Office of the Auditor General of Canada

Audits of Grant or Contribution programs

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1. Purpose and Introduction

1.1 Purpose

The purpose of this document is to provide guidance to auditors of grant or contribution programs. It is aimed at setting a threshold for obtaining audit level assurance when conducting program-level audits of grants or contributions. The document is complementary *to Guidance for Scoping Audits of Grant or Contribution Programs* (the scoping document), but serves a different purpose. The scoping document is intended to help teams identify problem areas in G&C programs, while this guidance describes a standard approach to G&C audits where the objective is to assess the overall quality of management or some variation on that idea.

1.2 Applicability

The guidance can be used for all types of value-for-money audits, including special examinations.

1.3 Prerequisite

The auditor must have a good understanding of the entity (Department, Agency or other government body), including its objectives, expected results and risk profile. Auditors are assumed to know audit theory and techniques, including a strong conceptual understanding of audit level of assurance, the extent of audit testing, sampling and how these concepts are applied in audit programming. Auditors should also read the *Treasury Board's Policy on Transfer Payments.*

1.4 Approach

The objective is to identify areas, functions or issues to be considered when designing audit programs at the specific grant or contribution program level. The questions posed are guidance and therefore not intended to be mandatory. However, where guidance is not followed auditors are expected to be able to explain the reasons for not doing so and to justify any approach followed.

The auditor's objective is to achieve audit level assurance consistent with the Office's VFM audit standards. How to achieve this level of assurance is specific to each grant or contribution program and is determined in the context of risk assessed at the program level, the extent of testing required to attain the desired level of assurance AND the overall control environment of the entity (department or agency) responsible for its execution. Accordingly, teams are encouraged to pursue any other matters significant to the specific programs they are auditing.

2. How to Use This Document

2.1 Read the Document

This guidance is intended to promote critical thinking. It is not a set of procedures to be followed blindly. On the contrary, it actively discourages that approach. So consider how best to use it to meet the objective of identifying areas, functions and issues for inclusion in the specific grant or contribution audit program.

2.2 Use information already available

Gather as much intelligence about the entity and the grant or contribution program under review as possible. Context is everything. Use your team's knowledge of the policy history, the program results desired, critical success factors, risks, known weaknesses, as well as matters specific to the program under review.

3. General Considerations

3.1 Efficiency and Effectiveness of the Audit

In theory, the process outlined in the scoping document, and its focus on the examination of a non-random sampling of projects in a specific program could be raised to an audit level of assurance. However, as mentioned above, the purpose of the scoping document and the objective its process seeks to achieve is simply to assist "… in the identification and assessment of risks and desired results as a basis for setting scope". It is a search for areas that merit audit attention.

This should not be construed as a search for reportable items or a focus on so-*called exception reporting*. The focus is on the assessment of risks and desired results by identifying areas of *potential* audit significance through the application of audit procedures[1] and sampling, the latter applied quite deliberately on a non-random basis. By modifying the extent of the initial testing used to assist in identifying areas of potential audit significance such that the testing is raised to an audit level of assurance the scoping exercise could indeed be a standards compliant audit from its inception. However, this would likely be inefficient and bring the VFM auditor down many blind alleys potentially containing little of audit significance.

3.2 Matters of Potential Audit Significance

The purpose of this audit guidance is to set out a minimalist approach to auditing areas identified as important for the proper management of grant and contribution programs.

3.3 Due Diligence

At the core of auditing grants and contributions is the determination of whether financial management and control is clearly evidenced[2]. There should be clear evidence for the following:

- integrity in program design consistent with the public interest;
- support for appropriate decision-making at all levels;
- availability of timely, relevant and reliable management information, both financial and non-financial;

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[1] Audit procedures include, for example, inquiry, observation, analytical procedures and general procedures such as reading minutes of meetings, contracts and the scanning of accounting and other records. All of these have application to auditing grants and contributions. Depending on the circumstances, some lend themselves audit-sampling techniques better than others.

[2] This bulleted list is based on the Office publication *Financial Management Capability Model,* 1999

- management of risk;
- efficient, effective and economical use of resources;
- accountability for the use of resources;
- a supportive control environment;
- compliance with authorities and safeguarding of assets; and
- monitoring and reporting of actual results.

