

Office of the Auditor General of Canada

**Report on a Review of the
Special Examination Practice**

Practice Reviews Conducted in the 2010–11 Fiscal Year

June 2011

Practice Review and Internal Audit

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Introduction

1. The Office of the Auditor General 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, annual 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.
3. The Practice Review and Internal Audit Team conducted practice reviews of two special examinations reported in the 2010–11 fiscal year. This work was done in accordance with the monitoring section of The Canadian Institute of Chartered Accountants (CICA) Handbook—“Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements (CSQC-1).” It was also done in accordance with the Office’s 2010-11 Practice Review and Internal Audit Plan, which was recommended by the Audit Committee and approved by the Auditor General. The plan is based on the systematic monitoring of the work of all audit principals (also referred to as “practitioners” in this report) in the Office on a cyclical basis.
4. To meet the CICA standards, 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 (which ensures that quality is built into the audit 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 examination product line, whose primary function is to provide leadership and oversight for the product line and to contribute to the quality of the individual audits.
5. This report presents the results of the special examinations we reviewed in the 2010–11 fiscal year.

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 FAA in 2009 changed the time period between

examinations from five years to a maximum of ten 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. Five special examinations were finalized in our practice review period (January 2010 to March 2011).

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) is effectively implemented, and
- the issued audit reports are supported and appropriate.

Scope and methodology

10. We conducted practice reviews of two special examinations out of the five reported during the practice review period (January 2010 to March 2011).

11. Our reviews included an examination of electronic (TeamMate) and paper audit files. We examined audit files related to the planning, examination, and reporting of the audits. We also interviewed audit team members, quality reviewers, and other internal specialists, as appropriate.

Quality management system elements and process controls reviewed

12. The Quality Management System (QMS) for Special Examinations is summarized in Appendix A. We focused our work on selected elements and process controls that we considered key or high risk (Appendix B).

Rating system

13. We applied one of the following ratings to each selected QMS element of the individual special examinations under review:

- **Compliance.** Office policy requirements and applicable auditing standards were met; minor improvements might be possible.
- **Compliance but needs improvement.** Improvements are necessary in some area(s) to fully comply with Office policies and/or auditing professional standards.
- **Non-compliance.** Major deficiencies exist; there is non-compliance with Office policies and/or auditing professional standards.

14. After completing the practice review, we concluded on whether the audit opinion was supported and appropriate.

15. This report highlights the procedures performed, the conclusions drawn, the deficiencies found, and the actions taken to resolve these deficiencies.

Results of the Reviews

Compliance with the quality management system and process controls

16. We found that the two reports we reviewed were appropriate and supported. One file complied with all but one element of the quality management system (QMS). The other needed improvements in five of the seven areas that we examined. Overall, in these two reviews, the results highlighted inadequate planning and a lack of timely senior management involvement and consultation. In some cases, too much work was carried out.

Opportunities for improvement

17. The observations and the recommendations from the two reviewed audits represent lessons learned and opportunities for the special examination practice.

Prioritizing special examination work

18. Time taken to complete the special examinations. Both of the special examinations that we reviewed in the 2010–11 fiscal year took more than 23 months from the start of the planning phase to the transmittal date of the report to the board of directors; usually, special examinations take an average of 12 to 18 months to complete.

19. In both of the files that we reviewed, the examination was interrupted to allow for the completion of other deliverables. As a result, the period under examination was extended—one by more than 14 months—and additional work had to be performed by audit teams.

20. In addition, we observed that, for both reports, more than six months passed between the date the report was completed and the date the report was issued. When a report is issued many months after the work has been completed, numerous changes may occur within the entity, which could have an impact on the observations noted in the report. We found that there was limited evidence supporting the nature and extent of the work carried out to the end of the examination period to confirm that the conclusions reached by the audit teams were still valid and that no subsequent events occurred since the date of the report.

21. Accountability. Responsibility for individual special examination audit quality rests with the responsible assistant auditor general. Nevertheless, as part of monitoring audit products and resources, the Executive Committee is informed of key indicators relating to audit products.

22. We noted that the Office's "on-time" performance indicator for special examinations reports on its ability to meet the statutory deadline. Since statutory deadlines were extended (as a result of the 2009 amendments to the *Financial Administration Act*), the special examinations we looked at were not reported as being late in the Office's internal reports. We would have expected that tracking of completion according to planned deadlines would have also been done. Hence, the information provided to the Executive Committee did not highlight that the special examinations were delayed.

Planning work

23. Risk-based planning. When selecting systems and practices for examination, practitioners are expected to take a risk-based approach. Critical systems and practices that the entity needs to meet its objectives should be selected for review and measured against suitable criteria. Selecting these systems and practices requires assessing the significance of possible events and how likely the risk of those events occurring can be controlled. The significance and consequences of events need to be considered when we select the systems

and practices that require detailed examination and, subsequently, when we determine how much audit work is required.

