

Office of the Auditor General of Canada

**Report on a Review of the
Annual Audit Practice**

Practice Reviews Conducted in 2008–09

May 2009

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, annual audits, and special examinations.
2. Annual audits include audits of the summary financial statements of the Government of Canada, the territories, Crown corporations, and other entities. They are performed in accordance with Canadian generally accepted auditing standards. They provide an opinion on whether financial statements are presented fairly in accordance with Canadian generally accepted accounting principles. In certain cases, they also provide an opinion on whether transactions examined conform to the legislative authorities that govern the activities of the entity concerned.
3. The Practice Review and Internal Audit team (PR&IA) conducted practice reviews of selected annual audits reported in 2006, 2007, and 2008. 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). It was also done in accordance with the 2008–09 Internal Audit and Practice Review Plan, 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 include an audit manual and a quality management framework for each product line. The Quality Management Framework and supporting audit methodology ensure that quality is built into the examination process. They guide auditors through a set of required steps to follow during annual audits, to ensure that the audits are conducted according to professional standards and Office policies. There is one product leader at the assistant auditor general level for the annual audit product line.
5. This report provides a summary of the observations related to the practice reviews of the selected annual audits and consolidates the results of these reviews.

Overview

Objective

6. The objective of a practice review is to provide the Auditor General with assurance that the Office's Quality Management System (QMS) for annual audit is appropriately designed and effectively implemented, and meets legislative requirements, professional standards, and the Office's policies and procedures for annual audits.

Scope and methodology

7. We conducted practice reviews of 11 annual audits with year-ends between December 2006 and March 2008, and we reviewed one special report on certain controls of a government entity. Of the annual audits, eight were audits of Crown corporations or departmental corporations, two were audits of a department in the context of the public accounts of Canada (defined as a large entity in the context of the audit of the summary financial statements of the Government of Canada), and one was an audit of a territorial government. As a result of prior-year delays in conducting practice reviews, we conducted more reviews this year than we normally would in order to meet the requirement to review each practitioner at least once every four years.

8. We stayed abreast of the annual audit practice by broadly reviewing the Annual Audit Manual, the Quality Management System, practice advisories, Office policies, CICA standards, and other documentation relevant to annual audits.

9. Our reviews included an examination of documentation and a review of electronic (TeamMate) and paper audit files. We examined annual 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 key process controls reviewed

10. We focused on selected elements of the Annual Audit Quality Management System (see Appendix A). Our practice review considered the

design of the Quality Management System and the following elements that we considered to be of higher risk:

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

11. We also looked at how the quality reviewers carried out their responsibilities for quality assurance. Quality reviewers are selected from management-level employees within the Office and 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 review is an important element of the Office's quality control system. The quality reviewer is involved with the individual audits from the initial planning decisions to the closing of the audit file.

Rating system

12. We applied one of the following ratings to each of the Quality Management System elements of the individual annual audits under review:

- **Compliance.** The expectation for the Quality Management System element or the key process control, generally accepted auditing standards (GAAS) or generally accepted accounting principles (GAAP) were met; minor improvements might be possible.
- **Needs improvement.** Improvements are necessary in some area(s) in order to fully comply with Office policies or professional standards (GAAS or GAAP).
- **Non-compliance.** Major deficiencies exist; there is non-compliance with professional standards (GAAS or GAAP) or Office policies.

13. After completion of the practice reviews, we also provided an overall opinion on whether the audit opinion was appropriate in the circumstances.

Should multiple elements of the Quality Management System be non-compliant, the audit opinion of the audit reported is at risk.

14. See Appendix B for more detail on the key process controls of the Quality Management System.

Reporting standards

15. This report follows Office policies and the monitoring section of the CICA's Handbook—General Standards of Quality Control for Firms Performing Assurance Engagements. The standards require that information on monitoring procedures performed, conclusions drawn from the monitoring procedures, description of deficiencies, and actions taken to resolve these deficiencies be communicated.

Results of the Reviews

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

16. Overall, we found that for the 12 audits reviewed, the reports were appropriate in those circumstances. We noted that 4 of the 12 audits complied with the Quality Management System and with CICA standards. The remaining 8 files needed improvements.

17. While good-quality audit work was evident throughout our reviews, we noted that all the audits required improvement in some of the elements reviewed in order to fully comply with Office policies and generally accepted auditing standards. Areas requiring the most improvement are use of a control-reliant approach, application of the methodology for testing controls, changes to the planned audit approach and use of the Summary of Audit Comfort, extent of review and involvement of management in the audit file, sampling methodology for substantive testing, substantive analytical review, file documentation, confirmation of accounts receivable cycle, file finalization, quality review, independence, and audits contracted out.

18. There were three areas of strengths and good practice. Specific opportunities for practice-wide improvements are also reported under "Opportunities for Improvement."

