Manual On Annual Audit

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

Ce document est également disponible en français.

Contents may not be reproduced for commercial purposes, but any other reproduction, with acknowledgments, is encouraged.

© Minister of Public Works and Government Services Canada, 2003

Table of Contents

Annual Audit Manual

Annual Audit of the Public Accounts of Canada, the Territories, Crown Corporations and Other Entities

Foreword

Annual Auditing — A Proud History

The Office's annual audit practice dates back more than 120 years to the appointment of Canada's first Auditor General, John Lorn McDougall, in 1878. His appointment followed passage of the *Act to provide for the Better Auditing of the Public Accounts,* which was given Royal Assent on 10 May 1878. The Act was based on the desire of legislators to "free the auditing of the public accounts from any interference on the part of the administration" by appointing an independent Auditor General who would be an officer of Parliament. The Minister of Finance told the House of Commons that the Auditor General's responsibilities would include examining the accounts and vouchers of government expenditures, and reporting to Parliament on "any deficiencies in the appropriation accounts of sums which [s]he thinks are not properly authorized in[her] opinion." That is, the Auditor General was to make sure that public funds were spent within the limits and for the purpose approved by Parliament.

Canada's first Crown corporations came into being before Confederation, but it was not until the introduction of the *Financial Administration Act (FAA)* in 1951 that efforts were made to make these entities more accountable to Parliament. The *FAA* required each Crown corporation's auditor (which was not necessarily the Auditor General) to report on the financial statements and accounting practices of the corporation. In addition, the auditor was required to "call attention to any other matter falling within the scope of the auditor's examination that in his/her opinion should be brought to the attention of Parliament." At the same time, this responsibility to report "other matters" was extended to cover departments and agencies by the *FAA.*

The passage of time, the *Auditor General Act* of 1977, subsequent amendments to the *FAA*, and other legislation have further strengthened the role of the Auditor General in conducting and reporting the results of the annual audits of the Public Accounts of Canada, the Territories, Crown corporations and other entities. The fact that Parliament and the Territorial legislatures continue to look to the Auditor General for independent advice and assurance is a testimony to its confidence in the quality of our annual audit work.

The policies, procedures and guidance outlined in this Manual are part of the Office's *Quality Management System (QMS)*. The QMS is designed to provide the Office with reasonable assurance that it conducts high quality audits in accordance with applicable legislative requirements, professional standards and Office policies. In other words, our QMS is intended to help us continue a proud tradition of serving the public interest through the assurance we provide from our annual audits.

Forward to this Manual

This Manual covers all annual audits conducted by the Office, including those carried out on the Public Accounts of Canada (specifically the audit of the Summary Financial Statements of Canada), the Territories, Crown corporations, international assignments and other audit entities. The Manual is supported by functional guidance and other procedures and tools specific to the product line, including a wealth of information available internally through our Annual Audit INTRAnet site.

The Annual Audit Manual has been built around professional standards and Office policies that auditors must meet to produce a high-quality audit. The Manual has a strong quality orientation based on current thinking and practice in first-class professional organizations. It provides a clear picture of the standard of quality expected from staff and emphasizes professional judgment.

This version of the Annual Audit Manual, first issued in October 2002, was extensively re-written to take into account significant new changes in our annual audit methodology emanating from a major Office initiative – the Advancing Audit Practices Project (AAPP). The AAPP led to some fundamental changes in the way we audit, including the introduction of One Pass Planning, the use of a "business risk" – based strategic focus, a new commitment to adopting a controls-reliant approach throughout the Office, the introduction of electronic audit tools and some fundamental changes in how we interact and work together as an audit team.

The Annual Audit Manual is the product of consultations with practitioners, the Practice Development Committee, Office specialists including functional responsibility leaders, as well as external consultants. Drafting new material for the manual and coordination of these consultations were primarily the responsibility of John Rossetti and Margaret Haire of the Annual Audit Practice Team. Additional material was provided by Barry Naik of the Annual Audit Practice Team and John Dunning of the Information Technology Audit Team.

The Manual is expected to be a focal point for the continuous improvement of our annual audit practice. Our knowledge and experience with annual auditing continue to expand and evolve; so will this Manual. If you wish to suggest additional issues that should be covered, or to offer any other comments or suggestions for improving the Manual, you may contact the Annual Audit Practice Team and/or the Professional Practices Group.

Introduction

Preface

1. The Office currently has a number of product lines: annual audits of the financial statements of the Government of Canada (Public Accounts of Canada), the Territories, Crown corporations and other entities; Special Examinations of Crown corporations; value-for-money (VFM) audits of departments and agencies including special studies; assessments of performance information and environment and sustainable development audits and studies. The Practice Development Committee of the Office works with staff to develop and approve policies and expected practices for each product line, with the objective of ensuring that these audits are conducted at the highest professional level.

2. The Annual Audit Manual has been prepared, in part, to explain the Office's *Quality Management System* for conducting annual audits. The Manual includes information about all aspects of the *Quality Management System* for Annual Audits, but focuses on conduct of the audit and consultation. The Office policies, methodology and supporting guidance and tools apply to all annual audits, including the Public Accounts of Canada, the Territories, Crown corporations, and other financial audit work including international annual audit engagements.

3. The Manual has been written primarily to meet the specific needs of annual audit practitioners. It describes the conceptual underpinnings of the Office's annual audit methodology, explaining in broad terms how these audits should be planned, conducted and reported. The Manual refers readers to some of the various audit tools and other guidance that exist, providing only minimal "how to" information. It does, however, identify additional sources of guidance that exist to help meet the needs of annual audit staff.

4. This Manual does not include an exhaustive description of auditing theory. Rather, it is intended as an efficient resource to explain the principles underlying the Office's approach to conducting annual audits, including the audit of compliance with legislative authorities.

How to Use This Manual

5. The Office has developed a quality management system to guide staff in managing annual audits. This system is designed to provide reasonable assurance that our annual audits are conducted in accordance with applicable legislative requirements, professional standards and Office policies.

6. There is an expectation that the framework for conducting annual audits described in this Manual will be followed by all Office staff. However, while it is recognized that no system is applicable in every circumstance, exceptions to Office policies, methodology and supporting guidance and tools should be rare. In these rare situations, the audit Principal should obtain the concurrence of his/her Assistant Auditor General, and in exceptional circumstances that of the Auditor General.

ANNUAL AUDIT POLICY

Staff (Office employees and contractors) should comply with Office policies, generally accepted auditing standards (GAAS) and apply Office methodology. In those rare instances where it is considered inappropriate or impractical to comply with Office policies or generally accepted auditing standards (GAAS), the team Principal should obtain prior approval from the responsible Assistant Auditor General and the Chair / Vice Chair of the AASEMC, through the Product Leader – Annual Audit or Public Accounts, regarding the proposed deviation. (September 2004)

7. For the annual audit of the Public Accounts of Canada, in those rare instances where it is considered inappropriate or impractical to comply with Office policies, Generally Accepted Auditing Standards and/or to apply Office methodology, the entity team Principal should also obtain the prior approval of the Public Accounts team Principal.

8. Under Section 6 of *The Auditor General Act*, we audit the Summary Financial Statements of the Government of Canada which are included in the Public Accounts of Canada. In this manual, the audit of the Summary Financial Statements of the Government of Canada is referred to as the Public Accounts audit.

Methodology Support

9. The Product Leader for Annual Audit is responsible for the ongoing support of the annual audit policies, methodology and supporting guidance and tools described in this Manual. Questions regarding interpretation or the application of particular aspects of the Office's approach should be directed to the Product Leader for resolution. Equally, innovative practices and suggestions for improvement are appreciated, and will be used to enhance the methodology and to improve practice throughout the Office.

10. For additional information, guidance and/or support, please contact:

Product Leader, Annual Audit	John O'Brien
Product Leader, Public Accounts	Clyde MacLellan

Context of our Annual Audit Practice

11. The Office's *Quality Management System* has been developed taking into account the unique environment in which we operate. This environment is comprised of a number of key characteristics that have shaped our annual audit practice. As noted in the *Foreword* section to this Manual, some of these characteristics have historical significance. All have influenced the development of Office policies and practices. These policies and practices are outlined in more detail throughout this Manual.

KEY CHARACTERISTICS	IMPACT ON OUR PRACTICE
Legal Mandate • The legal mandate of the Auditor General is generally described in the *Auditor General and Financial Administration Acts.* • However, other *Acts* of Parliament may include references to annual audits and other specific duties to be undertaken by the Auditor General. • The wording used in these *Acts* to describe our responsibilities is not always consistent.	• As a legislative audit office, it is important to ensure we have a proper legal basis for all of our annual audit work. Consultation with legal services, where appropriate, helps to ensure a proper legal basis exists for our work. • Terms of engagement are dictated by legislation, but we strive to be as consistent as possible across our portfolio. Consultation with our Annual Audit Practice Team contributes to achieving consistency. • Communicating with senior management of audit entities is important to ensure that we both share a common understanding of the terms of our annual audit engagements.
Appointment of the Auditor General • The Auditor General is appointed for a ten year term by the Governor in Council. • The Office's independence is established in the *Auditor General Act.*	• We have a high degree of independence, and are subject to few of the conditions that exist for public accounting firms that might jeopardize our independence. However, we do need to avoid situations involving potential conflict of interest, as outlined in the Office's *Code of Professional Conduct*. • Except in limited circumstances, the Office does not charge and/or recover fees. Nevertheless, we still have an obligation to be economical, efficient and effective in our annual audit work.

KEY CHARACTERISTICS	IMPACT ON OUR PRACTICE
Expectations of a Legislative Audit Office • The Office has an obligation to Parliamentarians to bring to their attention instances where our audit entities have not been in compliance with legislative authorities in all significant respects. • The Office is expected to bring to the attention of Parliamentarians any “other matters” that the Office believes they should be aware of. • As a legislative audit office, our work can, at times, involve politically sensitive issues that may increase our audit risk.	• Our annual audit work should be consistent with the expectations of Parliament. Addressing compliance with authorities and “other matters” is an integral part of the design, execution and reporting phases of every annual audit. • We report “other matters”, either directly or on an exception basis. In the Public Accounts of Canada, this information might be included in the *“Observations by the Auditor General on the Financial Statements of the Government of Canada”*, which we refer to in our auditor’s report. • Consultation with internal specialists and Office senior management helps to ensure sound judgment is exercised in planning, executing and reporting the results of our annual audit work. Consultation and senior management involvement also contributes to ensuring our work meets the needs and expectations of legislators, and that we communicate our findings clearly and succinctly.

