Office of the Auditor General of Canada

Report on a Review of the Special Examination Practice

Practice Reviews Conducted in the 2009–10 Fiscal Year

May 2010

Practice Review and Internal Audit

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Introduction

1. The Office of the Auditor General (the Office) conducts independent audits that provide objective information, advice, and assurance to Parliament, territorial legislatures, and Canadians. The Office has several product lines, including performance audits, financial audits, and special examinations.

2. Special examinations assess the management systems and practices of a Crown corporation and provide an opinion on whether there is reasonable assurance that there are no significant deficiencies. A significant deficiency is a major weakness that could prevent the Crown corporation from achieving specific objectives defined in the *Financial Administration Act.* These objectives are described in the Background section below.

3. The Practice Review and Internal Audit Team conducted practice reviews of selected special examinations reported in 2009. This work was done in accordance with the monitoring section of the General Standards of Quality Control for Firms Performing Assurance Engagements of the Canadian Institute of Chartered Accountants (CICA) Handbook. It was also done in accordance with the Practice Review and Internal Audit Plan 2009–10, which was recommended by the Audit Committee and approved by the Auditor General. The Plan is based on systematic monitoring of the work of all audit principals in the Office on a cyclical basis.

4. To meet the standards of the CICA, the Office establishes policies and procedures for its work. These are outlined in an audit manual, various other audit guidance tools, and a Quality Management System (QMS) for each product line. The QMS for special examinations and supporting audit methodology ensure that quality is built into the examination process. These guide auditors through a set of required steps to ensure that special examinations are conducted according to professional standards and Office policies. There is a product leader at the assistant auditor general level for the special examinations product line.

5. This report consolidates the results of the special examinations we reviewed in 2009–10 and summarizes the findings.

Background

6. The *Financial Administration Act* (FAA) requires each parent Crown corporation (with certain exceptions) to have a special examination of its organization. Amendments to the Act in 2009 have changed the time period between examinations from 5 years to a maximum of 10 years. These revisions also include a requirement for Crown corporations to make the report public.

7. The FAA requires the auditor to provide an independent opinion on whether the corporation's financial and management control and information systems and management practices provide reasonable assurance that, during the period under examination

- the assets of the corporation were safeguarded and controlled;
- the financial, human, and physical resources of the corporation were managed economically and efficiently; and
- the operations of the corporation were carried out effectively.

8. Overall, the Office is expected to complete more than 45 special examinations in a 10-year period. Ten special examinations were finalized in our practice review period (December 2008 to December 2009).

Overview

Objective

9. The objective of practice reviews is to provide the Auditor General with assurance that

- special examinations comply with professional standards and applicable legislative and regulatory requirements,
- the Quality Management System (QMS) has been appropriately designed and effectively implemented, and
- the QMS has been appropriately applied so that reports issued are supported and appropriate.

Scope and methodology

10. We conducted practice reviews of two special examinations out of the 10 reported during the practice review period (December 2008 to December 2009).

11. We stayed abreast of the special examination practice by reviewing the Special Examinations Manual, the QMS for special examinations, practice advisories, Office policies, the CICA assurance standards, and other documentation relevant to special examinations.

12. Our reviews included an examination of documentation and a review of electronic (TeamMate) and paper audit files. We examined files related to the planning, examination, and reporting of the audits. Our review focused on the most significant approvals, decisions, and reporting matters of the special

examinations. We also reviewed the substantiation file, which contains examination evidence most pertinent to the content of the audit report and ensures that observations, conclusions, and recommendations of the report flow logically and are well supported. We also interviewed audit team members, quality reviewers, and other internal specialists, as appropriate.