In short, auditing grants and contributions programs amounts to the determination of an appropriate level of due diligence in the management of public funds.

The meaning of *Due Diligence* when applied to the public sector may not be a simple or necessarily straightforward matter. For example, if we compare Black's Law Dictionary definition of the term and that contained in the current TB *Policy on Transfer Payments* the possibility of a greater burden being placed on the public servant becomes clearer. *Black's Law Dictionary* defines Due Diligence as:

> "Such a measure of prudence, activity, or assiduity as is properly to be expected from, and ordinarily exercised by*, a reasonable and prudent person (emphasis added)* under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the specific case".

It is appropriate to note that for a public servant dealing with public funds *the reasonable and prudent person* test may not suffice. In general those charged with responsibility for government programs are trained professionals, in the broadest sense of that term. They operate in a relatively structured environment where rules, regulations, standards and codes of conduct prevail and may, therefore, require a threshold of behaviour higher than that of the *reasonable and prudent person*.

The revised Policy on Transfer Payments, effective June 1, 2000, implies as much when it defines Due Diligence as:

> "… reasonable care or attention to a matter, which is good enough to ensure that provided funding would contribute to the intended objective of the transfer payment and stand the test of public scrutiny. This includes: (a) being guided by an understanding of the purpose and objectives to be achieved; (b) supported by competence and capability of information, resources and skills; (c) a shared commitment to what needs to be done and an understanding of respective authorities, responsibilities and accountabilities; and (d) ongoing monitoring and learning to ensure reassessment and effectiveness".

This definition contemplates quite a high order of conduct and behaviour, and may be interpreted to do so at a threshold higher than that expected of the *reasonable and prudent person*.

Evidence of the level of due diligence required by the policy will be found by applying a broad spectrum of conventional audit procedures at both the program and project level. The use of audit

sampling will most likely be restricted to selecting projects from specific programs. Various approaches to audit sampling in the context of grants and contribution programs are discussed in the Appendix below.

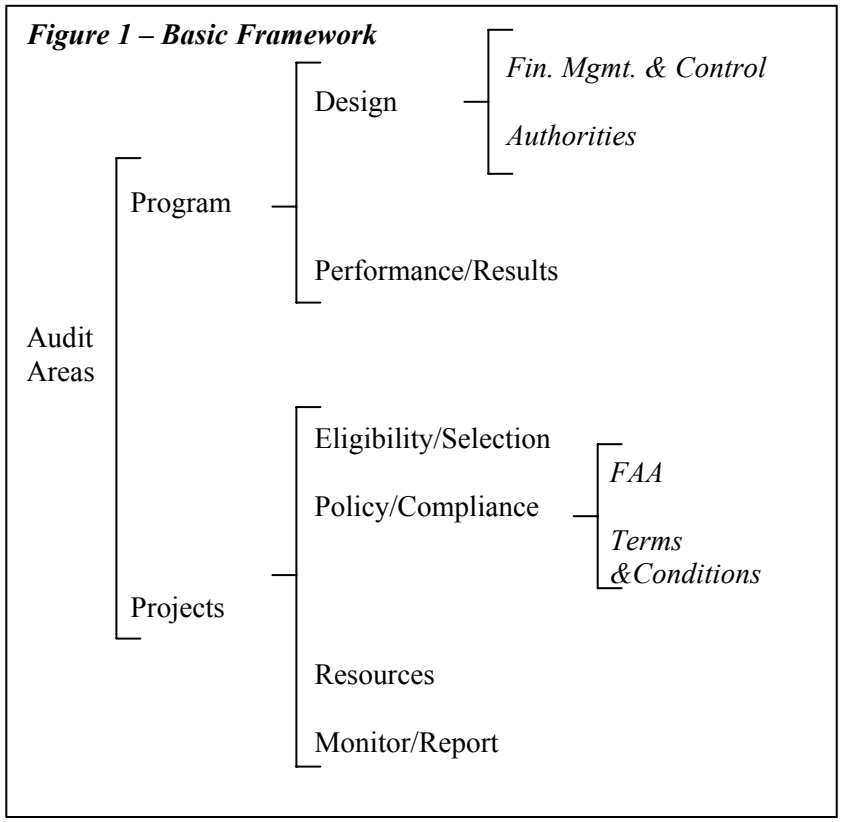
4. Suggested Audit Approach

4.1 Basic Framework

Grants and contributions are part of the category of expenditure called transfer payments. Transfer payments are transfers of money from the federal government to individuals and to organizations of various types, including businesses or other governments. The federal government does not directly receive goods or services in return. "Other transfer payments" are a third type of transfer payment.