KEY CHARACTERISTICS	IMPACT ON OUR PRACTICE
Audit Entities • There is little change from year to year in the portfolio of audit entities for which the Office performs annual audits. • Because of this fact, the Office has considerable experience with most of the entities we audit. • In some entities, the Office performs value for money Audits, "special examinations" and/or other types of audit work that further enhance our understanding of these entities. • There are typically few, if any, comparable entities in the private sector.	• Even though we generally have a long history with most of our audit entities, our environment is a dynamic one. Maintaining a sound knowledge of the entity's business and risks is an ongoing activity that should be visible throughout all phases of our annual audit work. • Many of our entities operate in specialized areas. Because of their public policy objectives, they often have unique characteristics not found in "similar" private sector entities. These differences need to be taken into account when consulting with internal and/or external specialists and in acquiring knowledge and understanding of specialized industries and/or unique industry accounting practices.
Professional Standards • The CICA Handbook was not written expressly taking into account the unique features of many public sector entities that we audit. • Public sector accounting standards are relatively new and continue to evolve.	• We comply with professional auditing standards, applied on a basis appropriate to the circumstances. • We frequently face unique problems for which there is little existing guidance. Consultation with internal and/or external specialists is necessary to reach sound, professionally defensible positions on these issues. • Application of accounting standards in our environment requires significant judgment that should be applied consistently across our client base. Consultation with the Annual Audit Practice Team contributes to achieving this consistency across the Office.

KEY CHARACTERISTICS	IMPACT ON OUR PRACTICE
Office Size, Organization and Staff • The Office has a relatively small number of professional staff that work closely together. • Annual audits are conducted in most of the groups within the Office. • The audit of the Public Accounts of Canada is the largest annual audit in the country.	• We have developed a corporate culture built on consultation and consensus-building. The Office values this culture, and has established policies and procedures that encourage and support these types of behaviours. • Completing the audit of the Public Accounts of Canada requires teamwork and cooperation of staff throughout the Office.
Office Methodology and Practices • The Office has an established methodology for conducting annual audits. • Our methodology evolves with changes in the practices of the private sector and other legislative audit offices, and as a result of innovation within the Office. • We strive to build in quality throughout all phases of the annual audit.	• The methodology described in this Manual applies to all of our annual audits. • As part of our “continuous learning” initiatives, the Office regularly surveys developments in the private sector and other legislative audit offices. • We work with private sector auditors on some engagements. On those engagements, we need to satisfy ourselves that the work of the joint auditor professional standards. • We emphasize “real-time” supervision and coaching that builds in quality as the audit unfolds. We expect file reviews to be completed, using “review by interview” techniques on a timely basis, their main objectives being to confirm that quality work is being done and resolve issues as they arise. We recognize that building quality in is more efficient than inspecting it in after-the-fact.

Organization of this Manual

12. The Annual Audit Manual consists of ten distinct sections.

CHAPTER		MATTERS DISCUSSED
	Introduction	The defining characteristics of our environment and how they have helped shape our practice
1	Approach to Annual Audits	Conceptual overview to the Office's overall approach for conducting annual audits
2	General Audit Management Issues	Broad audit management issues that have relevance to all phases of our annual audit work
3	Entity Risk Analysis	The Office policies and expectations regarding applying a "business risk" based approach in order to identify the key risks facing the entity. The resulting analysis is used as the basis for developing One Pass Plans and the strategic approach to annual audits.
4	Annual Audit Planning	The Office's expectations leading to the completion of the strategic approach for the audit
5	Annual Audit Execution	The four different sources of audit assurance (analytical procedures, reliance on management and monitoring controls, reliance on application controls, and substantive tests of detail), and other evidentiary matters
6	Annual Audit Reporting and Completion	The process of evaluating audit results, finalizing the auditor's report and communicating the results of our work to the audit entity and its audit committee (or equivalent)
7	Consultation	The Office's expectations regarding when consultations should take place
8	Practice Expectations Common to all Product Lines	Office policies and expectations in areas common to all of the Office's audit work such as access to information and conflict of interest
9	The Office's *Quality Management System* for Annual Audits	Key features of the Office's *Quality Management System* for annual audits

1 Approach to Annual Audits

Historical Perspective

1.1 In 2000, the Office of the Auditor General of Canada launched a comprehensive review of its annual audit methodology. The main objectives of this review were to modernize our audit tools and ensure that our methodology reflected current best practices. The review was prompted by several significant developments involving our profession, our clients and audit technology. These developments included:

- The adoption of sophisticated Enterprise Resource Planning (ERP) systems by large departments as part of the Government's *Financial Information Strategy (FIS)* and the need for audit tools and methodology to address these systems;
- A Joint Working Group (Canada-UK-USA) research study on new "business risk" based audit methodologies being adopted by major accounting firms worldwide, which suggested our current audit methodology was becoming outdated;
- The advent of more fully-integrated electronic audit tools with electronic working paper capabilities, having the potential to replace our heavily paper-based documentation processes; and
- A desire to provide assurance to the Auditor General and to Parliament that our resources are being deployed properly. In other words, the Office wanted a revised planning approach that led to audits being focused on areas of greatest risk to the achievement of government entities' objectives, while respecting all areas of our audit mandate.

1.2 In response to these developments, the Office initiated the *Advancing Audit Practices Project (AAPP)* to make recommendations for modernizing our audit methodology in the areas of long range audit planning and in our annual audit practice. The work of that project team led to the development of One Pass Planning (OPP) and the acquisition of audit methodology from PricewaterhouseCoopers LLP (PwC) and modern electronic audit tools (PwC's TeamMate). The PwC methodology and tools have been adapted, as necessary, to the mandate and policies of the OAG.

Key Elements of Our Annual Audit Methodology

1.3 The key elements of the AAPP methodology include:

- "Business Risk" Focus;
- Cumulative Audit Knowledge and Experience (CAKE);

- Reliance on Controls;
- Professional Judgment;
- The Re-performance Principle; and
- Teamwork.

"Business Risk" Focus

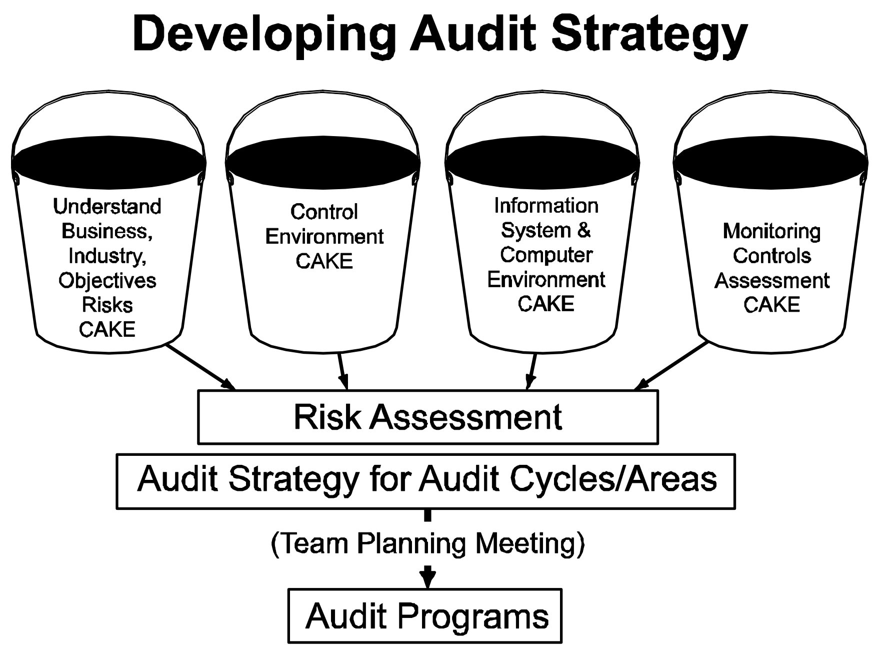
1.4 In order to provide assurance to the Auditor General and to Parliament that our audits are directed at areas of greatest risk to the achievement of government entities' objectives, we focus our work on "business risks". Business risks are those risks that are significant enough to be a threat to the achievement of entity objectives. In the context of annual audits, we concentrate on those "business risks" that have or could have an impact on the fair presentation of the entity's financial statements.

1.5 A number of important advantages are associated with the adoption of a "business risk" based audit methodology, including the following:

- With a "top down" approach, the audit team develops a deeper understanding of the strategies employed by management to achieve entity objectives;
- It encourages auditors to understand and take advantage of advances in governance in well-managed organizations, which provide new sources of evidence to auditors regarding the accuracy and completeness of performance information reported by the entity;
- It facilitates a more efficient audit, recognizing that more audit assurance can be obtained from reliance on business process systems, because advancements in technology have resulted in the development of accounting and operational systems that are inherently less prone to routine error;
- It encourages the auditor to develop a more extensive knowledge in the areas most at risk of having material undetected errors in the financial statements - estimates and other areas requiring significant degrees of management judgment. More knowledge in these areas should lead to better audit decisions in financial statement components that are more difficult to verify using traditional audit procedures;
- For commercially-oriented entities, the major issues that impact an entity's financial statements are likely to be associated with the manner in which the entity is managed to achieve its objectives;
- Armed with a better understanding of risks to the entity, the auditor is better able to detect material misstatements and/or management fraud; and
- Knowledge gained during the audit of the financial statements has a greater likelihood of adding value to the entity, as it is more focused in areas of management interest such as strengthening controls, managing risks and improving operations.

"CAKE"

1.6 Our **C**umulative **A**udit **K**nowledge and **E**xperience (**CAKE**) with the entity should always be considered in designing our audit approach. We have a considerable amount of CAKE in almost all of our entities because we are long-standing auditors of most of them. As well, we have conducted value-for-money audits or special examinations in many of our clients, broadening our knowledge of the entity and its business. Our CAKE is also derived from our knowledge of the entity's objectives and risks, assessments of its control environment, our understanding of its information systems and computer environment, a wealth of other past experiences, a history of known errors in specific areas, an appreciation for any complex and/or high volume of transactions it enters into, and experiences shared across the Office with other colleagues, teams and functional groups. In addition, our CAKE is enhanced by integrating IT specialist knowledge and experience into all of our large audit teams.



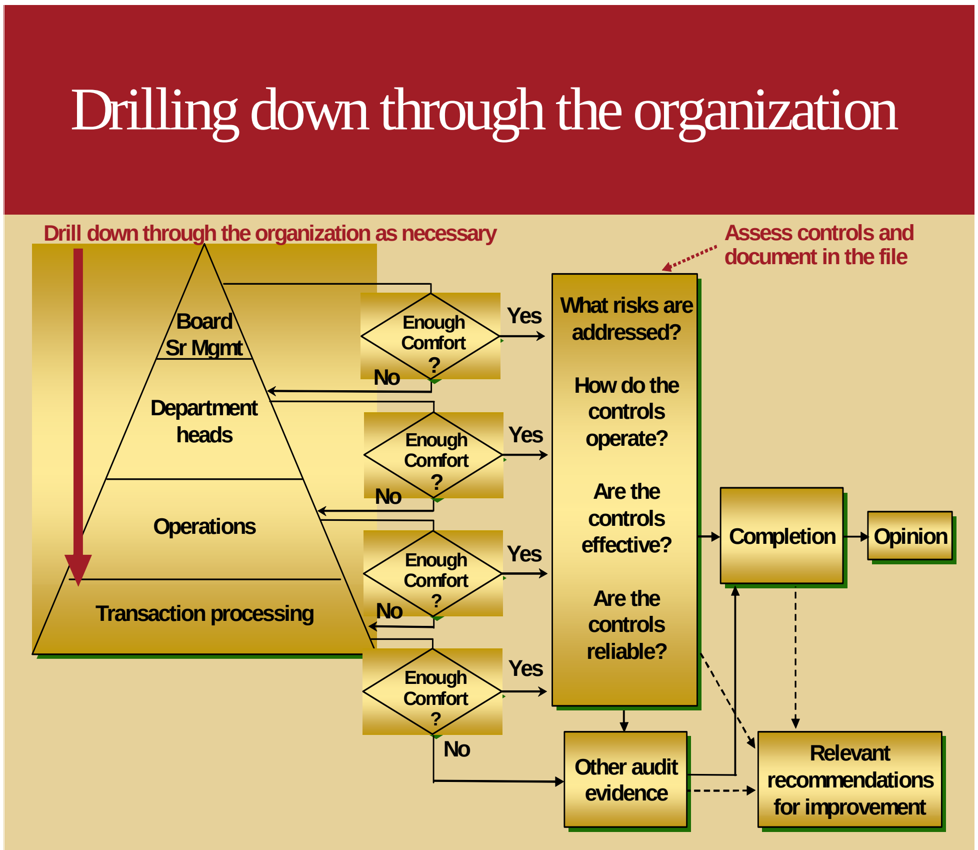
1.7 CAKE provides us with inherent assurance and facilitates our judgments about business risks and the existence and effectiveness of entity controls.