Overall management response. *The Practice Report identifies a number of important areas where the practice needs to improve in order to ensure compliance with the Office's Quality Management System (which includes professional assurance standards).*

All members of the Executive Committee are fully committed to implementing the management responses included in this report.

The Assistant Auditor General (AAG) Professional Practices Group (PPG) and the Product Leader are committing to take action in order to assist the practice in a full and successful response to the recommendations included in the report. These actions include such things as additional research, discussions with practitioners (including the Principal's Forum), improving communication efforts, making changes to TeamMate, further explaining and discussing the practice review findings at the Accounting and Auditing Update course, clarifying guidance, adjusting our methodology, and modifying our training courses where appropriate.

Further, in response to training issues identified in this report and the two other summary practice review reports, the AAG PPG will present an overall plan for necessary technical training to the Strategic Planning Committee in autumn 2009 for its approval.

In our view, the improvements that need to be made cannot be completely addressed by the actions we have committed to alone. In many cases our methodology is sound, but the execution has fallen short of what was envisioned and expected.

A full and successful Office response requires a commitment throughout the organization to learn and improve based on the findings of these reports. This commitment needs to begin with audit teams reviewing these findings together, and discussing what actions they will take individually and collectively to ensure that their audit work is in full compliance with our Quality Management System. We will use the Performance Audit Symposium and the Accounting and Auditing Update as a forum to inform and discuss with all staff the key findings in these reports, explain the quality control objectives, and outline who is accountable for ensuring that audits comply with these key quality control steps. It is also important that the AAGs continue these discussions with their staff at their regular group meetings, participate actively in PX forums, and discuss with the product leaders how their staff's actions can resolve the observations made in the reports. AAGs and PXs will need to lead these discussions and take responsibility for seeing that the required actions are taken.

Strengths and good practices

19. We noted the following three areas of strengths and good practices:

- **Consultation with other teams and experts.** One audit team clearly documented the consultation with other teams and experts. Furthermore, the consultations were appropriately considered. This audit team also prepared a thorough step-by-step analysis to determine which entities

should be consolidated into the reporting entity. The analysis was easy to follow and provided well-thought-out arguments in support of the audit team's position.

- **Reliance on other auditors.** Another audit team developed a template based on CICA assurance standards for reliance on another auditor to assess its ability to rely on the work of secondary auditors.
- **Audit efficiency.** One audit team was able to achieve audit efficiencies to strengthen internal controls by working with a client over time. In addition to achieving efficiencies, the client benefited from stronger controls. Another audit team made good use of the risk analysis developed in the one pass planning process to identify key risks and related controls that have an impact on the annual audit.

Opportunities for improvement

20. Each audit team reviewed received a summary of findings that included specific recommendations. The following observations and recommendations represent common opportunities for improvement across the annual audit practice based on the most common findings identified in the results of the individual practice reviews.

Conduct of the audit

21. Use of a control-reliant approach. Ten years ago, the Office emphasized the importance of adopting a control-reliant approach when conducting annual audits. In 6 of the 11 annual audit files we reviewed, we noted that the audit teams concluded that they were either unable to, or decided not to, rely on controls. The rationale supporting their decision and approval for adoption of such practices was often insufficiently documented or absent. In these cases, the audit teams adopted a substantive audit approach.

22. We expected that for audit entities that have complex information technology (IT) systems, the audit teams would have tested the general computer controls. At a minimum, walkthroughs, or/and key process controls, should have been identified and documented. We found that audit teams need to improve the documentation of key processes and general computer controls.

23. For the six files where the control-reliant approach was not adopted, we found the following weaknesses:

- In one case, the audit team did not involve the IT team early enough in the audit process for the IT team to conduct testing.

- In three more cases, the IT team and the audit team concluded that they could not rely on the general computer controls, but did not document the weaknesses or what the client needed to do so that in future the audit team could rely on the controls.
- Another audit file was contracted out and the contractors chose a substantive audit approach without documenting the reasons for doing so.
- In one other case, the audit team adopted a substantive audit approach and could have improved the rationale for not relying on the general computer controls.

24. Our opinion is that the IT team should be involved early in the planning process to assess general computer controls and computerized application controls in order to assist the audit teams. If the IT team determines that there are weaknesses in the general computer controls, and therefore cannot be relied on, the audit team needs to better document the rationale for not relying on the controls and report this to the entity for corrective action. Alternatively, when determining the audit approach, reliance on manual controls should be considered. We found that audit teams would benefit from better documenting their decision.