Quality Management System elements and key process controls reviewed

13. We focused our work on selected elements of the QMS for special examinations (see Appendix A) that we considered as high risk. These are the following:

- Conduct of the examination
  - Planning
  - Examination
  - Reporting
- Finalization of audit files
- Consultation
- Resourcing
- Independence
- Leadership and supervision
- Security

14. We also looked at how the quality reviewers carried out their responsibilities for quality control. Quality reviewers are management-level employees of the Office who are appointed to provide an objective evaluation, before the auditor's report is issued, of the significant judgments the audit team made and the conclusions reached in formulating its audit opinion. The quality reviewer is an important element of the Office's quality control system and is involved in individual audits from the initial planning decisions to the closing of the audit file. See Appendix B for a description of the key process controls reviewed for each selected element of the QMS for special examinations.

Rating system

15. For individual special examinations under review, we applied one of the following ratings to each selected element of the QMS:

- **Compliance.** Office policy requirements and CICA standards for assurance engagements were met; minor improvements might be possible.

- **Needs improvement.** Improvements are necessary in some area(s) to fully comply with Office policies and/or CICA standards for assurance engagements.
- **Non-compliance.** Major deficiencies exist; there is non-compliance with Office policies and/or CICA standards for assurance engagements.

16. After completing the practice reviews, we provided an overall conclusion on whether each special examination report we examined was supported and appropriate. If multiple elements of the QMS are non-compliant, the audit opinion is at risk.

Reporting standards

17. This report has been prepared in accordance with the monitoring section of the General Standards of Quality Control for Firms Performing Assurance Engagements of the Canadian Institute of Chartered Accountants (CICA) Handbook. The standards require that information be communicated on monitoring procedures performed, conclusions drawn from the monitoring procedures, description of deficiencies, and actions taken to resolve these deficiencies.

Results of the Reviews

Summary of compliance with the Quality Management System and process control elements

18. We found that the two reports we reviewed were supported and appropriate. In addition, one file fully complied with the elements of the Quality Management System (QMS) that were reviewed and with the CICA standards for assurance engagements. The other file needed improvement with respect to the elements of consultation and independence.

19. This year, special examination practice reviews did not highlight new observations. Given that the two special examination files reviewed in 2009–10 were already well under way when the results of the 2008–09 reviews were finalized, we did not expect all of the previous year's observations to be fully addressed in the files reviewed this year. The observations noted in our previous report, *Report on a Review of the Special Examination Practice: Practice Reviews Conducted in 2008–09* (also called the 2009 Summary Report) have been carried forward. These outstanding recommendations have yet to be addressed.

20. The 2008–09 practice reviews identified a number of instances where the QMS was not applied consistently and rigorously or where its design needed

improvement. As a result, the Office made it a strategic priority in 2009–10 to update and strengthen the design and implementation of the QMS. This priority is being addressed through initiatives such as a major update of the audit manuals and associated methodology and a review and update of the professional development curriculum.

21. Efforts have been made to address this strategic priority throughout the year and are ongoing.

Strengths and good practices

22. In the course of our practice reviews, we identified the following strengths and good practices for Office-wide consideration.

Involvement of senior management

23. In both special examinations we reviewed, documentation in the files clearly demonstrated an appropriate and timely involvement of senior management. Among other things, there was evidence of leadership, of direction provided to audit teams, and of active participation in key meetings and decisions at the planning and reporting phases of the audits. Compared to last year, this is an area of improvement in practice.

Good documentation

24. In both special examinations we reviewed, we found

- good documentation of key judgments and decisions,
- audit programs prepared and completed for all systems and practices examined, and
- substantiation files that contained appropriate evidence to support the observations and conclusions of the report.

25. The work of the quality reviewer was also well documented in the files. In addition, audit teams used TeamMate as the main repository of audit information, which helped to limit the number of paper files.

26. We recognize the efforts made by the audit teams and their commitment to adequately document their work and decisions. We noted improvements to the TeamMate audit tool (electronic file) and the addition of detailed audit steps that helped the audit teams to better document their work.