The following paragraphs outline the recommended minimum set of matters and types of questions to be raised in grant and contribution audits. While they were written with contributions in mind, the majority applies equally well to grants and, for that matter, to all types of transfer payments.

Figure 1 – Basic Framework



This minimum set of matters raised should not be interpreted as the only ones of interest to us. Auditors are also encouraged to pursue any other matters significant to the particular programs they are auditing.

The recommended approach poses questions at the program and project levels. These questions are phrased so that in general a "no" answer is both bad and serious and a "yes" response is good. The answers to these questions should be supported by sufficient evidentiary material consistent with audit level assurance. The reasons underlying either a positive or a negative response to the questions should be investigated and documented.

The suggested audit framework, shown graphically in Figure 1 above, concentrates on the program and the projects within it. At the program level the auditor focuses on program Design (which is defined so as to include authorities, compliance and financial management and control considerations) as well as Performance Monitoring systems. At the project level the auditor is concerned with Eligibility/Selection, Policy/Compliance, Resources and project Monitoring.

It is a Practices/Attributes/Results approach consistent with the scoping document methodology. Therefore, it is not sufficient to examine the program alone. Projects from within the program must be selected on an appropriate basis and to an extent sufficient for audit level assurance. The two legs of the audit approach, program and projects, are tightly linked and fully integrated, one with the other.

Under TB policy, departments and agencies "… must identify the potential perils, factors and types of risk to which their assets, *program activities* (emphasis added) and interests are exposed". The extent of audit testing is influenced by the auditor's view on inherent risk at the program level and by the entity and program level risk analysis, evaluation and assessment conducted by the department – see the scooping document, Section 5 and Appendix 2 for a more extensive discussion of Risk Analysis.

4.2 Program Level Considerations

4.2.1 Program Design – Clear Results and Capacity to Deliver

- Did TBS review and challenge the program design to ensure that it provided for effective control?
- Is there proper authority for the program?
- Is the program design fully consistent with the *Policy on Transfer Payments*
- Are the results expected from the program clear, measurable, directly related to objectives?
- Do the eligibility and assessment criteria, and any associated direction, directly address and contribute to these expected results?
- Does the program design address relevant risks?
- Is there a centre of expertise/central review group for grants and contributions in the organization to assist program management?
- Are responsibilities well defined – in particular, those of people who are not program staff but are involved in funding decisions?
- Do available resources (human, physical, financial and other) match the workload for the program?

4.2.2 Program Performance – Results Achieved

- Are actual project results measured and rolled-up?
- Is there on-going program information on achievement of expected results?
- Are there compliance audits/reviews of projects?
- Is there internal audit and, if so, are findings used by program management?

4.3 Project Level Considerations

4.3.1 Project Approval for the projects audited

- Is eligibility proven and documented?
- Is there a persuasive case for each project approval based directly on all of the assessment criteria as well as the principles of incrementally and need?
- Is there sufficient and appropriate substantiation for both?
- Is there a proper agreement in place (completely consistent with program terms and conditions), and are expected project results clear and derived directly from the project assessment?
- Should the contribution be repayable?
- Section 32 – Is there certification by the responsible officer that sufficient funds were available in the appropriation before an agreement was signed?

4.3.2 Project Staff, Resources and Organization

- Are responsibilities of, and relations among, program officers supportive and clear?
- Does program staff have the time and means to enforce the rules and carry out their responsibilities?
- What staff behaviour is encouraged/discouraged and why?
- Does staff have information, tools and essential resources to do their jobs well?
- Does staff know how to assess an application under the program, and how to monitor a project with due diligence?