25. Some audit team members stated that they preferred to use a substantive audit approach rather than relying on controls, given the pressures of meeting the audit budget. We realize that moving to a control-reliant approach requires an investment in time but, in our opinion, audited entities will benefit from stronger financial management controls and the Office should achieve audit efficiencies over time. Further, in three of the six files where the control-reliant approach was not used, our reviews revealed that the principal and the assistant auditor general's involvement came late in the audit and their role in setting the preliminary audit approach was limited.

26. Recommendation. The Office should take the following steps:

- Require that the involvement of the IT team for testing of general computer controls be made mandatory when complex information systems are used by an entity. This involvement should be early in the planning process, with results documented and communicated to audit teams on a timely basis.

If general computer controls can be relied on, the IT team should identify and test key application controls in collaboration with the audit team.

- Report to audited entities any weaknesses identified in the general computer controls environment. Follow-up should be done with the audit

entity on a periodic basis. If the audit team is unable to rely on general computer controls due to weaknesses in the environment, this should also be reported to the signatory of the auditor's report in the report clearance memorandum. Weaknesses should also be included in the Report to the Audit Committee.

- Require all audit teams to develop a multi-year plan, in order to move to a control-reliant approach, and have it approved by the responsible assistant auditor general and reported to the Product Leader for monitoring. Where audit teams believe a substantive audit approach is more efficient, this decision should be clearly documented in the file.

Management's response

- *We agree that involvement by the IT team is mandatory when general computer controls (GCCs) are to be tested. Since the audit of GCCs is generally a prerequisite for a control-reliant audit approach, it should be done early in the audit.*

We believe that our existing methodology and training makes this point clear, but will undertake to have practitioners reminded of this requirement, as recommended.

We agree that, in most cases, a collaborative approach between the audit team and IT specialists should be used to identify and test key application controls. In some cases, the audit team may have suitably qualified members to undertake the testing of application controls without the direct involvement of IT specialists, although we recognize that this situation is likely to be less common than the former.

- *We agree with the general point being made. Teams have a professional responsibility to bring to the attention of management and those charged with governance any significant weaknesses identified in internal control. This would include significant weaknesses identified in GCCs. We agree that there should be follow-up of significant control weaknesses reported to management and those charged with governance.*

There may be other, less significant weaknesses that the team has identified. These should also be brought to the attention of management, either orally or in written format. However, the audit team should not be compelled to follow up on these matters because they are not, by definition, significant weaknesses.

- *We agree that every audit in the Office's portfolio should be considered for a control-reliant audit approach for major transactional streams. We would expect that this is the case in most of the larger and more sophisticated*

entities we audit. However, the Practice Review findings indicate that this may not be the case.

Before mandating the Office-wide development of a multi-year plan to adopt and/or enhance our existing approaches, we would like to “take stock” of where we are as a practice, and then develop an appropriate strategy for moving forward. We may also need to assess our capacity to provide sufficient IT Specialist assistance to support this direction, depending on how far we need to move.

Accordingly, the Product Leader will survey practitioners during the year to ascertain the balance between predominantly substantive approaches and predominantly control-reliant approaches, discuss the situation with the Professional Practices Group, and report back to the Executive with a proposed strategy by December 2009.

27. Application of the methodology for testing controls. We noted that of the five audit teams that adopted a control-reliant approach for certain audit cycles, four audit teams had difficulty applying the guidance on controls as intended. Although guidance on control testing was issued in January 2006, our observations are that the methodology is not well understood and applied.

28. More specifically, we observed that four out of five audit teams would have benefited from clarifying the links between the control tested and the transaction process, the expected results of each control tested, and the results obtained, as required by professional standards. A reviewer having no previous connection with the audit engagement would find it difficult to understand the procedures performed, the results obtained, and the significant findings determined. Moreover, in the three cases where activities were carried out in more than one location and controls were tested over a cyclical period, we found that the rationale for testing controls and segregating the audit population could have been better documented.

29. Four out of five audit teams did not adequately document the nature, extent, or significance of deviations found. Audit teams did not consider the impact of the deviations on the control being tested. An assessment of whether additional samples should be tested or a decision to rely on other compensatory controls should have been documented. In two cases, the deviations resulted from using an inappropriate sample population, which the audit teams did not either recognize or address.

30. Moreover, we noted that two out of five audit teams selected a sample size that did not match the level of assurance planned. As a result, the audit teams did not test enough items to be able to conclude on the effectiveness of the control, as required by control testing methodology. However, the audit teams had performed sufficient additional substantive audit procedures.

31. Finally, we noted that two audit teams made an effort to use the “year of no change” approach to testing controls. In one case, the audit team should not have used this approach as control testing methodology does not allow for year of no change when reliance on computer controls is not adopted. In the other case, we found that the audit team needed to better document the rationale for the conclusion regarding the assessment of changes in key controls and the adequacy of relying on prior year’s evidence.