Establishment of a liaison committee

27. In one special examination we reviewed, the audit team established a liaison committee that included the Crown corporation’s senior executives and

senior audit management. This committee was created at the beginning of the audit and met at key steps during the audit. Because the Crown corporation in question was large, establishing this committee was a good way to communicate with the entity during the audit, to facilitate discussion of audit observations, and to ensure prompt receipt of coordinated management responses.

Opportunities for improvement

28. The Practice Review and Internal Audit Team has seen many examples of good audit work in the files we reviewed in the 2009–10 fiscal year. However, there continue to be areas that need improvement across the special examination practice. As previously mentioned, these observations mainly relate to areas raised in last year's summary report that remain outstanding and in need of improvement.

Roles and responsibilities of the Product Leader and Special Examination Practice Team

29. Professional standards and Office policies on quality control require that appropriate consultation take place during the course of an engagement and that documentation of consultations be sufficiently complete and detailed. In the Office and in the context of a special examination, consultations include those with internal specialists, the Special Examination Product Leader, the Special Examination Practice Team[1] (SEPT), and the quality reviewer.

30. In our 2009 Summary Report, we noted that documentation of consultations needed improvement. In some cases, there was no evidence that appropriate consultations were carried out; where they were, the input of those consulted and how the audit team dealt with comments received was not always well documented. Also, we noted that the roles and responsibilities of the Product Leader and the SEPT needed to be clarified.

31. In the two special examinations reviewed this year, we found that the specialists and advisors were consulted on a timely basis, and overall, these consultations were adequately documented, including the disposition of comments received. We saw that the SEPT was involved in the two files we reviewed; notably, they were involved in reviewing examination plans and reports. However, we did not find evidence of the Product Leader's involvement. It was not always clear to the audit teams when and on what the Product Leader should be consulted.

[1] The Special Examination Practice Team provides assurance to the report signatory about consistency of reports and adherence to reporting according to Office policies and professional standards. It also provides advice on the application of the Office's Quality Management System.

32. In the fall of 2009, a new Product Leader was appointed, and the Office clearly documented and communicated the senior roles and responsibilities for audit quality, including those for the Product Leader and the SEPT. However, at the time the special examinations we reviewed took place, these roles were still under development.

33. We understand that the Product Leader and the Special Examination Practice Team are further defining their roles and responsibilities.

Documentation of the type of work performed in the annual financial audit

34. Our 2009 Summary Report indicated that the area of risk assessment needed improvement in all the files we reviewed. Audit teams needed to do a better job at linking their risk assessment to the selection of key systems and practices for detailed review. They also needed to better document reasons why they excluded certain systems and practices from more detailed examination. Decisions on planning and on determining the extent of the work to be undertaken also needed to be better documented.

35. The two files we reviewed this year showed improvement in documentation related to risk assessment. However, for both files, audit teams needed to better document the extent to which they relied on existing information from the annual audit file. The teams needed to better document their judgment and the work they performed to confirm that examination work could be limited to the assurance already obtained in the annual audit.

36. A complete examination file should include a summary of the work performed in the annual financial audit—from which assurance is derived in the special examination—and the amount of assurance derived from this audit work.

Role and responsibilities of quality reviewers

37. Quality review is an important element of quality control within the Office. We found that the quality reviewers assigned to both special examinations we looked at were experienced in their role. In both files their work was timely, sufficient, and well documented.

38. In last year's summary report, we noted that the Office needed to review the guidance material available to quality reviewers and clarify roles and expectations. We also recommended training as well as developing a mandatory checklist to assist the reviewers in performing their duties according to standards and Office policies.

39. This year, we noted that the new version of TeamMate includes a specific section dedicated to the quality reviewers' work and associated audit steps. This additional guidance will help quality reviewers and audit teams meet professional standards and Office requirements.

40. The Office now needs to ensure that this information in TeamMate is in line with the roles and responsibilities of the Quality Reviewer, as outlined in the document "Senior Roles and Responsibilities for Audit Quality" (November 2009). Notably, the Office's new expectations related to the review of the budgeting decisions and assurance that the main controls/steps in the QMS have been applied/completed have to be reflected in the methodology and related audit tools. Further, the Office still needs to offer training to quality reviewers and to the audit teams.