24. In both of the files that we reviewed, we noted that the audit teams used the standard criteria suggested by the Office for special examinations. However, we found that the level of work performed was not always in line with the risks associated with the systems and practices selected for review. Ultimately, both audit teams experienced challenges in adjusting the level of work, needed to obtain enough audit evidence to conclude on the audit criteria, with the associated audit risks, size, and complexity.

25. When planning special examinations and determining which systems to select for detailed review, audit teams are expected to build on their knowledge of business and on the work that was carried out in the previous special examination. The work performed in the planning phase of the special examination and during the previous annual audit should also be considered and documented.

26. These considerations can limit the additional detailed work to be performed as part of the special examination and provide for an efficient audit approach. During our reviews, we noted that both audit teams did not always consider the work performed in the planning phase or the work performed during the related financial audit (along with the related evidence), when they determined how much work would be performed during the special examination.

27. Resourcing. Adequate planning means ensuring that appropriate resources are assigned and available to carry out the audit work. While both audit teams had documented the resources available to perform the examination work, we could not find evidence of the practitioners assessing the adequacy of those resources (that is, determining whether they were at the necessary level and whether they had time to conduct the work).

28. We expected practitioners to document how they mitigated the risks associated with inexperienced auditors who were not familiar with the methodology or the practice of special examination. In one file, the auditors were relatively inexperienced, and we expected the practitioner to be more involved in the special examination.

Senior management involvement

29. It is important that senior management be involved in key steps of the audit, to provide direction to the audit team and to guide them in all phases of the audit. We noted that senior managers were involved in discussing the risk areas and attending some key meetings with the entity. However, in one of the two files we looked at, the practitioner got involved too late in the review process, and minimal time was spent on review and supervision.

30. Extent of review. Overall, the two files that we reviewed lacked timely senior management involvement. In one of the two, we also found little evidence that the practitioner performed a timely and sufficient review of key working papers and decisions, to ensure quality of the review. This, combined with the other issues that we observed—such as work programs being too large for the size and complexity of the audit, unnecessary audit work being carried out, and audit messages being redrafted—might have led to audit inefficiencies.

Consultations

31. Consultations for the Office's special examinations include those with internal specialists—such as the Special Examination Product Leader, the Special Examination Practice Team¹ (SEPT), and the quality reviewer—and external specialists.

32. For both files, teams consulted with the SEPT and the Product Leader. Generally, the SEPT reviewed examination plans and reports on a timely basis, whereas the Product Leader was involved late in the reporting phase. In both files, the comments provided were of such importance that the audit teams had to delay their planned reporting date, conduct additional audit work and redraft their reports. In our view, the audit teams need early feedback, from the practice and product leaders so they can make timely adjustments to their audit reports.

33. The necessity of clarifying the roles and responsibilities of the SEPT and product leader was noted in our previous reports. Again this year, the timing and nature of consultation with SEPT and the Product Leader was not always clear to audit teams.

34. In our view, the review of draft reports should be performed earlier. Moreover, the Product Leader and SEPT's roles and expectations should be further clarified and communicated. This includes their role in the

- special examination planning, including their role in challenging the systems and practices selected for examination and the extent of the work to be carried out; and
- reporting phase, including the timing and nature of their expected involvement.

35. Recommendations

- The Office should review its internal performance indicators for timeliness, to monitor progress against planned deadlines as well as statutory deadlines.

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.

- The Office should clarify the roles and responsibilities of the Special Examination Practice Team and Special Examination Product Leader in both the planning and reporting phases.

Management has responded. *Management accepts the recommendations and will undertake the following actions:*