32. As a result of our review, we found that audit teams are either doing too much audit work or not enough. In four of the five files where a control-reliant approach was adopted, neither the audit practitioners nor the quality reviewers identified the deficiencies. In our opinion, this suggests inadequate supervision, review, or understanding of control testing methodology.

33. Recommendation. The Office should incorporate the following:

- Develop or acquire a refresher course on control testing for the audit community and, more specifically, management-level employees.
- Review planning parameters and key controls tested thoroughly and early in the process by the audit team’s management level personnel. Results from testing the key controls should be appropriately reviewed and documented. Moreover, corrective actions to the audit approach should be taken, if applicable.

Management’s response

- *We agree that this would be a useful idea to address a number of the recommendations made in this report.*

It will be considered as part of the evaluation of the “gap analysis” of our existing technical training program carried out by PricewaterhouseCoopers as part of the Strategic Alliance project. That analysis will be used to develop the future technical training curriculum for the Office. The evaluation of the technical training “gap analysis” will be completed by the Annual Audit Practice Team and presented to the IFRS Steering Committee by December 2009.

- *We agree. These expectations will be reinforced through various forums for discussion with staff.*

34. Changes to planned audit approach and use of summary of audit comfort. We noted that, in at least 3 of the 11 annual audit files we reviewed, the audit teams did not complete their strategic audit approach and related planning documents on a timely basis. In all cases, documents were reviewed and approved close to or after the finalization of the audit work, or well into the

examination phase. Moreover, in 5 of the 11 files we reviewed, the audit strategy was not carried out as planned and key changes to it were made during the audit. In addition, we saw no evidence that management and the quality reviewer were aware of or had approved the key changes.

35. We further noted that for at least 4 of the 11 files, the Summary of Audit Comfort—a tool used to assess the level of assurance obtained from each audit procedure and to ensure that sufficient work was performed for each significant financial statement assertion—was not always completed or, when completed, contained errors. The assessment did not include all audit procedures, nor did the summary of comfort always document the levels of assurance obtained. These deficiencies were not identified by either the audit supervisor or the quality reviewers.

36. Recommendation. The Office should ensure the following:

- All significant changes to the audit strategy should be approved by the audit principal or the assistant auditor general, be brought to the attention of the quality reviewer in a timely manner, and be documented in the report clearance memorandum.
- The quality reviewer's checklist should be adjusted to include confirmation of the review of documentation and discussion of any significant changes to the audit approach.
- The audit principal should certify that the audit work has been carried out in accordance with the audit plan and that significant changes have been reflected in the overall audit plan.

Management's response

- *We agree. These expectations will be reinforced through various forums for discussion with staff.*
- *We agree. The Professional Practices Group is currently revising annual audit quality reviewer checklists to provide improved guidance to quality reviewers. These checklists will be finalized and in place by December 2009.*
- *We agree. This will be reflected in the TeamMate annual audit sign-off checklist as well as in TeamMate by October 2009.*

37. Extent of review and involvement of management in the audit file. In 3 of the 12 audit files we reviewed, we saw little evidence of senior management's involvement, given the complexity of those audit engagements. Through our discussions with the audit teams, it was clear that the audit principal and

responsible assistant auditor general had been involved in the audit, but it was difficult to determine the extent and timeliness of their involvement. In some cases, audit teams mentioned that although management had been involved, the time spent had not been charged to the audit. In our view, this practice is inappropriate.

38. In 8 of the 12 files we reviewed, and as highlighted throughout this report, we found that improvements were needed in the documentation of the level of involvement and timeliness of review of key information by the audit principal and the assistant auditor general.

39. Recommendation. Practitioners¹ should be reminded that they need to document the nature and extent of their review to demonstrate their level of involvement in the audit files, as required by the assurance standards.

Management's response. *We agree. This recommendation is already reflected in Office methodology and will be reinforced as the Office manuals are updated in 2010 and through forums for discussion with staff.*

40. Sampling methodology for substantive testing. Our review of the six files that used a substantive sampling approach, such as dollar unit sampling, indicates that audit teams need to improve their understanding of how to apply the Office methodology. When using representative or statistical sampling, audit teams need to define the objective of the test, the population from which the sample is selected, the definition of an error, and the confidence level for the test. In all six files, we noted that one or more of these elements was missing.

41. In two of the six files, we found that improvement was needed in defining errors and determining whether additional testing was required. Furthermore, in at least four files, had the audit teams clearly documented the test objective, audit efficiencies could have been achieved, as other procedures had already provided audit assurance.

42. The results of our review pointed to the need to offer further training. Two of the audit teams chose an extensive level of testing when a moderate level would have been sufficient, as audit assurance was also gained from other procedures, such as analytical reviews or testing of selected high-value items. Choosing an extensive level of testing can result in too much audit work being performed. Another audit team arbitrarily opted to test a number of items without justifying its decision. In our view, these tests did not provide sufficient audit evidence to support the audit team's conclusion. The audit team was required to further document and explain its rationale.