Independence

41. Assurance standards require that auditors be independent of the entity they are auditing. Accordingly, threats to independence and the safeguards used to reduce such threats to an acceptable level must be assessed and documented. The Office has specific policies and procedures designed to avoid independence infractions. Notably, each auditor is required to complete a declaration of independence form for each assurance engagement they are assigned to.

42. We noted in our 2009 Summary Report that not all those involved in the audit work had confirmed their independence and completed the form. This was again the case this year. At the time the examinations were conducted, Office policy did not require all individuals advising the audit team in the conduct of its audit to complete a declaration of independence form.

43. A revised practice advisory was issued in December 2009 clarifying that all those involved in reviewing the audit work or advising the audit team members (for example, quality reviewers, internal advisors, advisory committee members, internal specialists) are now expected to assess, document, and address threats to independence at the beginning of every assurance engagement by completing an independence form.

Disclosure of the source of criteria

44. As required by professional standards, audit reports should identify the criteria against which an organization is evaluated and disclose the source of the criteria. For performance audits, sources of criteria are disclosed in the "About the Audit" section of each report. In our 2009 Summary Report, we noted that it could be beneficial for the special examination audit teams to adopt the same practice. This application would also provide consistency among audit practices.

45. Over the years, the Office has developed criteria for a large number of entities and activity areas, which may also apply to current audits. However, the fact that these criteria have been used in the past does not, itself, make the criteria authoritative. It is the responsibility of auditors to re-assert the source and suitability of the criteria.

46. Last year, the Office had agreed to include the sources for criteria in the next Special Examination Report Template. The revised template still provides the broad statement that the examination criteria were based on our experience with performance auditing and our knowledge of the subject matter. We recognize that the criteria are discussed with management and are accepted by management and those in charge of governance. Reporting would be further enhanced if the sources of criteria were disclosed.

Follow-up of Management Actions on Recommendations of Previous Practice Reviews

47. As indicated earlier, management made it a strategic priority in the 2009–10 fiscal year to update and strengthen the design and implementation of the Quality Management System. In response to significant changes in international and Canadian auditing standards, findings of internal practice reviews, and feedback received from practitioners, the Office has identified the need to renew its audit methodology for the three product lines: annual audit, performance audit, and special examination. This initiative, Renewal of Audit Methodology (RAM), has many components, including a change management component to ensure an effective transition. A separate project dealing with the review of the Office's overall training strategy is also under way.

48. The Office has informed us that many outstanding recommendations made in previous practice review reports will now be addressed as part of RAM, the training strategy, and other initiatives. We will continue to monitor how management considers the recommendations made in previous years in these projects.

Conclusion and Recommendations

49. We conclude that the two examination reports were supported and appropriate. Furthermore, based on the two practice reviews performed, our cumulative knowledge, and the follow-up on management actions taken on recommendations from previous years, we conclude that for the elements of the Quality Management System (QMS) we reviewed, the design is appropriate. However, implementation of the QMS still needs improvement.