Reliance on Controls

1.8 We are committed to adopting a controls reliant approach to our audits where possible, recognizing that it is generally the most cost-effective strategy. We identify the controls best suited for reliance by drilling down through the organization, and generally placing reliance on the highest level controls that we believe will help us achieve our audit objectives for the financial statement component(s) in question. The process can be illustrated as indicated pictorially on the opposite page.

1.9 The degree of controls reliance should always be assessed on a continuum. Control assurance can range all the way from none to very high levels, depending on the quality of the controls and the ability to test them cost-effectively. The auditor determines where on the "controls continuum" the entity lies for each business cycle. In other words, the auditor determines the level of control assurance likely to be possible in the circumstances.

1.10 We obtain assurance from prior years' control testing for years in which there has been no significant change in an automated process on which we have previously established reliance. In such a "year of no change", we perform minimal enquiry and corroboration to confirm the fact that there have been no substantive systems changes. We also confirm with our IT audit specialists that changes to automated processes would be detected through monitoring controls in place.



1.11 We recognize the fact that most of our clients are heavily dependent on information technology for financial management and control purposes and for supporting operations, particularly with the adoption of ERP systems by large department as part of the Government's Financial Information Strategy (FIS). As such, the audit team for every significant entity has a member with specialist IT training and knowledge. These team members contribute their expertise in identifying business risks, assessing the control environment, developing an appropriate audit strategy and coaching/supervising/leading the team in identifying key controls and developing and executing appropriate tests of controls and other procedures.

Professional Judgment

1.12 We believe in delegating responsibility as appropriate, and emphasize the importance of applying the knowledge, skills and experience of our audit Principals, Directors and responsible Assistant Auditors General. The professional judgment of these individuals plays a crucial role in determining the nature and extent of the audit procedures required in a given circumstance, the quality of the resulting audit assurance obtained and the degree of any cross-component audit satisfaction obtained through other audit procedures.

The "Re-performance Principle"

1.13 We are committed to complying with professional standards in terms of documenting the nature, extent and timing of our audit procedures and their results. However, we do not document unnecessarily. Except in rare circumstances, we do not retain copies of client documents in our files. Our documentation principle is to always record enough information in the file that another auditor could duplicate the work performed by reference back to entity records.

1.14 ***National Archives of Canada Act.*** With respect to compliance with the *National Archives of Canada Act*, staff should be aware that there are two types of information created, received or used in an audit, regardless of their format (electronic or paper, visual or auditory). They are:

- Records that are kept to support decision-making; and
- Transitory information.

1.15 Records must be retained in our files, whereas, transitory information should be discarded as soon as possible after it is no longer needed. Generally, routine entity documents reviewed as part of our audit testing would be considered transitory as they are used to prepare a subsequent record in the form of a working paper or note to the file indicating the work or testing performed. A copy of an entity document would become a record if it supported an exception or issue, such as non-adherence to entity policies.

1.16 Additional "Guidance for Managing Audit Records in the OAG" is available on the Annual Audit INTRAnet site.

ANNUAL AUDIT POLICY

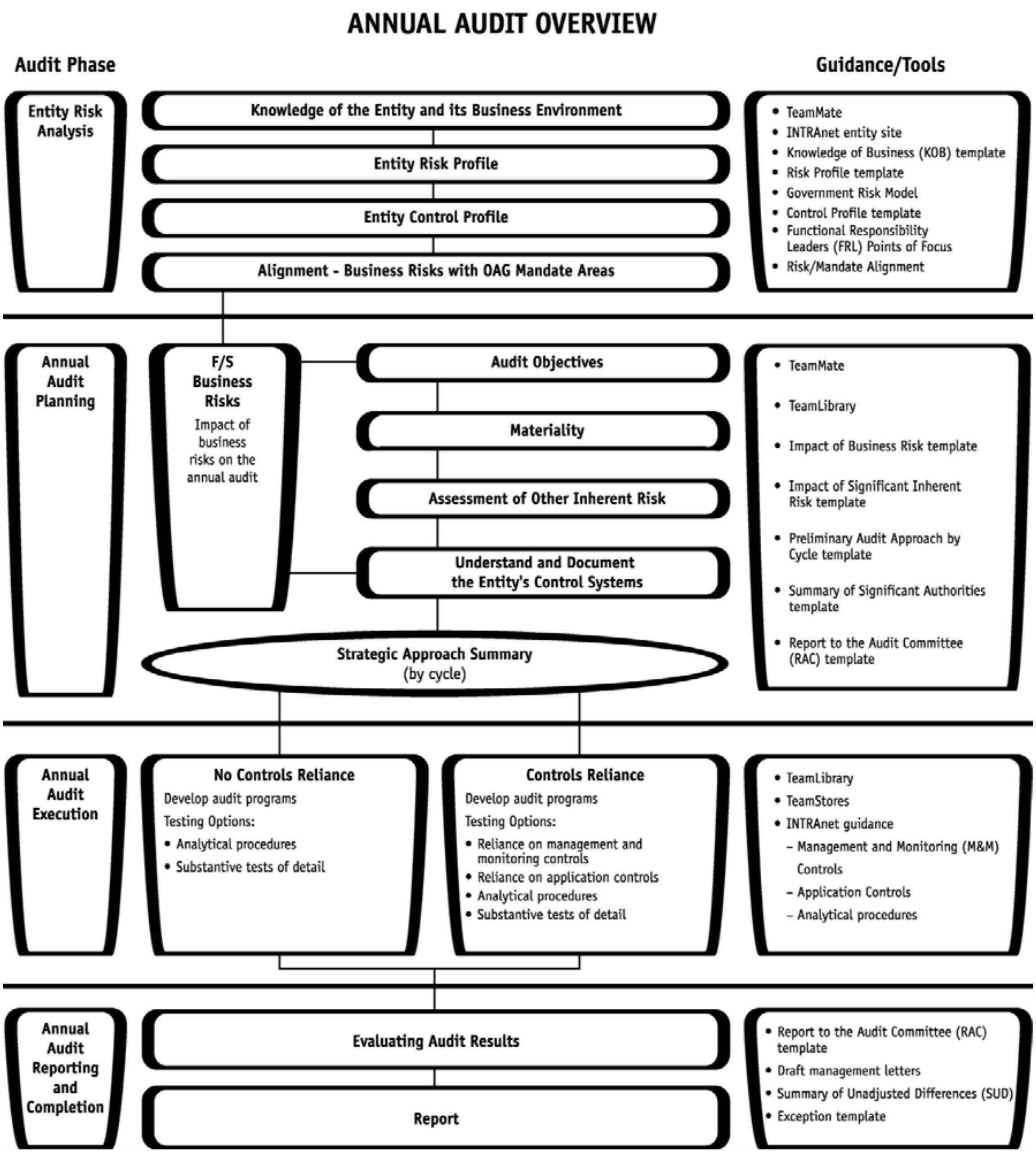
In carrying out an annual audit, the audit team should ensure that all "records" are documented in the audit file. Guidance for Managing Audit Records in the OAG.

Teamwork – Briefing, Coaching, and "Review by Interview"

1.17 We are committed to working as a team, emphasizing collaboration and two-way communication. Supervisors explain clearly what is required and expected, and auditors discuss the progress of their work and their audit findings with the supervisor as the audit evolves. Consequently, review is largely performed as the audit work progresses, and not at the end of the audit. Our objective is to do the right work, and do it right the first time.

Overview of the Office's Approach to Conducting an Annual Audit

1.18 The following represents a pictorial overview of the Office's approach to conducting annual audits. More extensive discussion of each major component of the annual audit follows.



One Pass Planning (OPP) — General

1.19 One Pass Planning (OPP) was developed, amongst other reasons, as a response to the planning challenges faced by the Office of the Auditor General in responding to multiple audit mandates within the same audit entity. For departments and agencies, these mandates could include one or more of the following:

- Value for money;
- Compliance with legislative authorities;
- Annual audit – Public Accounts – the audit of the Government's Summary Financial Statements;
- Assessment of performance information; and
- Work relating to our environmental and sustainable development mandates.

For Crown corporations these are:

- Annual audit – Crown corporations, other separate entities, territorial governments and territorial Crown corporations and other entities; and
- Special examinations in Crown corporations.

1.20 OPP is a two step process involving:

1) Entity Risk Analysis – whereby the audit team identifies the significant business risks facing the organization and aligns them with the appropriate audit mandate area; and
2) Planning – whereby the audit team develops a long range plan (three to five-year view) of desirable audit projects (based on the most significant business risks facing the organization), taking into consideration the Office's various audit mandates, strategic priorities of the Auditor General and other factors.

1.21 OPPs are carried out approximately once every five years for departments and agencies. Special examinations of Crown corporations are also performed once every five years, and use a methodology that is very similar to the Entity Risk Analysis component of OPP.

Entity Risk Analysis

1.22 The objective of Entity Risk Analysis is to identify the high level "business risks" facing an organization. Business risks are those risks that are significant enough to be a threat to the achievement of entity objectives.

1.23 The Office's methodology leads the auditor through a rigorous process designed to flesh out an entity's significant business risks. This process is founded on an extensive knowledge of the entity's business, its operating environment, its control framework and its operating history, specifically building on our

Cumulative Audit Knowledge and Experience (CAKE). In an annual audit environment, the Entity Risk Analysis is updated annually in order to reflect the most current information and developments available about the entity and its business environment. In an OPP year, the update is more comprehensive and is conducted in greater depth.

1.24 The audit team uses a series of tools and techniques, combined (where appropriate) with consultation with specialists, in order to identify business risks appropriate to the entity. These tools and techniques include existing knowledge residing on the entity sites (INTRAnet) and in the prior years' audit files, review of annually updated information such as entity business plans, interviews with senior officials (and in OPP years, with external stakeholders), the study of risk factor models, completion of an Entity Control Profile (using a template and additional guidance with consideration points designed to assist the team), environment overview guidance documents, and other information and tools built into TeamMate.