4.3.3 Project Monitoring – Funding Used for the Intended Purpose

- Is there proof of appropriate project monitoring?

- Section 34 – Is there proof that the performance conditions of the agreement were met before each payment was made?

- Section 33 – Is there proof that the finance officer signing for Section 33 was assured that Section 34 was met before authorizing payment?

Appendix

Approaches to Audit Sampling

Introduction

There are two general approaches to audit sampling: non-statistical and statistical.

Non-statistical sampling, sometimes called judgment sampling, is the determination of sample size or the selection of the sampled items using judgment reasoning rather than the mathematics of probability. This type of sampling is used because many audit tests and procedures must be performed outside a statistical sampling context (for example: reviewing records, having discussions with personnel and reviewing high value items). Conceptually, the difference between non-statistical sampling and statistical sampling is that the latter possesses mathematical rigour in that it allows auditors to use probability-based calculations for sample reliability and the risk of reliance on the sample. It permits mathematically derived quantitative responses to the following questions:

- What is the estimate of error?
- How confident should one be of the estimate?
- How precise a statement can be made about the estimate?

The concepts of confidence level, confidence interval and estimate projection are dealt with more fully below.

Both statistical and non-statistical approaches require professional judgment in planning, selection and evaluation of samples. Judgment also arises when dealing with specific matters such as: population definition, deviation definition, selection method, population characteristics and choosing a sampling plan.

For a sampling plan to be statistical it must meet two requirements: the sample items must have a known probability of selection; and the sample results must be mathematically evaluated.

Two statistical sampling models considered applicable to audits of Grant and Contribution Programs are discussed below: Attribute sampling and Dollar-unit sampling. The discussion is very brief. **For in-depth knowledge or advice on the application of statistical techniques generally the FRL Surveys should be consulted.**

As a general comment, there are two types of conclusions that may be sought:

- What percentages of files (or projects or items) have a particular characteristic or characteristics, which may be either positive or negative? This question can be answered through an attribute sampling approach.

- What is the aggregate dollar value of files (or projects) which contain a particular characteristic or characteristics? A dollar-unit sampling is a useful way to address this question.

In other words, attribute sampling tells us how prevalent deviations are, dollar unit sampling tells us their potential dollar impact.

Confidence Interval and Confidence Level in Statistical Sampling

The confidence interval is the plus-or-minus (±) figure usually reported in newspaper or television opinion poll results. For example, if a confidence interval of ±4% is used and 47% of the sample contains the attribute or characteristic being tested for then one can be "sure" that if the whole population had been tested between 43% (47-4) and 51% (47+4) would have had that attribute or characteristic.

The confidence level is a different concept: it tells "how sure" one can be. It expresses the degree of "sureness" or assurance held that material error does not exist. It too is expressed as a percentage and represents how often the true or actual percentage is reflected inside the confidence interval. For most purposes a 95% confidence level is used.

Putting confidence level and confidence together, and using the previous example, one may be 95% confidant that the true percentage of the population exhibiting the characteristic being tested for is between 43% and 51%.

The confidence level is the converse of risk. Mathematically expressed risk is 1 – Confidence Level. For example, if the confidence level is 95% the risk is 5%, i.e. 1 - 0.95 = .05 or 5%. This means, as a practical matter, the auditor is prepared to take a 5% risk of being wrong (or, in confidence level terms, to accept a 95% probability of being right). Using the opinion poll example cited above, the pollster is prepared to take a 5% risk that the true or actual percentage is not reflected inside the confidence of ±4%.

Attribute Sampling

Definition. Attribute sampling is a statistical method used to estimate the proportion of items in a population containing a characteristic or attribute of audit interest. This proportion, called the occurrence or deviation rate, is usually expressed as a percentage, and represents the ratio of items containing the attribute in the total population. Typically it is used to determine whether the rate of deviation from a prescribed control policy, procedure or regulation in a population exceeds a tolerable rate.