50. We discussed our observations and recommendations with management, who agreed with the recommendations.

51. Recommendations

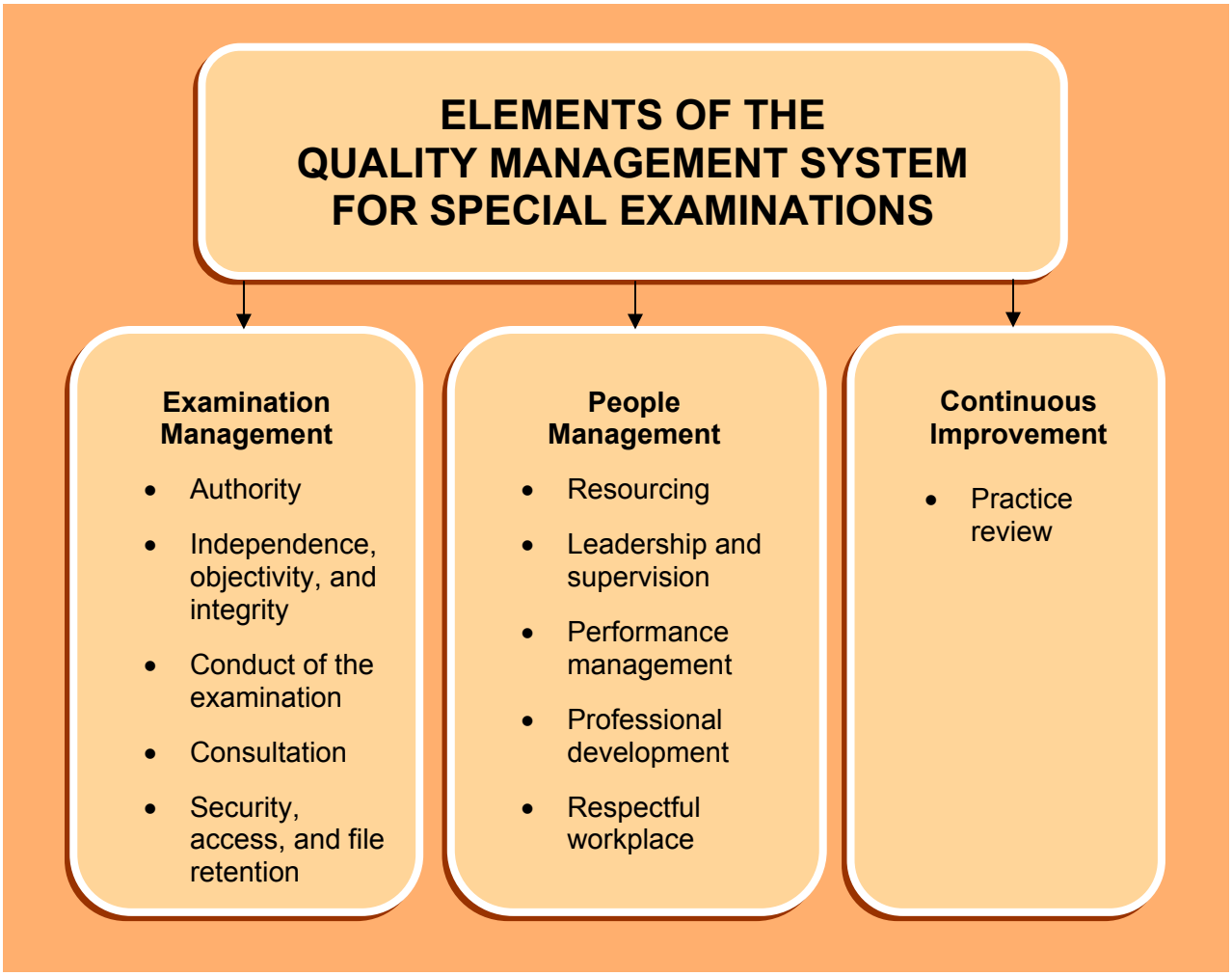
- The Office should prepare an action plan to address the observations raised in the report. It should specifically address the roles and responsibilities of the Product Leader, the Special Examination Practice Team, and the quality reviewers; the work performed in the

annual audit file; and disclosure of the sources of criteria in the special examination report.

- Practitioners should take action to ensure
  - that all individuals involved in the audit assess, document, and address threats to independence at the beginning of every assurance engagement by completing an independence form; and
  - that they better document the use of the work performed in the annual financial audits when applicable.

Management has responded. *Management agrees with the recommendations. Detailed responses and planned actions are included in Appendix C.*

Appendix A—Quality Management System for Special Examinations



Appendix B—Quality Management System Elements and Process Controls Reviewed

Our review covers the following Quality Management System elements.