1.25 **Knowledge Residing on the Entity Sites (INTRAnet).** To help in developing our knowledge of the entity and retaining our cumulative audit knowledge and experience (CAKE), the "Entities" segment of the INTRAnet takes a "top-down" approach as follows:

- A federal portfolio page drills down to more information – a list of entities generally organized by *FAA* Schedule and related entity links. These links call up the entity's Internet site, its enabling legislation and/or an expanded "entity site" (if available). International and territorial audits are available through the left navigation bar.
- An "A-Z" listing of entities we audit provides access to liaison information and the entity's Internet site or the expanded "entity site" as appropriate.
- Expanded "entity sites" are maintained by the audit team [coordinated through a Knowledge Manager] to help capture and share entity knowledge. Currently, work on expanded sites is limited to federal departments and some agencies. The content of this site is evolving and growing, uses on-line government information sources, provides research sources and includes team-based information, e.g., OPP presentation to the Executive Committee.

1.26 **Prerequisites to Identifying "Business Risks".** There are three major steps that must be performed to provide the prerequisites necessary to identify the entity's significant business risks:

- Acquiring a comprehensive **Knowledge of the Entity** from applying the tools and techniques identified above;

- Completing an **Entity Risk Profile** by identifying entity-specific risk factors, using the Generic Government Risk Model developed by the Office. This model categorizes risk factors along four dimensions: factors in the operating environment; factors that affect the achievement of mandate; factors that affect governance; and factors that affect operations; and
- Acquiring sufficient knowledge to build an **Entity Control Profile** that allows the auditor to formulate a preliminary assessment of whether, on an overall basis and for particular business processes, a controls-reliant approach to the annual audit is feasible.

1.27 The knowledge assimilated during the performance of these three steps is then used to identify the key business risks faced by the entity. The Entity Risk Analysis phase of the audit is completed by **Alignment of the Identified Business Risks with OAG Mandate Areas**. Those business risks of significance to the annual financial audit are then addressed in the strategic planning phase of the audit.

Annual Audit Planning

1.28 During the annual audit planning phase, the audit team develops an audit approach that will provide sufficient appropriate audit evidence to support the opinion we are to provide on the entity's annual financial statements (as well as compliance with authority considerations). This approach begins with an analysis of the business risks identified during the Entity Risk Analysis that were deemed to have a significant financial statement impact.

1.29 Annual audit planning also requires a sound understanding of the Office's specific mandate with that entity. For example, the auditor considers the nature of the opinion that is to be provided, whether or not an opinion on compliance with authorities is required and any other information the auditor is required to provide in his/her report (for example, whether proper books of account have been maintained). The auditor develops a plan that, if properly executed, will achieve the mandated **Audit Objectives**.

1.30 The auditor also considers planning **Materiality** and the nature and extent of audit risk (or ultimate risk). These important considerations guide the auditor in developing audit procedures that will meet users' needs and provide sufficient but not excessive audit evidence.

1.31 Most, but not all, matters of significance to the audit can be derived from the identified business risks. Accordingly, the auditor makes an **Assessment of Other Inherent Risks** that could impact the financial statements. These might include the introduction of new accounting standards requiring complex calculations and/or new systems to generate the information required to support compliance with the standard, new transactions entered into for the first time, errors identified in the prior year, the existence of fraud risk factors, or major changes in one or more business processes.

1.32 Our audit approach is based on adopting a controls-reliant approach wherever practical. Accordingly, for major business processes we ensure that we **Understand and Document the Entity's Control Systems**. This work includes documenting an understanding of the Information Technology Control Environment in TeamMate, and creating/updating a high-level business process mapping that identifies key controls for all significant business process systems.

1.33 Once the business risks and other inherent risks with potential financial statement impact have been determined, the financial statement components and related assertions that could be affected by the business and other inherent risks are identified. The auditor then considers how to most efficiently and effectively derive the required audit assurance. The Office's methodology requires the following approach to making these determinations:

- Identify the controls that mitigate the identified risks. Plan to rely on high level management and monitoring controls first, and "drill down" to application controls where higher reliance is possible (or where management controls are considered weak or difficult to test);
- Use analytical procedures to derive the remaining assurance, if possible;
- Assess whether any residual risk(s) remain that are not adequately addressed by controls or the analytical procedures. If so, consider "targeted" (high risk/value) tests of details and, if necessary, "top-up" testing;
- In those rare cases where a controls reliant approach is not appropriate and other types of substantive tests of detail do not provide sufficient assurance, consider a dollar unit sampling approach.

1.34 The overall audit approach is then summarized in the **Strategic Approach Summary** folder in TeamMate, where it is assessed by the Quality Reviewer (if applicable) and approved by the responsible Assistant Auditor General or the audit Principal where he/she has been delegated authority to sign the Auditor's Report.

Our Methodology from an Assurance Perspective

1.35 Professional assurance standards require the auditor to obtain sufficient, appropriate audit evidence to support the content of his/her report. This evidence provides the auditor with "assurance" that the financial statements are not materially misstated.

1.36 Assurance is derived from three sources:

- Inherent assurance;
- Controls assurance; and
- Substantive assurance.

1.37 The Office's annual audit approach is intended to maximize, to the extent prudent and practical, inherent assurance and control assurance. To comply with generally accepted auditing standards, which require that some substantive assurance must always be obtained, the auditor is encouraged to obtain substantive assurance primarily through analytical procedures, and only if necessary from tests of details.

Inherent Assurance

1.38 The Office's methodology involves a significant upfront time investment by the audit Principal and Director, building on their cumulative audit knowledge and experience (CAKE). The Principal's and Director's CAKE is enhanced annually by updating their knowledge of the entity's business and environment, by interviewing senior entity officials and through key document review. This process, which culminates with the completion of the Entity Risk Analysis, is the major source of the inherent assurance acquired by the auditor.

Control Assurance

1.39 Our methodology encourages a controls-reliant approach to conducting the audit, which generally provides a significant degree of assurance more efficiently than through substantive audit techniques. Obtaining this assurance requires not only that the overall control environment and control systems of the entity are conducive to such an approach, but that effective controls exist at the management and monitoring level and, preferably, at the application level as well. Consequently, in addition to the procedures performed during the Entity Risk Analysis, the audit team would also assess the information technology control environment.

1.40 Because of the importance we attach to adopting a controls-reliant approach, an individual with expertise in information technology matters (and audit) will normally be an integral member of the audit team. This individual will help ensure appropriate assessments of the IT control environment and the extent of controls assurance that can practically be achieved, perform tests of the general computer controls where necessary and assist the other team members in testing application and management and monitoring controls.

1.41 Ultimately, the degree of control assurance obtained from the completed audit procedures is determined by the professional judgment of the audit Principal. If no control assurance is possible, a management letter should be issued to the entity identifying the needed controls and encouraging their implementation to improve management of their operations. Reporting to Parliament should also be considered where control weaknesses are significant and pervasive.

Substantive Assurance

1.42 In accordance with GAAS, the auditor ***always*** seeks some substantive assurance because of the inherent limitations of internal control. Substantive assurance is obtained from either analytical procedures or tests of detail. Auditors are encouraged to obtain substantive assurance primarily through the use of analytical procedures.

1.43 While the Office encourages adoption of a controls-reliant approach, it is recognized that for some audit entities, particularly our smaller clients, a substantive approach may be more appropriate and more cost-effective. In such cases, no control assurance is sought, and the necessary substantive assurance would be derived from a combination of analytical procedures and appropriate substantive tests of detail. Regardless of audit approach however, we should always have a reasonable understanding of the control framework in the entity, and be prepared to recommend strengthening internal controls where necessary.

2 General Audit Management Issues

Quality Management System (QMS)

2.1 The Office's Quality Management System (QMS) is designed to provide "reasonable" assurance that annual audits are conducted in accordance with applicable legislative requirements, professional standards and Office policies. Reasonable assurance recognizes that the cost of managing risks should not exceed the benefits likely to be derived.

2.2 The overriding goal of our QMS is to ensure that the Auditor's Report is appropriate in the circumstances. The QMS takes a holistic approach to the audit, identifying behaviours, expectations and policies that touch on the individual, the audit team and the Office as a whole.

2.3 The eleven elements of QMS, described in detail in Chapter 9, address a broad spectrum of activities that are grouped into three major categories:

- Audit Management;
- People Management; and
- Continuous Improvement.

2.4 The conscientious application of these elements would normally be expected to result in efficient and effective audits that add value to the entity while assuming an acceptable level of audit risk. The technologies, tools and team-working concepts in our annual audit practice will assist staff in achieving the objectives of our QMS.

2.5 When conducting an annual audit, audit staff should also be conscious of, and should act in accordance with, our established Office Values of:

- Serving the public interest;
- Independence and objectivity;
- Commitment to excellence;
- Respectful workplace;
- Trust and integrity; and
- Leading by example.

These values are fully supported by the eleven elements of our QMS.

2.6 The QMS provides the framework for completing a “quality audit”. Accordingly, staff are expected to be familiar with its structure, expectations and the specific annual audit policies it encompasses. Although most audit policies set expectations only for senior members of the audit team, audit team members individually and collectively are responsible for building quality into their work.

Our Responsibilities as Legislative Auditors

A Government Accountable to Parliament

2.7 The people’s right to control how their taxes are spent is one of the cornerstones of democratic government. In Canada, like other parliamentary democracies, this control is carried out on behalf of citizens by their elected representatives, the Members of Parliament.

2.8 The government of the day must obtain the permission of Parliament before it can collect, borrow or spend money. After it spends tax dollars, the government must also be able to show that it spent the correct amount, for the purposes approved by Parliament. This obligation of government to answer for its actions is called accountability.

2.9 Over the years, a process has developed to hold the government to account. The government must report fully on its performance by submitting to the House of Commons:

- the annual spending plans of each department;
- reports on the past year’s activities; and
- annual financial statements showing all federal spending, borrowing, and taxing, known as the Public Accounts of Canada.

2.10 These documents are intended to provide Members of Parliament with the information needed to hold the government to account. But one more link in the accountability process is needed: ***independent audit of that information***. Members of Parliament need this impartial reporting so that they can effectively question or challenge the government on its performance.

2.11 The Auditor General of Canada audits government operations and provides the objective information and advice that helps Parliament to hold the government to account.

The Work of the Office

2.12 The statutory duties of the Auditor General provide her with a broad mandate to conduct audits and examinations in order to report on how well the government has managed its affairs. The Auditor General does not comment on policy choices, but does examine how those policies are implemented. Accordingly, the subjects of her legislative audits are varied and address:

- whether expenditures have been made in accordance with legislative authorities;
- the appropriateness of the Government's accounting policies;
- the fair presentation of the financial statements of various government entities;
- constraints to economical, efficient and effective management of government resources;
- the quality of financial management and control within government;
- whether existing procedures are effective in managing the assessment, collection and proper classification of government revenues;
- the management of human resources in government;
- departmental sustainable development strategies and action plans; and
- instances where expenditures have been made without due regard to economy or efficiency.