Application. Attribute sampling is considered ideal for tests of control and tests of transactions because it measures the frequency of occurrence. It is said to be "binary", i.e. "yes or no", and the characteristic being sampled for either exists or it does not. However, the determination of "yes" or "no" may sometimes require a subjective judgment. For example, it is relatively straightforward to determine the existence of an appropriate Section 34 (of the FAA) sign-off on an authorized expenditure for an approved project; it either exists or it does not. On the other hand, if the test were to determine the existence of an adequate business case for the project then what constitutes "adequate" would require a subjective judgment against agreed criteria.

Attribute Sample Size. In general, the larger the sample, the surer one can be that it truly reflects the population. This indicates that for a given confidence level, the larger the sample size, the smaller the confidence interval. However, the relationship is not linear (i.e. doubling the sample size does not halve the confidence interval).

The auditor, using professional judgment, must strike a balance between the confidence interval, confidence level and sample size.

Sampling, by definition, has risk attached to it – the higher the level of acceptable risk, the lower the level of confidence, and the smaller the sample size.

Table 1 – Sample Sizes for Known Populations 95% confidence level, 10% confidence interval

Population Size	Sample Size
25	20
50	33
100	49
200	65
500	81
1,000	88
2,500	92
5,000	94
10,000	95
100,000	96

For most purposes in auditing, a confidence level of 95% with a confidence interval of 10% is considered adequate.

Where the size of the population is known and using the preceding confidence level and confidence interval as the standard *Table 1* shows sample sizes for the indicated populations.

Non-random samples, possibly giving rise to erroneous conclusions, usually result from some flaw in the sampling procedure and auditors should be alert for such errors during sample plan design and during sample selection.

Alternative Attribute Sampling Techniques. There are at least three variations in the application of Attribute sampling technique: Fixed sample size, Stop/Go or Sequential sampling and Discovery Sampling. Generally the motivation behind using one approach over another is driven by a desire to keep sample sizes small when circumstances permit.

Dollar-unit Sampling

"Dollar-unit sampling … is a very simple concept. It is simply a method of statistical sampling in which every dollar … in an accounting population is given an equal chance of selection. This is done by changing the customary definition of *sampling unit* from being a *physical unit* … as in classical sampling techniques, to being an *individual dollar.*

Dollar-Unit Sampling: A Practical Guide for Auditors
by Leslie, Teitelbaum and Anderson

Dollar-unit sampling (DUS) uses a combined-attributes-and-variables[3] method of statistical inference. It differs from most sampling techniques in that the sampling units are defined as individual dollars rather than as physical units (such as inventory items).

DUS, also called Monetary Unit or Value Weighted Sampling, gives an equal chance of selection to an individual monetary unit, which in fact cannot ordinarily be examined separately. Rather, the whole item, which includes the specifically selected monetary unit, is hooked out for examination. This method systematically weights the selection in favor of the larger amounts but still gives every monetary value an equal opportunity for selection.

Dollar-unit sampling can be used where the auditor wants to:

- Estimate, within a specified degree of reliability, the characteristics of a population; or

- Estimate, with a specific degree of reliability, the value of a population or one of its characteristics

In an audit context, a sampling plan in which the monetary unit is the sample item the auditor performs his test not on the individual monetary unit but on the account balance, file or other item, which includes the monetary unit selected. While focused, conceptually at least, on individual dollars when one dollar is selected it pulls with it the unit to which it is attached. This unit, in a grant and contribution audit, would be a project file in a specific program. Audit testing of that file would then proceed using a predefined audit program. In the end it is a sample of dollar units that is audited and used to derive a judgment about the entire population of dollars from which the sample was selected.

Bibliography

Jones, Peter, *Statistical Sampling and Risk Analysis in Auditing,* Gower, 1999.

Guy, Dan M., Carmichael, Douglas R., Whittingham, O. Ray, *Practitioner's Guide to Audit Sampling,* John Wiley & Sons Inc., 1998.

Leslie, Donald A., Teitelbaum, Albert D., and Anderson, Rodeny A., Copp Clark Pitman, *Dollar-unit sampling - A practical Guide for Auditors.*

[3] Variable Sampling is concerned with variations in some measurement or characteristic possessed by every member of the population. Typically it is a used to answer the question "how much?" It can be applied to populations made up of dollars, units of weight, days, etc.