Conduct of the examination—Planning. We determined whether the work was adequately planned and whether key systems and practices were selected for detailed examination on the basis of risk. We also assessed whether the team provided information in the audit files to support its decision to exclude certain systems and practices from further examination. As well, we determined whether suitable criteria for evaluating the subject matter were identified and developed. Attention was given to whether planned audit work was carried through into examination and reported.

Conduct of the examination—Examination. We looked at the substantiation files and other audit files to determine whether sufficient and appropriate evidence was obtained to provide a reasonable basis to support the conclusion in the report.

Conduct of the examination—Reporting. We reviewed the report to determine whether it addressed all key systems and practices and the associated criteria and whether it was relevant, coherent, clear, and credible. We also determined whether the oversight of the report effectively ensured consistency with the Office's mandate and principles and with past corporate decisions.

Finalization of audit files. We determined if audit files were closed within 45 days of transmittal of the Report to the Board of Directors of the entity, as required by Office policy.

Consultation. We determined whether consultation was sought from authoritative sources and specialists with appropriate competence, judgment, and authority to ensure that due care was taken, in particular when dealing with complex, unusual, or unfamiliar issues. We also determined whether the consultations were adequately documented, and whether the audit team took appropriate and timely action in response to the advice received from the specialists.

Resourcing. Based on interviews with staff and a review of documents, we determined whether audit teams had collective knowledge of the subject matter and the auditing proficiency necessary to fulfill the audit requirements. As well, we determined whether the individuals carrying out the work had adequate technical training and proficiency. We also considered the number of staff and the timing of their availability.

Independence. We determined whether all individuals performing audit work in an assurance engagement, including specialists, were independent in carrying out their responsibilities and in forming their conclusions.

Leadership and supervision. We determined whether individuals working on the audit received an appropriate level of leadership and direction and that

- adequate supervision of all individuals, including specialists, was provided to ensure that audits were properly carried out;
- all team members were encouraged to perform to their potential; and
- all received appropriate recognition.

Security. We determined whether the audit teams followed appropriate procedures to ensure confidentiality and appropriate access to sensitive information. More specifically, we checked whether the audit teams took protective measures in regard to classified information and adequately controlled the external circulation of draft versions of the special examination plan and report.

Our review covers the following key process controls.

Review by the quality reviewer. We determined whether the quality reviewer carried out, in a timely manner, an objective evaluation of the significant judgments made by the team, the conclusions reached in supporting the report, and other significant matters that have come to the attention of the quality reviewer during his or her review.

Documentation. We determined whether the work of the quality reviewer was adequately documented.

Subsequent action. We determined whether the audit team took appropriate and timely action in response to the advice received from the quality reviewer.

Appendix C—Management Response to the 2010 Report on a Review of the Special Examination Practice

Introduction

For the two special examination reports reviewed, and based on cumulative knowledge and the follow-up on management actions taken on recommendations from previous years, Practice Review concluded that for the elements of the Quality Management System (QMS) reviewed, the design is appropriate. However, implementation of the QMS needs improvement. The two special examination reports were supported and appropriate.

This document provides management's response to the practice review recommendations and observations that have been made as well as its associated action plan. The action plan also identifies responsibility for implementing the planned actions and timelines for completion.

The following key overarching elements apply to all parts of our practice review action plan.

1. Renewal of Audit Methodology (RAM) project. This project includes revising and updating our audit methodology. The RAM project also includes revising and updating related audit tools, checklists, and training and developing a change management component to ensure that our methodology is put into practice.

2. Involvement of senior management. It is crucial that senior managers are involved, in a timely and appropriate manner, in all phases of the audit, key judgements, and key conclusions resulting from the audit work.

3. Monitoring of the Action Plan. Individual projects within the action plan are themselves being monitored through existing mechanisms (for example, a steering committee regularly meets to oversee the RAM project). The Office's Executive Committee will also monitor progress and ensure that audit methodology is fully complied with in practice. Success in addressing the issues raised in the report will also be monitored by the ongoing practice review program.