2.13 The products of the Office are reports to the House of Commons and to various others including ministers, legislative assemblies, boards of directors and managers. These products include the auditor's reports emanating from the annual audits we conduct.

Compliance with Authority — General

2.14 Parliament, under the limits set out in the Constitution, has the pre-eminent position in the Canadian system of government because it makes the laws by which we are governed. The Cabinet, whose authority to govern derives from the constitution, is subordinate to Parliament because it is constrained by laws passed by Parliament. Ministers responsible for Crown corporations report to Parliament in discharging their accountability for these corporations.

2.15 To operate effectively, a system of government must itself demonstrate a high degree of respect for and compliance with the law. This extends to all authority instruments by which Parliament and the government of the day convey the intention of how the authority is meant to work. Examples of these instruments include the *Financial Administration Acts* (*FAA*) of the federal and territorial governments, regulations, and charters and by-laws of Crown corporations. The responsibility for observing the provisions of the applicable authorities governing the entity rests with its management. They are expected to develop management controls designed to provide reasonable assurance of compliance with legislative authorities.

2.16 The role of the Office as the legislative auditor for Parliament is governed by the federal and territorial governments' *FAA* and by the *Auditor General Act*. Some legislation, including Part X of the federal *FAA*, specifically requires the auditor to opine on compliance with specified authorities. The Office may also be asked to provide an opinion on compliance by virtue of an order in Council pursuant to Section 11 of the *Auditor General Act*.

2.17 It is the Office's view that, in order to serve Parliament well, we should be scoping "compliance with authorities" into all of our annual audit work. We should focus our efforts on key authorities that could be expected to come to our attention during the course of our annual audit examination, and we should report any instances of significant non-compliance in our auditor's report.

2.18 Consequently, each year, using various approaches, we perform detailed procedures designed to assess compliance with significant legislative authorities. All instances where we find significant non-compliance are also considered by the Auditor General for reporting to the House of Commons.

2.19 None of the various types of audits undertaken by our Office addresses itself specifically and exclusively to the "authority" dimension. Compliance with authority is a pervasive matter in legislative auditing and it cannot be divorced from any of the other work that we do. Although the weight given to compliance with authority will vary with the auditor's judgments regarding risk and significance — as will the specific approaches adopted — all of the Office's work should include appropriate consideration of compliance with authority.

Compliance with Authority — Public Accounts of Canada

2.20 A fundamental principle of control over the public purse is that Parliament's authorization is required for the government to spend, borrow and raise revenues.

2.21 Government programs and activities are first given legal effect through enabling or "program" legislation. Appropriation authority may be contained in such legislation when it specifies the conditions under which payments may be made or it specifies the amounts to be paid, until the authority is withdrawn (statutory authorities). Annual spending is authorized by appropriation acts. The schedules to appropriation acts are made up of "votes", which set the limits and stated purpose for which the government may spend money.

2.22 Borrowing is normally authorized through the borrowing acts. Borrowing may also be authorized under Section 47 of the *Financial Administration Act (FAA)*.

2.23 The raising of revenue is authorized through specific legislation such as the *Income Tax Act.* Subject to the provision of such legislation, revenues may also be authorized through general legislation such as Section 19 of the *FAA*, which provides for the Governor in Council to set fees or to authorize ministers to set fees by order.

2.24 Compliance with authority to spend, borrow, and raise revenues is a basic principle underlying the government's accounting system. The accounts of Canada generally reflect parliamentary authorizations by including an authority code within the chart of accounts coding block for each transaction. The Public Accounts of Canada, which are prepared from the accounts of Canada, report on the government's use of authorities.

2.25 The Summary Financial Statements of Canada are included in the Public Accounts. As an overall summary, their fundamental purpose is “to provide information to Parliament, and thus to the public, to facilitate an understanding and evaluation of the full nature and extent of the financial affairs and resources for which the Government is responsible”. The notes to the Summary Financial Statements also include summaries of compliance with spending and borrowing limits. In addition, general statements of compliance are contained in the Preface to the Financial Statements of the Government of Canada and the Statement of Responsibility by the government.

2.26 Unlike the auditor’s requirements for Crown corporations (see below), there are no specific requirements under the *FAA* or the *Auditor General Act*, to include any statement in the Auditor General’s opinion on the Summary Financial Statements on compliance with authorities. Nevertheless, given the fact that the Auditor General’s opinion on the statements extends to the appended notes, given the role of the Office as legislative auditor, and given the representations of management in the statements related to compliance, the authorities component is an integral part of the audit of the Summary Financial Statements of Canada. Accordingly, the audit reflects compliance with spending, borrowing and revenue authority considerations.

Compliance with Authority — Crown Corporations

2.27 Federal Crown corporations named in Schedule III of the *Financial Administration Act*, and their wholly owned subsidiaries, are important vehicles through which the government meets public policy objectives. Public ownership, together with their public policy orientation affects their accountability, management and control requirements. These entities are subject to the provisions of Part X of that *Act* insofar as accounting, auditing and reporting matters are concerned. These provisions require the auditor to express separate opinions on: the fairness of the corporation’s financial statements in accordance with generally accepted accounting principles; whether the accounting principles were applied on a basis consistent with that of the preceding year; and whether the transactions that have come to the auditor’s notice in the course of the audit are in accordance with specified authority instruments. These instruments are: the requirements of Part X of the *Financial Administration Act*, associated regulations, the charter and by-laws of the corporation or subsidiary, and any directives given to the corporation by the Governor in Council.

2.28 Compliance with authorities is not limited to the financial transactions in the narrow sense, but rather covers any activity for which the entity is responsible, such as the preparation of the corporate plan. In addition to this, the auditor’s understanding of the entity’s business and legal framework may cause him or her to become aware of situations or transactions that could infringe other Canadian legislation. It is important for the auditor to assess such transactions for their possible impact on financial statements and to consider them for reporting to the appropriate authority.

2.29 In the case of Crown corporations, instances of non-compliance that are considered significant must be reported to the appropriate minister in accordance with the relevant subsections of the *FAA*. Once reported, they become candidates for inclusion in an Auditor General's periodic Report, generally as an Audit Note. Reporting in a periodic Report would normally only be made after the corporation's annual report is tabled in Parliament.

Compliance with Authority — Other Entities including Territorial Governments

2.30 Other entities on whose financial statements the Auditor General expresses a separate opinion include departmental corporations, territorial governments and corporations required by law to publish separate audited financial statements, and other entities.

2.31 The mandate and objectives for the audit of the financial statements of other entities, including territorial governments, will depend on the provisions of the legislation or Order in Council appointing the Auditor General. In all cases, it is important that the audit objectives established for the specific appointment reflect the role of the Auditor General as Parliament's (or a Territorial legislature's) auditor and the authorities dimension of legislative auditing.

2.32 The *Auditor General Act* requires the Auditor General to report any matters that she considers to be of significance or of a nature that should be brought to the attention of the House of Commons. Regardless of whether the specific annual audit mandate requires compliance with authorities reporting, we would include a description of any significant non-compliance we found in our auditor's report, and consider whether it should also be reported to Parliament.

"Other Matters"

2.33 Annual auditors also have a responsibility to be on the alert for, and to report, "other matters" falling within the scope of the audit that, in their opinion, should be brought to the attention of Parliament. The *Financial Administration Act*, the *Auditor General Act* and professional assurance standards collectively permit the Auditor General to report such "other matters". In recent years we have reported "other matters" dealing with issues such as transfers to foundations (2001 Public Accounts), the growth of the accumulated surplus in the Employment Insurance Account and the funding of the Parc Downsview Park (a subsidiary of Canada Lands Corporation).

2.34 "Other matters" are *not* reservations of opinion, but are reported in accordance with the requirements set out in Section 5701 of the CICA Handbook (Assurance) – Other Reporting Matters. Accordingly, "other matters" identified during annual audits are reported in a separate paragraph of the auditor's report following our opinion. In addition to the use of our auditor's report, other reporting vehicles are often used to help ensure that Parliament is made aware of these “other matters”. These vehicles include: our *Reports to Parliament (Other Observations chapter)*, the *Auditor General’s Observations on the Financial Statements of the Government of Canada*, and our *Report on Other Matters* to the territorial legislative assemblies.

2.35 Determining whether or not a potential “other matter” should be reported requires professional judgment and consultation. The overriding characteristic of all “other matters” is **significance to Parliament**. The Office’s VFM Manual (paragraph 4.34) indicates that “*identifying matters of significance . . . involves answering the following types of questions:*

- *Does the subject have an important impact on results?*
- *Is it an area of high risk?*
- *Does it involve material amounts?*
- *Does it have the potential to result in improved performance, accountability or value for money? Will it make a difference?*
- *Is it an issue with visibility or of current concern? Is it of interest to Parliamentarians and Canadians?”*

ANNUAL AUDIT POLICY

All annual audits conducted by the Office should include specific and appropriate consideration of the existence of both significant non-compliance with authorities and “other matters”.

Audit Team Roles and Responsibilities

2.36 Auditing involves a team effort in pursuit of the goal of an efficient, effective annual audit that satisfies our terms of engagement, meets Parliament’s and other stakeholders’ needs and complies with professional standards and Office policies.

2.37 “Teamwork” is a broad concept that generally refers to coordinated efforts by a group of people working together for a common cause. Teamwork in this Manual refers to efforts undertaken by the audit team.

The Audit Team

2.38 The ***audit team*** is generally comprised of the following individuals. On smaller teams, not all of the staff levels listed below will be members of the “audit team”:

- The entity Principal;
- Director;

- Audit Project Leader;
- Audit professionals;
- Member(s) of the Information Technology group;
- Audit trainees working toward a professional accounting designation;
- Other Office staff, including support staff, summer students, co-op students and others;
- In some instances, external specialist(s); and
- Depending on the circumstances, the responsible Assistant Auditor General may operate as a member of the audit team and oversee the work of the team.

Successful Audit Teams

2.39 A successful audit team will have the following characteristics:

- The knowledge, skills, and expertise necessary to successfully complete the audit;
- Independence and objectivity;
- A commitment to each other to support an environment where coaching, review by interview, information sharing, and ongoing communication are the responsibility of everyone; and
- A commitment to executing the audit plan in an efficient and effective manner.

In simple terms, what the Office strives to achieve in building audit teams is:

Doing the right work;

Doing it with the right people; and

Doing it right the first time.

Roles and Responsibilities – Audit Team

2.40 The following discussion outlines the principal responsibilities of the various members of an audit team. It is important to recognize that, although different teams may have different staff complements, in every team there are basically 3 levels of staff:

- Engagement manager;
- Team leader; and
- Team member.