¹ In the context of this report, the term "practitioner" is intended to mean all individuals who conduct audit work.

43. In our view, substantive testing requires additional training. We further noted that the Office's current training curriculum does not include training for substantive testing.

44. Recommendation. The Office should consider the following:

- Remind audit teams to clearly document in the audit file the objective of the test, the definition of an error, and the confidence level desired.
- Remind management to review key sampling parameters before audit work is conducted. Exceptions noted should be assessed and documented to determine their impact on the overall population and audit work conducted.
- Offer training for substantive testing as part of the curriculum for the annual audit methodology. We understand that the Office is currently reviewing its training curriculum for annual audits. We encourage it to consider the current recommendation in its decision-making process.

Management's response

- *We agree. The objective of the test, the definition of an error, the confidence level desired, and the key sampling parameters will be reinforced through various forums for discussion with staff.*
- *We agree. The expectation will be reinforced through various forums for discussion with staff.*
- *We agree. Training for substantive testing will be considered as part of the evaluation of "gap analysis" of technical training carried out by PricewaterhouseCoopers as part of the Strategic Alliance project. That analysis will be used to develop the future technical training curriculum for the Office. The evaluation of the training gap analysis will be completed by the Annual Audit Practice Team and presented to the IFRS Steering Committee by December 2009.*

45. Substantive analytical review. Analytical review is an important tool for obtaining audit evidence, and rigorous procedures must be performed. Audit teams generally completed the five-step process as required by Office methodology. However, we noted in at least 5 of the 11 annual audit files, the analytical reviews were superficial, with little work done on the underlying data, the assumptions used, or the explanation of variances. For example, in one audit file, the underlying data was not substantiated further than through enquiry. In another audit file, the audit team set an expectation but did not document a rationale for using the benchmark. In a third file, the audit team did not include an

explanation for a significant variance. This observation was not noted by the reviewers of the audit engagements or the quality reviewer.

46. Recommendation. The Annual Audit Manual provides guidance and details the approach to analytical review. Audit practitioners should be reminded how to substantiate an analytical review and that an appropriate level of review of the file must be conducted. The practice review findings should be considered for inclusion in training for analytical review.

Management's response. *We agree. These expectations will be reinforced through various forums for discussion with staff, including existing training programs.*

47. Confirmations as part of the accounts receivable cycle. Using confirmations as a procedure for significant accounts receivable is a generally accepted auditing standard requirement. In three files, we noted that the audit teams did not send confirmations for significant accounts nor did they document the rationale for not doing so.

48. Recommendation. Audit practitioners should be reminded that audit decisions for the confirmation of accounts process should be clearly documented, as required by Office policy. The practice review findings should be considered for inclusion in training.

Management's response. *We agree. These expectations will be reinforced through various forums for discussion with staff, including existing training programs.*

File documentation

49. With the strengthening of CICA auditing standards and the creation of the Canadian Public Accountability Board, expectations for file documentation are higher than ever before. Audit files need to show the procedures performed, the evidence obtained, and the conclusions reached with respect to relevant financial statement assertions. Audit documentation should clearly demonstrate the work performed.

50. In all of the 11 annual audit files and the special report on certain controls of a government entity, we found that the quality of the working paper files could be improved. Some working papers were incomplete and gave the impression of poor supervision and review. Although we were able to accept the files in their totality, the quality of the working paper files needed improvement to meet the requirements of the standards. The audit teams often had to provide further evidence to support their audit reports. This audit evidence was stored outside

the audit files in emails or in other paper or electronic files or folders not included in the audit files.

51. Among the issues identified for all 12 files, we noted the need to improve the following:

- adequate documentation of the scope, the nature, and conclusions reached from consultations, when they occurred, and the agreement of parties consulted (4 out of 12);
- audit evidence for using the work of entities' internal auditors (1 out of 12);
- the documentation of discussion at meetings with audit committees. We noted that working papers documented the information presented to the audit committees but fell short of documenting the questions that were asked or answered or the particulars of any other audit-related discussion that took place (8 out of 12); and
- the timeliness and consistency of file review and involvement in the file (8 out of 12).

52. Recommendation. Audit practitioners should be reminded of the documentation and review requirements of the CICA standards. More specifically, they should be reminded of the need to document the nature and extent of consultations, the need to document discussions with audit committees, as well as the timeliness of their signoff to denote responsibility for work they have done. The practice review findings should be considered for inclusion in training.