Responses and Action Plan

Practice Review Observations	OAG Response/Planned Actions	Responsibility
Recommendation: The Office should prepare an action plan to address the observations raised in the report and more specifically: • the roles and responsibilities of the Product Leader and the Special Examination Practice Team,	**Agreed.** The definition of the respective roles and responsibilities of the Product Leader[2] and the Special Examination Practice Team has been completed and is found in the *Senior Roles and Responsibilities for Audit Quality* approved 12 November 2009.	Completed.
• the roles and responsibilities of quality reviewers,	The roles and responsibilities of quality reviewers outlined in the *Senior Roles and Responsibilities for Audit Quality* document was approved 12 November 2009 and was the basis for the update of the most recent Special Examination TeamMate Library that was made available for pilot testing in March 2010. However, engagement quality review is one aspect of the overall requirement for an effective office-wide system of quality control. This office-wide system for quality control is being developed and implemented through the Renewal of Audit Methodology (RAM) project. It is management's intention that in the short-term, by the end of December 2010, steps will have been taken to address this office-wide system. As a first step, an office-wide policy on engagement quality control review will be issued followed by an office-wide tool to support the quality review process. Then, the Professional Practices Group will participate in various fora for ongoing communication with practitioners and quality reviewers to deploy this information.	Assistant Auditor General (AAG) Professional Practices Group/Office-Wide Team

[2] The Office has appointed Assistant Auditors General as product leaders for each of its audit practice lines. The primary functions of a Product Leader are to provide leadership for the audit practice line, provide oversight for the audit practice line, and contribute to the quality of individual audits.

Practice Review Observations	OAG Response/Planned Actions	Responsibility
	In the longer term, by June 2011, through the RAM project, guidance and procedures will be developed for office-wide engagement quality control reviews. This will then be followed by more formal training later in 2011. These timelines will be confirmed as the more detailed RAM plan for this work stream is reviewed and approved.	
• the work performed in the annual audit file, and	The Special Examination Practice Team (SEPT) will clarify for practitioners and individual audit teams the importance of having complete examination files that include at least a summary of the work performed in the annual financial audit, the conclusions arrived at, and the amount of assurance derived from this audit work during the team-based training sessions provided by SEPT, prior to the commencement of each special examination.	Special Examination Practice Team
• disclosure of the sources of criteria in the special examination report.	By the end of December 2010, in order to further enhance our special examination (SE) reporting and include the disclosure of the criteria, the SE Report template and other support to SE teams will be provided as follows: • The SE Report template will identify the common criteria used in special examinations and disclose the source of the common criteria. • Where, if warranted, the common criteria have been revised to better suit the specific special examination, SEPT will work with the SE teams to appropriately document the source of the altered criteria in the SE report. • For those criteria that are specific to a Crown corporation, SEPT will work with the SE teams to appropriately document the source of the engagement-specific criteria in the SE report.	Product Leader/AAG Professional Practices Group/Special Examination Practice Team

Practice Review Observations	OAG Response/Planned Actions	Responsibility
Recommendation: Practitioners should take action to ensure that • all individuals involved in the audit assess, document, and address threats to independence at the beginning of every assurance engagement by completing an independence form, and	**Agreed.** In support of practitioners' responsibilities to properly address all matters related to independence, Office methodology was updated in December 2009 and now requires the completion of independence forms as outlined in the practice advisory on Independence.	Audit AAGs/Audit Practitioners
• they better document the use of the work performed in the annual financial audits when applicable.	SEPT will remind audit practitioners of the importance of having complete examination files that include at least a summary of the work performed in the annual financial audit, the conclusions arrived at, and the amount of assurance derived from the audit work during the team-based training sessions provided by SEPT prior to the commencement of each special examination.	Special Examination Practice Team/Audit Practitioners