2.41 Engagement managers (generally the Principal and Director) – have primary responsibility for strategic planning, resolving issues with the client and recommending the nature of the audit report to be given and the content of communications with the entity. The general responsibilities of engagement managers include:

- Personal involvement and leadership in the completing the Entity Risk Analysis. In particular, identify significant business risks to the entity and those with the potential of having a significant impact on the entity's financial statements;
- Engage IT audit specialists and others as required in preparing the audit plan;
- Personal involvement and leadership in developing the strategic plan for the audit, including assessing the identified risks and developing appropriate audit procedures to address the identified risks;
- Develop an audit strategy that is controls-reliant to the extent possible and practical;
- Where appropriate, identify areas where an audit entity can take steps to improve its internal controls and promote a more controls-reliant audit in the future;
- Provide input and direction into the development of communications with the entity and the audit committee;
- Ensure that the members of the audit team are independent and objective;
- Ensure that collectively, the audit team possesses the required competencies (capabilities, knowledge and experience) necessary to successfully perform the audit;
- Review all key risk sections of the audit file;
- Review "by interview" and encourage others to do so;
- Approve all key decisions in executing and reporting the audit including the disposition of advice received from internal and external specialists;
- Review the audited financial statements and ensure that, in his/her opinion, they comply with appropriate standards;
- Promote teamwork and the conduct of an efficient, effective audit;
- Participate in team meetings and share information that is significant to the work of other team members;
- Build relationships and represent the Office with senior entity officials;
- Evaluate staff performance and provide developmental feedback; and
- Finalize the final TeamMate file for submission to Records.

> **ANNUAL AUDIT POLICY**
>
> **The audit team should include a Director who is a qualified accountant where a non-accountant Principal has been assigned responsibility for an attest or Public Accounts audit. (May 2005)**

2.42 Team leaders (generally the APLs or senior, experienced audit professionals, and occasionally Directors) – have primary responsibility for ensuring that the strategic plan, as outlined in the Strategic Approach Summary, is executed as intended, supervising and coaching staff and resolving day-to-day audit management issues. The general responsibilities of team leaders include:

- Personal involvement and leadership in the development of the detailed audit plans for individual sections of the audit;
- Resolve audit issues as they arise, working with staff, the client and the engagement manager(s) as necessary;
- Draft internal and external communications, including Reports to the Audit Committee, Management Letters, and the Report Clearance Summary;
- Ensure that the detailed audit plan is executed in accordance with the direction set out in the strategic plan;
- Assign staff to audit tasks in a manner that matches their capabilities with developmental opportunities and personal interests;
- Oversee development of tailored audit programs to make them more efficient and relevant to the specific entity, including the use of tailored analytical procedures;
- Day-to-day management of the audit including “on-site” supervision of audit professionals and others;
- Ensure that junior staff understand the work they are responsible for, the audit procedures they will execute and when they are expected to be completed;
- Coach team members on an ongoing basis and resolve minor audit issues as they arise;
- Keep the engagement manager(s) apprised of any significant audit issues;
- Assist the engagement manager(s) in analyzing significant audit issues and propose strategies to address them;
- Review “by interview” on a real-time basis;
- Ensure the detailed audit programs are executed properly;
- May execute the audit program for high risk areas requiring a significant degree of management judgment or estimates, or that involve complex transactions;

- Ensure that key audit documents such as legal letters, the management representation letter, the list of required client-prepared schedules, and confirmations are prepared on time and in an accurate manner;
- Lead by example in terms of coaching, listening, supporting, assisting and establishing collegial and inclusive working relationships;
- Participate in team meetings and share information that is significant to the work of other team members;
- Regularly monitor the status of the audit, hold progress meetings with the client;
- Provide input to the engagement manager(s) in evaluating the performance of staff;
- Ensure that staff replicate their work regularly in order to keep the TeamMate entity Master file up-to-date and prevent the loss of the work performed to date; and
- Maintain control over the TeamMate entity Master file.

2.43 Team members (APLs, audit professionals, students and occasionally support staff) – have primary responsibility for completing individual sections of the audit assigned to them, and working closely with team leaders in order to ensure they achieve the intended objectives with their work. The general responsibilities of team members include:

- Execute one or more audit sections in accordance with the detailed audit program;
- Seek guidance and direction from the team leader(s) or the engagement manager(s) when audit issues are identified;
- Keep the team leader(s) and/or the engagement manager(s) informed on a regular basis of the work being undertaken, audit findings, overall progress, any constraints or difficulties being encountered and other relevant information;
- Identify opportunities to improve the audit approach or specific audit procedures;
- Document the work performed efficiently and effectively in accordance with Office policies, including documentation of “exceptions”;
- In some cases, supervise one or more team members, including audit trainees and/or other staff;
- Ensure that staff they are supervising understand the work they are responsible for, the audit procedures they will be executing and the planned completion date;
- Make every effort to facilitate coaching and review “by interview” with the direct supervisor and/or with those being supervised;
- Participate in team meetings and share information that comes to the team member’s attention that is significant to the work of other team members;

- Maintain sound professional relationships with the client; and
- Make the engagement manager(s) aware of any real or potential conflicts of interest that could threaten the actual or perceived independence of the auditor.

2.44 It is important to note that staff may fill different roles for different aspects of the audit. For example, an auditor may have responsibility for more than one section of the audit file and may have supervisory responsibilities for one of those sections. In this example the auditor will perform some elements of the role of team leader for the section where he/she is supervising the work of another staff member and will assume the role of team member for those sections where she/he has sole responsibility.

2.45 **Responsible Assistant Auditor Generals** for audits where the Auditor General signs the Auditor's Report or has delegated signing authority to the responsible Assistant Auditor General:

- Participate in, and approve, the Entity Risk Analysis, comprising the information in the Entity Risk Analysis folder of TeamMate;
- Approve the strategic plan for the audit, comprising the information included in the Strategic Approach Summary folder in TeamMate;
- Approve key reporting documents, comprising the information in the Report Clearance Summary folder of TeamMate;
- Review significant communications with the entity and with the Audit Committee;
- Attend selected meetings of the Audit Committee and interviews with senior members of the entity and stakeholders;
- Build relationships and represent the Office with the most senior entity officials and the Chair of the Audit Committee.
- Audit Principal - the Principal is responsible for planning, conducting and reporting the audit. In some cases, the audit Principal has been delegated signing authority and will assume some of the responsibilities of the Assistant Auditor General for those audits.

Role of Information Technology (IT) Audit Specialists on the Audit Team

2.46 Under the Office's annual audit methodology, the IT Audit Specialists are integral members of the audit team, whose primary responsibilities are to:

- Assist the entity Principal in identifying and evaluating strategic IT risks in the organization as part of the Entity Risk Analysis;
- Assist the entity Principal in understanding the entity's information and accounting systems, and determining the nature and extent of controls reliance that is feasible in the entity;
- Test the "general" computer controls in situations where reliance on application controls is desired; and

- Work with other team members in the design, execution and evaluation of tests of controls, including application controls and management and monitoring controls.

2.47 The extent of the IT auditor's involvement will depend upon the nature and extent of planned reliance on controls and the complexity of the audit entity's IT systems and business cycles.

ANNUAL AUDIT POLICY

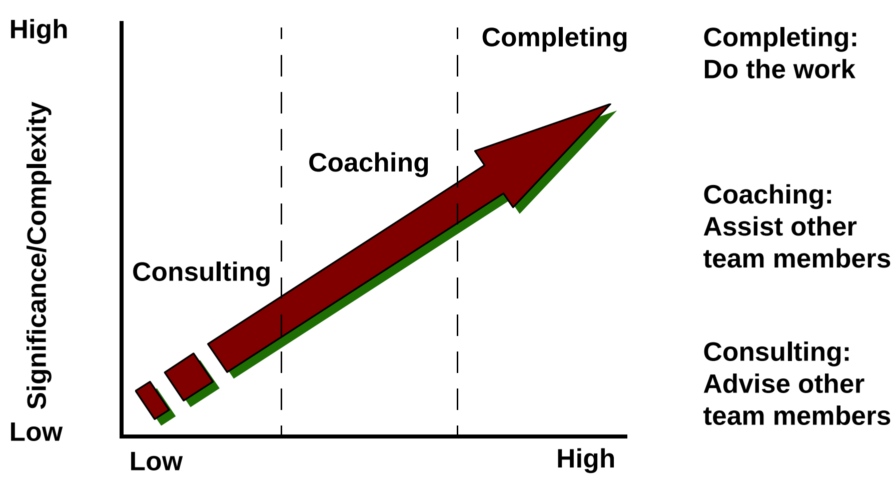
The audit Principal should ensure that the audit team has members with sufficient specialized information technology knowledge and audit skills. An Information Technology Specialist is member of the audit team for all entities with Enterprise Resource Planning or other significant computer systems.

2.48 When a reliance on controls approach is envisaged for a key business cycle, or when there have been significant changes during the year in the audit entity's systems or business cycles ("year of change"), the role of the team member with specialized IT knowledge and experience (the IT auditor) will be more significant. The IT auditor's involvement will increase in planning the audit and in documenting, assessing and testing general computer and business cycle controls.

2.49 As shown below, the level of this involvement correlates with the significance or complexity of the audit entity's computer systems and business cycles.

2.50 A complex system is one that requires an in-depth knowledge of computer environments due to factors such as complex transaction flows or processing, automated controls, complex computer hardware or software, client developed or modified software, or complex calculations.

LEVEL of an IT AUDITOR'S INVOLVEMENT



2.51 Factors that would suggest complex computer systems include the following:

- high volume of transactions;
- complex calculations being carried out by systems;
- significant computer generated transactions;
- electronic commerce, EDI or internet enabled applications;
- complex interfaces between key business cycles and related applications; and
- Enterprise Resource Planning systems (e.g. SAP, Oracle Financials, PeopleSoft, J.D. Edwards).

2.52 The decision on whether or not the system is complex should be approved by the audit Principal, in consultation with the Director and the IT audit specialist team member.

2.53 The table below summarizes the main IT-related tasks and recommended approach for the use of IT auditors.

Controls reliant approach for a key business cycle				
Complex systems			Less complex systems	
Recommendations on when to use IT Auditors	**Auditors**	**IT Auditors**	**Auditors**	**IT Auditors**
Gather and update systems information and Mapping	Complete Mapping	Complete IT environment	Complete	Coach
Decision on planned reliance on controls for various key business cycles	Complete	Consult	Complete	Consult
Document, assess, select and test general computer controls	-----	Complete	-----	Complete
Document and assess monitoring controls	Complete	Complete and Coach	Complete	Consult
Document and assess business cycle controls	Complete	Complete & Coach	Complete	Coach
Select and test key business cycle controls	Complete	Complete & Coach	Complete	Coach

2.54 For complex systems where a controls reliant approach for a business cycle is adopted, a combined team of financial and IT auditors should perform the various controls-related tasks. An IT auditor should do the work on general computer controls. For other IT related tasks in less complex systems, the generalist financial auditors should do the work, under the direction and advice of the IT auditor.

External Specialist(s)

2.55 In some audits it may be necessary to contract externally for specialized knowledge, skills and experience (e.g. professional actuary). The responsibility to identify the need for external specialist knowledge, and to obtain the services of the specialist, rests with the entity Principal. The specific responsibilities of the external specialist will normally be defined by the contractual relationship with the Office. The entity Principal is responsible for the quality of the work of the external specialist, for the proper evaluation and application of the specialist's findings and for complying with CICA standards on use of a specialist.