Management's response. *We agree. Documentation policies for all product lines are clearly laid out in a February 2007 Practice Advisory and will be incorporated into audit manuals as they are updated. These requirements will be reinforced through forums for discussion with staff, including existing training programs.*

File finalization

53. The Office's policy on finalizing audit files requires that annual audit files be completed 45 days after the date the report is released. This is defined as the date when the Board of Directors approves the financial statements. Files may be kept open longer, if warranted, with the approval from the assistant auditor general.

54. We observed that 4 out of the 12 audit files we reviewed were not finalized within the requirements set out in the Office policy. For all four of these files,

changes were made to the files after the 45-day limit, but the audit teams did not document the nature and extent of these changes or obtain the assistant auditor general's approval as required by Office policy. For one of these audit files, the electronic files were not finalized until seven months after the audit report was released. We noted that for one audit file, the electronic file was finalized within the 45-day limit, but we could not determine whether the paper files were filed at the same time because the regional offices do not have a process for archiving paper files within the 45-day limit.

55. Recommendation. The Office should

- reinforce the 45-day limit for completion of annual audit files, as required by Office policy;
- consider the feasibility and practicality of introducing automatic closure of the audit files, which would require written justification and approvals for extension of delays; and
- review, in all regions, current records management practice for archiving paper files to ensure that procedures clearly show compliance with Office policy on finalization of audit files.

Management's response

- *We agree. Documentation policies for all product lines are clearly laid out in a February 2007 Practice Advisory and will be incorporated into audit manuals as they are updated. These requirements will be reinforced through forums for discussion with staff.*
- *We agree. The Professional Practices Group and the product leaders will work with the IT Group (Corporate Services) to investigate and conclude on the appropriateness of automatic closure of audit files, including timelines for changes if required, by the end of November 2009.*
- *We agree. This observation will be discussed by the Product Leader with the AAGs and the responsible principals in the regional offices. A common protocol will be developed and implemented in the regional offices by December 2009.*

Quality review

56. For certain higher-risk audit engagements, the Office appoints quality reviewers to provide an enhanced level of quality assurance. The Annual Audit Practice Team provides guidance and has developed quality review checklists for annual audits. Eight of the twelve audit files we reviewed were assigned a quality reviewer. Quality review checklists were used in six of the eight files.

57. Our review of the audit files revealed that further improvements are needed to the nature, extent, and timing of quality reviews conducted. In five cases, we noted that the quality review performed did not fully meet Office policy and the requirements of the standards. Through discussion with quality reviewers and audit team members, we noted that the quality reviewer's role is not well understood by either the quality reviewers or the audit teams. In our opinion, additional training and guidance on quality review is needed.

58. In one audit file, we saw little evidence that the audit team had consulted the quality reviewer. The audit team stated that they either had verbal consultations with the quality reviewer or that they did not deem it necessary to advise the quality reviewer of progress throughout the audit. These decisions and consultations were not documented, and the quality reviewer did not complete the checklist required. For the same file, we considered that the time recorded by the quality reviewer was insufficient to have carried out an adequate review.

59. For a second audit file, after discussion with the audit team and after additional information was provided, it was clear to us that the quality reviewer was consulted on significant matters. However, we could not find evidence that the quality reviewer had completed his review prior to the release of the audit report. In another file, information was sent to the quality reviewer very late in the process, and it was not clear from the documentation on file that the quality review was completed before the release of the Auditor's Report to the Audit Committee.

60. Our identification of observations in the audit files that were not noted by quality reviewers shows that there is still a need for improvement in this area.

61. Recommendation. The Office should

- reassess current guidance on quality review and clarify expectations on the role of quality reviewers; and
- offer training to first-time quality reviewers and to audit practitioners on their roles and responsibilities related to quality reviews of annual audits.

Management's response

- *We agree. The role of quality reviewers has been clarified by the Office and was communicated to staff by a Practice Advisory in May 2009.*

The Professional Practices Group (PPG) is currently revising annual audit current checklists and developing new checklists for special examinations and performance audits to provide improved guidance to quality reviewers. These checklists will be finalized and in place by December 2009.

- *We agree. PPG will develop and offer guidance and training for quality reviewers and audit practitioners as appropriate.*

Independence

62. Assurance standards require that auditors be independent of the entities they are auditing. Accordingly, threats to independence and the safeguards employed to reduce such threats to an acceptable level need to 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 audit. This form is to be placed in the audit file.

63. In one file, we found that independence declarations were not completed by several audit team members. In another file, the independence declarations were destroyed after the audit, and in a third file, the declarations were completed at the end of the audit. We also found that in one audit, independence declarations were completed but were not placed in the audit file as required. Neither the practice reviewers nor the quality reviewers made note of these deviations from Office policy and assurance standards.

64. We also noted that the Office does not currently require that individuals advising the engagement team in the conduct of their audit sign a declaration of independence. These individuals include the Auditor General, the Deputy Auditor General, quality reviewers, internal advisers, internal specialists, information technology staff, and all others involved in performing audit work. We are of the opinion that they should sign a declaration of independence.