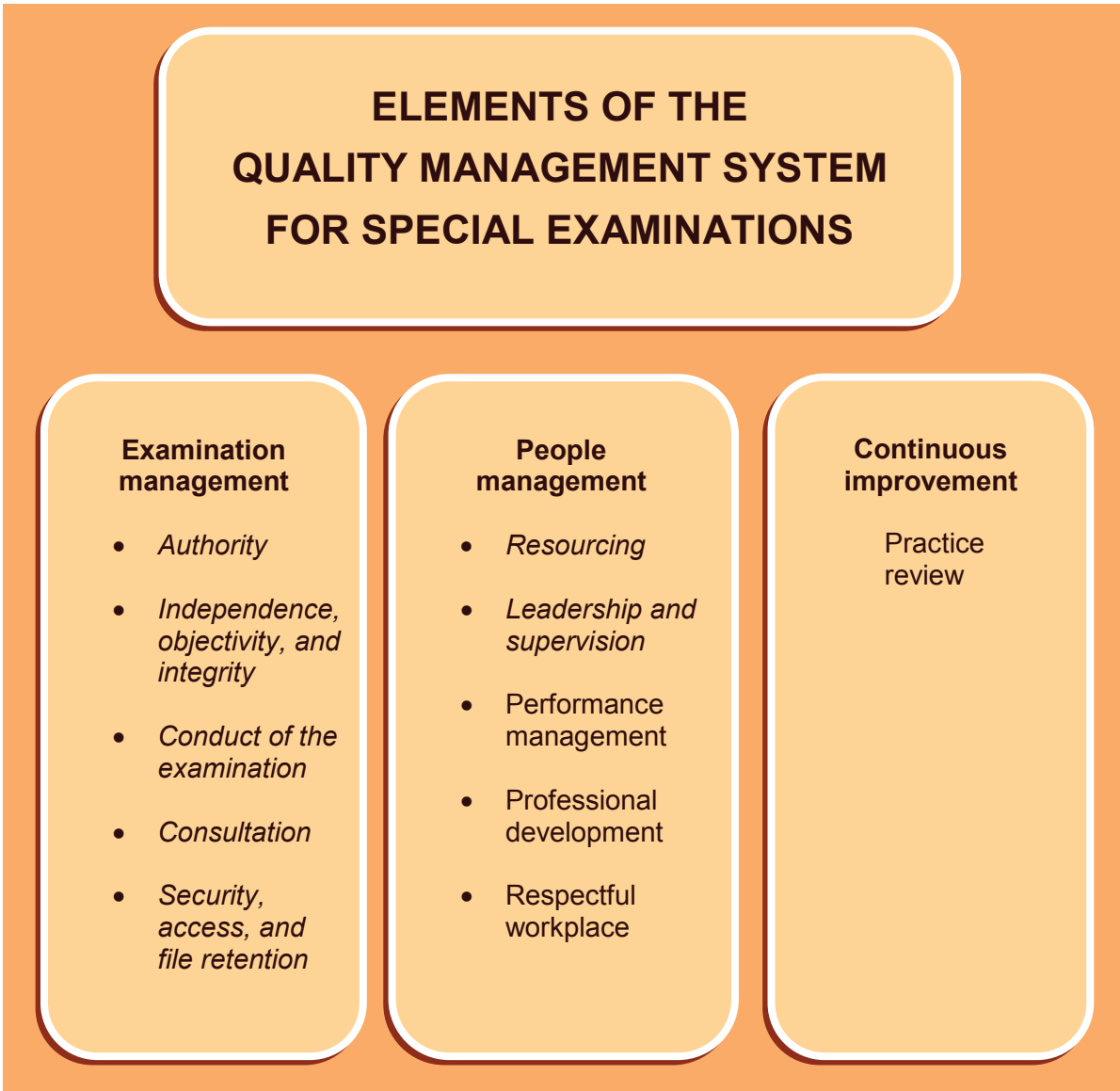
- *The Product Leader will provide additional options with respect to the progress of Special Examination reports to the Executive Committee by 31 December 2011 for its consideration and approval.*
- *The clarification of the roles and responsibilities of the Product Leader and the Special Examination Practice Team has been completed and they are included in the procedures for planning and reporting in the current Special Examination TeamMate library being rolled out in November 2011.*

Conclusion

36. For the special examinations that we reviewed, we conclude the auditor's reports were supported and appropriate. However, we also conclude that there are opportunities for improvement in the implementation of certain elements of the quality management system.

Appendix A—Quality Management System for Special Examinations

The elements italicized in the table are included in one or many of the Quality Management System elements or process controls described in Appendix B.



Appendix B—Quality Management System Elements and Process Controls Reviewed

Our review covers the following Quality Management System elements and key process controls:

Conduct of the examination

As part of conduct of the audit, we reviewed the following process controls:

- **Planning.** We determined whether the work was adequately planned and whether issues were selected on the basis of risk, their significance and auditability, and their relevance to the Office's mandate. As well, we determined whether suitable criteria for evaluating the subject matter were identified and developed. Attention was given to the development and application of audit logic matrices and whether planned audit work was carried through into examination and reported.
- **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. We reviewed the report for secondary evidence and reached a conclusion on the adequacy of the team's rationale for including such information.
- **Reporting.** We reviewed the report to determine whether it addressed high-risk areas, and the audit criteria, and whether it was relevant, coherent, clear, and credible. We also determined whether 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 final approval of the audit report, as required by CICA assurance standards and Office practice requirements.

Consultation

We determined whether consultation was sought from authoritative sources and from specialists who had the appropriate competence, judgment, and authority to ensure that due care was taken, particularly when they were 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 and other parties consulted, including the quality reviewer.

Resourcing

Based on interviews with staff and on 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 audit 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, including specialists, had been independent in carrying out their responsibilities and in forming their conclusions.

Leadership and supervision

We determined whether the individuals who worked on the audit received an appropriate level of leadership and direction and whether

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