Internal Specialists

2.56 In any given annual audit, there may be wide variation in nature and extent of consultation with ***internal specialists***. These individuals contribute directly to the success of the audit team by providing knowledge and expertise in areas that may be specialized, complex, contentious or unusual. These individuals are not members of the audit team *per se*, but assist the team in ensuring that its audit objectives are achieved. For annual audits, the following internal specialists are frequently consulted:

- **Annual Audit Practice Team (AAPT)** members provide advice on the Office's assurance methodology and on technical accounting matters for all annual audits;
- **Section 6 Team** members provide advice of a methodological or technical accounting nature relating to the audit of the Summary Financial Statements of the Government and/or audits of departmental financial statements;
- **Legal Services** provide legal opinions;
- **The Financial Instruments** Team (similar role to AAPT role above) provides advice of a methodological, technical accounting or management control practices nature in relation to managing and reporting financial instruments; and
- Other specialists.

Delegation at the Team Level

2.57 Delegation of audit responsibilities at the audit team level is the responsibility of the audit Principal. In addition to the audit risk associated with an engagement audit Principals should consider two other broad categories of factors in determining the appropriate degree of delegation and the assignment of responsibilities to team members. These are:

- Parliamentary interest; and
- Office internal factors.

2.58 Audit entities may attract the attention of Parliament for a variety of reasons. This interest could arise from:

- legislative changes affecting the entity;
- matters raised during "Question Period";
- letters to the Office from Members of Parliament;
- media attention; and
- partisan debate.

2.59 In general, the greater the Parliamentary interest in an entity, the greater the risk to the Office.

2.60 There may also be factors internal to the Office that could affect the degree of delegation in the engagement. These include:

- significance of planned changes in the audit approach;
- experience of the team;
- continuity of staff;
- tightness of reporting deadlines; and
- availability of specialists, where required.

2.61 Where a number of these factors are present, it may be appropriate for the audit Principal to modify his/her approach to delegation. For example, the presence of factors indicating higher risk to the Office would suggest the need for such actions as:

- increased involvement by the Principal and the responsible Assistant Auditor General in key aspects of the audit;
- more extensive consultations with internal and/or external specialists; and/or
- assembling a more senior and experienced audit team.

2.62 Conversely, the presence of conditions suggesting lower risk to the Office may indicate there could be increased delegation to more junior staff; and/or less involvement with consultants and/or specialists. For example, in lower risk engagements the following actions might be appropriate:

- the responsibilities normally assigned to the audit Principal could be delegated to an experienced Director;
- the degree of involvement by the Principal in key aspects of the audit could be reduced; and
- the responsibilities normally assigned to a Director could be delegated to an experienced audit professional (AP).

2.63 The audit Principal would normally ensure that significant changes in his/her assessment of the audit risks associated with the engagement are discussed with the responsible Assistant Auditor General. Significant increases or decreases in the perceived risk to the Office should be communicated to the Product Leader, Annual Audit, and their impact, if any, on the Office's Delegation of Signing Authority discussed.

Delegation of Signing Authority

2.64 The Office has a formal Delegation of Signing Authority document that identifies who will sign annual auditor's reports, whether a Quality Reviewer has been assigned to the audit and the nature of the review of financial statements to be performed by the Annual Audit Practice Team. The Delegation of Signing Authority document is updated periodically, and is available on the Annual Audit INTRAnet site.

Roles and Responsibilities — Quality Assurance Services

2.65 There are three ***quality assurance services*** that support the Office's quality management system. The first two are involved prior to the completion of the audit, while the latter generally takes place post-completion of the audit:

- AAPT;
- Quality Reviewer; and
- Practice Review.

2.66 The AAPT provides assurance to Office signatories that the Auditor's Report is appropriate, the entity's financial statement presentation is in accordance with professional standards and that the Office adopts similar positions and practices in relation to common issues across its portfolio.

2.67 Quality Reviewers are appointed for audits generally associated with higher risk to the Office. Quality reviewers provide an independent and objective perspective to the audit Principal or AAG by considering whether the team has followed a sound process for identifying "business risks", that the audit strategy for addressing those business risks that have financial statement implications is reasonable, that significant issues have been addressed properly, that communications to the entity and to key stakeholders are consistent with Office expectations, that the entity's financial statements appear to be consistent with professional standards and that the auditor's report is appropriate in the circumstances.

2.68 Practice Review fulfils two key roles within the Office. First, they provide assurance to the Auditor General that our annual audits meet professional standards and that the auditor's reports issued by the Office were appropriate in the circumstances. This work involves annually conducting post-audit practice reviews on a sample of completed audit files. Practice Review may also examine "horizontal" issues of interest to the Office's annual audit practice as a whole. Second, the Practice Review function promotes "continuous improvement" in our audit practices through reports, presentations, learning days and other means.

Sufficient and Appropriate Audit Evidence

General Considerations

2.69 The Strategic Approach Summary is intended to provide a high level roadmap as to the most efficient and effective strategy for obtaining sufficient appropriate audit evidence to support the auditor's report. The detailed audit programs, in turn, provide specific directions to audit staff regarding the nature and extent of audit tests to perform. Therefore, if the audit plan is executed as intended, the team should have acquired the requisite evidence.

2.70 In addition to the documentation standards required under generally accepted auditing standards, the Office has two additional requirements that all auditors should be aware of: the need for solicitor-client privilege letters to be sent before an audit begins; and compliance with the *National Archives of Canada Act*.

2.71 **Solicitor-Client Privilege Letters.** As a result of a court decision several years ago, federal entities are now requesting that the Office, prior to commencing any audit, send a letter to the deputy head of the organization informing him/her of the audit and stating that any information requested during the course of the audit will be pursuant to fulfilling our responsibilities under the *Auditor General Act* or the *Financial Administration Act*, and does not constitute a waiver of solicitor-client privilege. The Office has agreed to issue such letters under the signature of the responsible Assistant Auditor General, and the entities have agreed to formally respond in order to confirm our mutual understanding of the basis of such requests. Sample letters and guidance in relation to solicitor-client privilege letters are available on the Annual Audit INTRAnet site.

2.72 **National Archives of Canada Act.** With respect to compliance with the *National Archives of Canada Act,* there are two types of information created, received or used in an audit, regardless of their format (electronic or paper, visual or auditory). They are:

- Records that are kept to support decision-making; and
- Transitory information.

2.73 *Records* must be retained in our files, whereas, *transitory information* should be discarded as soon as possible after it is no longer needed. Generally, routine entity documents reviewed as part of our audit testing would be considered transitory as they are used to prepare a subsequent record in the form of a working paper or note to the file indicating the work or testing performed. A copy of an entity document would become a record if it supported an exception or issue, such as non-adherence to entity policies.

2.74 Additional "Guidance for Managing Audit Records in the OAG" is available on the Annual Audit INTRAnet site.

Responsibility

2.75 Audit plans are only as good as their execution. The auditor is responsible for documenting the nature, timing and extent of the work performed in executing the plan. The auditor is also responsible for concluding on the results of their work. Proper supervision and coaching help ensure that the audit objectives have been met and that a quality audit has been achieved. This is confirmed through file review and other corroborative means. The audit Principal and the individual managing the audit are responsible for ensuring that sufficient appropriate evidence is obtained to support the content of the Auditor's Report.

ANNUAL AUDIT POLICY

The audit Principal and the individual managing the audit should ensure that there is sufficient and appropriate audit evidence to support the content of the Auditor's Report.

2.76 For the annual audit of the Public Accounts of Canada, the Public Accounts team relies on the work performed by the entity teams. Entity teams are responsible for ensuring that there is sufficient and appropriate audit evidence to support the content of the Reporting Package provided to the Public Accounts team.

Documentation Standards in TeamMate

2.77 The execution of an annual audit must be documented in a manner that complies with generally accepted auditing standards, which requires the work performed and any related findings to be documented in the audit file. The nature and extent of working papers in the audit file is a matter of professional judgment, however, the audit staff should be guided by the following documentation principles:

- provide evidence essential to support the Auditor's Report;
- provide a record of the key planning decisions and information that clearly illustrates the nature, extent and timing of audit procedures performed, the results thereof and the conclusions drawn from the audit evidence obtained;

- record sufficient information in order that the work could be re-performed, but no more than necessary;
- maximize the use of descriptive tailored audit programs, which become the record of work done and minimize documentation requirements;
- use the "Results" field for the majority of the documentation needs;
- create separate working papers only where necessary (for example: high risk areas, audit work based on entity prepared schedules, best presentation of a large body of information);
- avoid putting copies of entity documents in the file, in cases where they can be described in sufficient detail that they could be re-obtained from the entity;
- use scanners on an exception basis to capture client documents electronically;
- emphasize face to face communication among team members to clarify expectations, streamline documentation and facilitate review;
- deal with issues as they arise in order to encourage documentation of only the most important issues; and
- document issues, including "Exceptions", only once in the audit file.

2.78 The nature and extent of documentation is not dependent on audit risk and selected audit strategy (i.e. the degree of controls reliance); rather it is more dependent on the nature of the testing and the related findings.

2.79 Overall, the documentation should be based on the **re-performance principle.** Under the re-performance principle, the audit procedures are documented with sufficient detail (where possible, within the audit program), to enable a user to understand what evidence was obtained, how it was acquired and, if necessary, re-perform the steps using documentation retained by the entity.

2.80 During the team planning meeting, the team should agree upon common working practices, including documentation techniques unique for the engagement; for example, how lead schedules will be documented and included in the working papers, the nature of issues that should be tracked as "Exceptions", use of entity prepared schedules, how time will be tracked, and what will be maintained within the electronic audit file and what, if any, in a paper audit file. To the extent possible, the audit team should obtain documentation from the entity in electronic format.

Audit Programs and Audit Findings

2.81 Tailored audit programs are the key to documentation of sufficient, appropriate audit evidence within the electronic audit file. The "Audit Step" field should specify the work to be performed. The objective and the related financial statement assertions should also be specified in the appropriate field for each audit step.

2.82 The “Results” field should be used to summarize completion of the work performed. This may include a list of transactions reviewed if this information is not documented on a separate, linked working paper, in order to meet the re-performance principle. Copies of entity records should not ordinarily be retained in the working papers unless one of the following conditions exists:

- The entity does not have a reasonable document retention policy that covers the documents or records referred to;
- There is a known issue or an area that involves a question of judgment or principle;
- The computerized system does not retain the details of transactions examined or reviewed;
- There is concern that a document or record (in electronic form or hard copy) may be amended or altered; and/or
- It is a record under the National Archives of Canada Act.

2.83 The information recorded in the “Background” field is carried forward when the file is rolled over for the next year’s audit. Therefore, this field may be used to record information that would assist in the understanding of the audit step and that does not change significantly from year to year. For example, this field may be used to record descriptions of relevant systems or control procedures, key entity contacts, or information regarding the nature of the items examined.

Exceptions

2.84 Significant issues should be documented as “Exceptions” and linked to the appropriate audit step(s). To avoid unnecessary documentation and ensure timely resolution, team members should discuss the issue with the project leader, audit Principal, or Director prior to documenting a finding as an “Exception”.

