performed by Acquisitions Branch, the assessment of the control activities performed by PWGSC-W over the FMS account as well as the review of bank statements, bank reconciliations and supporting documents for the fiscal year April 1, 2013 to March 31, 2014.

This review was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

Interviews were conducted with key personnel from Acquisitions Branch (the Director General, Washington Region, several Managers, Washington Region, and the Manager, Munitions and Weapons Systems Division, Acquisitions Branch). Relevant processes and documentation were examined and tested. Based on analysis of the information and evidence collected, the review team prepared review findings and conclusions, which were validated with PWGSC-W management.

Criteria

The criteria used to assess the FMS account were based on the identified risks identified in our Planning Phase. We looked at the controls over the funds that flow through the Foreign Military Sales account, to assess if they are adequately designed and operating as intended.

The following review criteria were reviewed and accepted by Acquisitions Branch.

The criteria were as follows:

- There is oversight from Acquisitions Branch's head office concerning FMS procurements.

2013-805 Targeted Review of Washington Operations – Foreign Military Sales Account Final Report

- Key control activities exist to:
 1. Prevent unauthorized transactions (e.g. withdrawals, opening/closing of bank accounts) in the FMS Account.
 2. Prevent fraudulent activity or to detect misappropriation of funds in the FMS account.
 3. Prevent inappropriate segregation of duties in activities related to the FMS account.
 4. Prevent banking errors from going unnoticed and not addressed on a timely basis.

We also used a judgemental sample methodology to ensure that a variety of transactions from each bank statement was obtained (i.e. initial deposits, withdrawals, amendments etc.).

Our sample size included 50 transactions from four bank reconciliations in the period April 1, 2013 to March 31, 2014 (4 withdrawals, 45 deposits and 1 adjustment).

Details of the sample are as follows:

- Total - 50 out of 247 transactions (100% monetary value of withdrawals and 56% monetary value of deposit to account)
- May – 14 out of 35 transactions (100% monetary value of withdrawals and 64% monetary value of deposit to account)
- July - 11 out of 70 transactions (100% monetary value of withdrawals and 60% monetary value of deposit to account)
- September - 14 out of 93 transactions (100% monetary value of withdrawals and 53% monetary value of deposit to account)
- December - 11 out of 49 transactions (100% monetary value of withdrawals and 51% monetary value of deposit to account)

Targeted Review Work Completed

The review fieldwork was substantially completed on June 20, 2014.

Targeted Review Team

The review was conducted by members of the Office of Audit and Evaluation, overseen by the Director of Procurement Audit and under the overall direction of the Chief Audit and Evaluation Executive.

The review was reviewed by the quality assessment function of the Office of Audit and Evaluation.