65. We noted that the new release of TeamMate, the electronic documentation tool, was updated in the fall of 2008 to require quality reviewers, IT team members, and specialists and others involved in the audit to complete and sign a declaration of independence. However, the Office-wide practice advisory on independence has yet to be updated and communicated to all employees.

66. Recommendation. The Office should

- formally clarify that all individuals involved in performing audit work, including quality reviewers, IT team members, specialists and others, are required to be independent and to complete the independence declaration; and
- remind all employees that independence declarations are to be completed and approved early in the audit process and filed appropriately, before the audit work begins.

Management's response

- *We agree. The Professional Practices Group will issue a Practice Advisory for all product lines clarifying independence requirements in September 2009. These requirements will be incorporated into audit manuals as they are updated.*
- *We agree. The need to have completed and approved independence forms in place before work on an audit begins will be reinforced through forums for discussion with staff.*

Audit work contracted out

67. Our practice review included audit work that had been contracted out to an external audit firm. The Office does not require that external audit firms use Office methodology with a view to learning from the audit work performed by the contractors. We noted that while the audit opinion was fully supported, the sample sizes chosen by the contractor were smaller than our methodology would require. This may be an opportune time to review our methodology for potential efficiencies for the Office. Therefore, we felt it important to carry out a post-mortem and to evaluate the impact on our Office methodology and the guidance provided to audit teams.

68. Recommendation. The Office should consider the need for changes to our methodology based on our experience where audit work has been contracted out.

Management's response. *We agree. In each of the last two years, a "lessons learned" exercise has been organized by the Practice Leader. The results have been reported to the AASEMC and the Executive Committee and shared with the Annual Audit Practice Team (AAPT). AAPT will consider the findings of the most recent "lessons learned" exercise, including whether any changes are required to our methodology, in concert with the Strategic Alliance initiative. This will be completed by December 2009.*

Follow-up of management actions on prior practice review recommendations

69. Opportunity for practice-wide improvements in the areas of resourcing, training and guidance on the control-reliant approach, the update of the Annual Audit Manual, and the use of the summary of audit comfort were reported in the September 2007 Report on a Review of the Annual Audit Practice of the Office of the Auditor General of Canada—Audits Conducted in 2005 and 2006. This report included management's action plan to address the recommendations. For a

complete update of the status of the implementation of past recommendations, see Appendix C.

70. We applied the following ratings to assess the progress made on the past recommendations:

- **Completed.** Most of the original recommendation has been fully addressed.
- **Partial implementation.** Some progress has been made to address the recommendation but action is still required to achieve the desired results.
- **Limited implementation.** Little progress has been made in addressing the recommendation; much more action is required.

71. The previous recommendations noted a need for more training and guidance on the control-reliant approach. The Annual Audit Practice Team released a new version of TeamMate in December 2008 to address those requirements.

72. We have recommended to the Annual Audit Practice Team that all the practice advisories and TeamMate revisions that are changes or enhancements to audit policy be included in the Annual Audit Manual so that users have only one source to reference.

Conclusion

73. Based on the practice reviews performed and our cumulative knowledge, we conclude that for certain elements of the Quality Management System reviewed, the design and implementation needs to be improved to ensure compliance with professional standards and Office policies and procedures for the annual audit practice. Overall, we found that for the 11 annual audits reviewed and the one report on certain controls of a government entity, there was sufficient and appropriate evidence to support the reports in those circumstances. However, improvements are needed for the Quality Management System and professional standards to be effectively implemented.

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

75. We wish to express appreciation to all those who did practice reviews of annual audits, to audit teams that cooperated with such reviews, and to all others considering the results of our practice review and follow-up of prior practice review recommendations on either an audit team or Office-wide basis.

Appendix A—Quality Management System for annual audits



Appendix B—Quality Management System elements and process controls reviewed

Our review covers the following Quality Management System elements:

Independence, objectivity, and integrity. We determined whether all individuals performing the audit, including specialists, were objective in carrying out their responsibilities and in forming their conclusions. As well, we determined whether auditors were free, and appeared to be free, from relationships that might bias their professional judgment.

Conduct of the audit. We determined whether the audit was planned, executed, and reported in accordance with Canadian generally accepted auditing standards, applicable legislation, and Office policies and procedures. We considered whether the Office meets its reporting responsibilities by having in place appropriate audit methodology and recommended procedures and practice aids that support efficient audit approaches, producing sufficient audit evidence at the appropriate time.

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, particularly 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 review of documents, we determined whether audit teams had the required qualifications and competencies necessary to carry out the audit. As well, we determined whether the individuals assigned to specific tasks had adequate technical training and proficiency. We also considered the number of staff and the timing of their availability.

Leadership and supervision. We determined whether individuals working on the audit received an appropriate level of leadership and direction. We also determined whether adequate supervision of all individuals, including specialists, was provided to ensure that audits were properly carried out, and whether all audit team members were encouraged to perform to their potential, and all received appropriate recognition.

Our review of the quality reviewer's role covers the following key process controls:

Review by the quality reviewer. We determined whether an eligible quality reviewer was assigned to each high-risk audit. We also determined whether the quality reviewer performed his or her review of the annual audit in a timely manner to ensure that the Quality Management System had been applied as specified in the Annual Audit Manual, and that the quality reviewer provided advice to the audit principal on risk areas in a timely manner.

Documentation and communication. We determined whether the work of the quality reviewer was adequately documented, and whether it was communicated to the audit team.

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—Status of actions taken by management on recommendations of the 2007 Practice Review Report on the Annual Audit Practice

Recommendations—2007	Management response—2007	Status as of 31 March 2009
Resourcing The Public Accounts team should review the time budget with the audit team to ensure that the budget is appropriate.	Agreed. The budget allocations to departmental teams are established based on the joint knowledge of and recommendations by the departmental and central teams. Overall, the departmental teams were within 3 percent of the total hours budgeted for departmental teams in the year reviewed. Each year the budget is reconsidered based on the previous year's actual results and current year issues. In response to this recommendation, we will discuss the budget with the audit team and take action as required.	Completed
Conduct of the Audit—Training and guidance on the control-reliant approach The Professional Development Team and the Annual Audit Practice Team should ensure that the release of significant new methodology guidance is more closely accompanied by training in the subject matter.	Agreed. The Annual Audit Practice Team and the Professional Development Team will work to better synchronize our respective plans and priorities. Although it was delivered later than intended, the training for conducting a control-reliant audit approach is now in place.	Completed However, current Practice Review findings suggest that further training is required.
The Annual Audit Practice Team should develop templates to enhance guidance for a control-reliant approach and to ensure consistent application within the Office.	Agreed. In the next months, our team will have discussions with the audit teams to determine their needs for further templates in this area. We will also review existing guidance to ensure	Partial implementation The Office is working with an external consultant to identify gaps in methodology, new tools, and additional

Recommendations—2007	Management response—2007	Status as of 31 March 2009
<p>Conduct of the Audit—Update of Annual Audit Manual and TeamMate</p> <p>The Annual Audit Manual should be updated to reflect all changes to annual audit methodology, including practice advisories. The TeamMate audit program should include the requirement to review the design of controls as well as their implementation and use by the entity regardless of the audit approach used (substantive or control-reliant).</p>	<p>that it is up to date and clearly written. As part of the 2007 Annual Audit Update, we will remind auditors where the existing guidance can be found and who should be called if they have queries on how to apply the guidance.</p> <p>Agreed. The update of the Annual Audit Manual to reflect the revisions to CICA generally accepted auditing standards since 2004 is incomplete. However, for revisions subsequent to 2004, we have provided guidance to practitioners through the issuance of practice advisories. There is a direct link to these practice advisories through the “front page” of the Annual Audit section of the INTRANet. An initiative is also under way to revise the annual audit methodology framework while converging with the international standards for auditing. The objective is to develop, update, streamline, and centralize the annual audit methodology. We expect the initiative will be implemented before the end of 2009.</p> <p>TeamMate has requirements in each business cycle to document control activities. As part of the next revisions to the TeamMate library/stores, we will revise TeamMate steps, clarifying the requirement to review the design of controls as well as their implementation and use by entities regardless of the audit approach used.</p>	<p>guidance required. The Office has yet to adopt the additional guidance and templates recommended. These will be rolled out as part of Phase II of the project, which is estimated to be in 2010.</p> <p>Partial implementation</p> <p>The update of the Annual Audit Manual is progressing. A new release is expected to be released by October 2009.</p> <p>Revisions to TeamMate audit programs were implemented in the fall of 2008.</p>

Recommendations—2007	Management response—2007	Status as of 31 March 2009
<p>Conduct of the Audit—Use of Summary of Audit Comfort</p> <p>The Annual Audit Practice Team should review the guidance provided to further clarify the purpose and mandatory use of the Summary of Audit Comfort matrix.</p>	<p>Agreed. Over the next months, we will meet with teams to find out how they are using this document, why there are inconsistencies in applying it in practice, and how its application could be clarified and improved.</p>	<p>Completed</p> <p>As part of the information session held to inform practitioners on the content of TeamMate #5 in December 2008, the Annual Audit Practice Team emphasized the importance of the Summary of Audit Comfort and the importance of having the document reviewed by the senior management team.</p>