Hard Copy Information

2.85 With the implementation of electronic working paper files, hardcopy working papers should be kept to a minimum.

2.86 In some instances, a small paper file will be required to store original copies of key documents not available electronically. The paper file could be used to retain critical documents such as the final signed financial statements, the management representation letter, the legal letter(s), and any third party confirmations.

2.87 In other cases, the audit team may chose to scan key hard copy documents into the electronic file. Discretion should be exercised when scanning documents due to the excessive amount of file space required by these images, which considerably slows the replication performance of the file. For lengthy documents, the audit team should endeavor to identify key pages to be scanned.

2.88 Copies of draft correspondence and documentation including draft financial statements should not generally be placed on the audit file. The audit file should contain only final documentation. Draft documentation (e.g. draft financial statements) should only be retained in either the electronic or paper file where this is necessary to evidence the performance of audit procedures or the reaching of audit conclusions (i.e. a "record" under the *National Archives of Canada Act).* Wherever possible, such procedures should be documented on a separate working paper rather than on draft documents in order to reduce the need to incorporate a large number of such documents into the file.

ANNUAL AUDIT POLICY

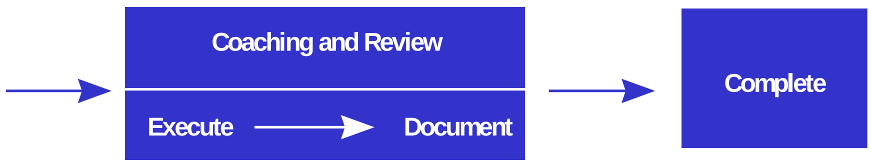
Information should only be retained in the audit file that is essential to: describe the formulation of the audit plan; explain the nature, extent and timing of the audit tests and other procedures to be performed; describe the results of the auditor's tests and his/her conclusions thereon; and comply with the *National Archives of Canada Act.*

The level of detail retained in the audit file should sufficient to enable re-performance of the tests and procedures performed.

TeamWork — Briefing, Coaching and File Review

2.89 Generally accepted auditing standards require the work of assistants to be properly supervised. The CICA Handbook states that supervision consists of "*determining by such means as observation, discussion and review whether the work carried out by assistants is properly executed*". Accordingly, audit work must be reviewed to ensure that it has been performed in accordance with the approved plan, that the work has been adequately documented, and that findings and conclusions are appropriate and any contentious or complex issues have been properly resolved.

2.90 To meet this GAAS requirement, the annual audit is conducted using a "team-based" process characterized by real-time coaching, periodic team update meetings and "review by interview". This process may be depicted as follows:



2.91 Supervision is an important aspect of quality management. It should be characterized by "real-time" supervision and coaching that builds in quality as the audit unfolds. Using coaching, briefing and "review by interview" techniques, auditors should receive levels of supervision and coaching appropriate to their skills and experience. It is the responsibility of the audit Principal to ensure that all team members receive timely and appropriate direction and supervision.

2.92 Verbal interaction is an important tool for helping to ensure that audits are well conducted, and the audit should be characterized by continuous and ongoing communication between and amongst audit team members. The key elements of effective teamwork are:

- Briefing;
- Coaching; and
- Review by Interview

2.93 ***Briefing*** meetings embody a two-way communication process where less experienced staff are encouraged to think through the process both at the audit level (involving the whole team), as well as at the task level. Briefings should occur throughout the audit, starting with the team planning meeting during the initial stages of the audit, continuing with regular meetings throughout the fieldwork and concluding with a team debriefing meeting after the fieldwork is substantially complete.

2.94 The primary purpose of the team planning meeting is to discuss with team members the key audit strategy decisions involving business risk, other inherent risk and the preliminary audit strategy by business cycle. The team planning meeting is discussed further in Chapter 4 – Annual Audit Planning – Engagement Management.

2.95 Teams should meet regularly throughout the fieldwork to share information, to explain issues and to provide feedback on the progress of the audit. On larger engagements, this communication could take the form of, for example, weekly update meetings.

2.96 After the fieldwork is substantially complete, a team debriefing meeting is held for the whole team to provide feedback on all aspects of the audit, which promotes the philosophy of continuous improvement and provides an opportunity to evaluate the overall evaluation of audit performance.

2.97 ***Coaching*** involves an interactive discussion, one-on-one between a team member and his/her supervisor, where the individual being coached is encouraged to think issues through rather than merely following a set of instructions. Coaching occurs on an ongoing basis to assist staff in setting goals, evaluating issues, outlining options, determining action steps and performing the work. Coaching will often occur simultaneously with file “review by interview”. Coaching should be applied at all staff levels.

2.98 File reviews are an essential tool for providing quality assurance to the Office and for teaching purposes. The quality-related benefits of file review are maximized when the reviewer(s) concentrates on matters of significance, while its teaching benefits are maximized when feedback is timely. In order for both of these benefits to be realized, file reviews should be completed by an appropriately senior member of the audit team. File reviews by interview are encouraged because they promote timely discussion between the reviewer and the auditor, eliminate unnecessary queries and facilitate quick responses by the auditor.

2.99 In ***review by interview*** the reviewer ensures that all necessary work has been carried out and documented through effective questioning and probing. Instead of reviewing work primarily by reading the working papers, the team member and the reviewer/supervisor discuss the work carried out and the results achieved. Work should only be reviewed in detail once, unless it is a high risk area or issue. The overall review of the assignment by the audit Principal is likewise performed by discussion. Evidence of review of audit working papers should be indicated by electronic signature on the working papers and audit procedures summaries.

2.100 Coaching and review by interview are conducted on-site by the section supervisors, team leader, and from time to time, the audit Director and Principal. This on-site interaction results in better development of team members as well as more frequent interaction with entity personnel. In addition, documentation is streamlined as part of this process to reflect the professional requirement to comply with GAAS and to ensure the audit is as efficient and as effective as possible. Our objective of eliminating unnecessary documentation is dependent on the continuous and ongoing communication between and amongst all team members throughout the audit.

2.101 Coaching notes should be used sparingly. Examples of the appropriate use of coaching notes include: follow-up points jointly agreed upon as a result of a "review by interview" session, personal reminders or to-do lists, or lists of outstanding information from entity staff.

2.102 Coaching notes should not be used to document audit evidence. Audit working papers should stand alone as a record of work done in an audit. Any matters raised during the review/coaching process should be addressed and documented in the working papers.

2.103 The extent of file review is a function of audit risk and significance. Each file, however, would normally be reviewed by an individual more senior than the individual who prepared the file, and who possesses appropriate knowledge and experience in the areas subject to review. Only one level of detailed review is generally necessary for most audit areas. Two levels of detailed review are generally appropriate for higher risk areas.

2.104 Issues should be discussed with the team leader and the Principal/ Director, as appropriate, as soon as they are identified. This allows issues to be appropriately followed up, discussed with the entity and documented at an early stage of the process. Consequently, final review should not be a lengthy process, since the team leader, Director and audit Principal are already familiar with the issues.

2.105 The Information Technology (IT) audit Director may review the work of the IT auditors on the team, depending on the complexity of the IT Environment, the nature and extent of IT involvement and the arrangements with the audit Principal. The audit Principal and/or the individual managing the audit should ensure that they have a sufficient understanding of the IT-related aspects of the audit work performed, the results achieved and the conclusions reached.

2.106 Approval must also be obtained from the Assistant Auditor General (AAG) at key stages of the audit, except in those cases where authority to sign the Auditor's Report has been delegated to the audit Principal. Specifically, the responsible AAG must approve the strategic approach to the audit at the planning phase and the recommendation for signing of the Auditor's Report at the reporting phase. The responsible AAG will indicate approval by electronic review of the Strategic Approach Summary in the Annual Audit Planning folder, and of the Report Clearance Summary in the Reporting and Completion folder of the audit file.

ANNUAL AUDIT POLICY

The audit Principal should ensure that all working papers are reviewed, on a timely basis, by a qualified member or members of the audit team. The individual managing the audit should ensure that all coaching notes have been cleared and working papers updated upon completion of the audit.

The Audit of the Public Accounts of Canada

2.107 The annual audit of the Public Accounts of Canada is perhaps the largest annual audit in Canada. As such, it touches most entity teams in the Office. Therefore, it is important that there is an understanding of how this audit is managed and where general responsibilities lie.

2.108 The Public Accounts annual audit is the examination of the summary financial statements of the Government of Canada. The Office's primary reporting responsibility is to the House of Commons. The objectives of the Public Accounts annual audit are derived from the Auditor General's responsibilities set forth in Section 6 of the *Auditor General Act*:

> *"the Auditor General shall examine the several financial statements required by section 64 of the Financial Administration Act to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express [her] opinion as to whether they present fairly information in accordance with stated accounting policies of the federal Government and on a basis consistent with that of the preceding year together with any reservations [s]he may have."*

Managing the Audit

2.109 The Principal responsible for the Public Accounts team has been delegated responsibility for managing the annual audit of the Public Accounts of Canada. The Public Accounts team Principal is responsible for the overall planning, execution and reporting of the audit. For practical reasons, some of these responsibilities are delegated to entity Principals, who are responsible for those aspects of the Public Accounts audit touching the entities they have day-to-day responsibility for (departments, agencies, Crown corporations or other entities). The entity team Principals provide some of the evidence necessary for the Public Accounts team Principal to complete his/her work.

2.110 Exact roles and responsibilities are generally outlined in material supplied to the entity teams by the Public Accounts team. The primary source of this information is the *Central Strategic Plan for the Annual Audit of the Summary Level Financial Statements of the Government of Canada* on the Annual Audit INTRAnet site. Further information is available from the Public Accounts team Principal.

Methodology

2.111 The methodology outlined in this Manual applies to the annual audit of the Public Accounts of Canada. The Office policies included in this Manual were written from the point of view of managing a single audit engagement of one entity. Clarification on how Office policies apply to the audit of the Public Accounts of Canada has been provided throughout this Manual.

Communications with Audit Entities

General

2.112 Our auditor's report is typically addressed to one or more bodies such as the House of Commons (Public Accounts of Canada), the Legislative Assembly (Public Accounts of the Territories) or the Minister responsible for the entity being audited (Crown corporations and most other audit entities). However, senior management of the entities we audit and, where one exists, a body having oversight responsibility for the financial reporting process (such as an audit committee), are the parties we have most day-to-day contact with. These parties also have a direct interest in our work, and often are best suited to making use of the "value added" aspects of an annual audit, such as addressing control weaknesses or other matters of significance we may identify. It is important that they understand the annual audit process.

2.113 Communicating with entity senior management is one of the important responsibilities of the audit Principal. He/she should communicate the terms of the audit engagement, any matters of audit significance and the results of our work, to senior management and the body having oversight responsibility for the financial reporting process. This information should be provided to our clients in a timely manner.

ANNUAL AUDIT POLICY

The audit Principal should communicate with management of the audit entity and, where one exists, the body having oversight responsibility for the financial reporting process, at key stages of the audit including the planning and reporting phases.

2.114 It is important to ensure that the information conveyed is clear, succinct and meets the expectations and needs of those to whom it is addressed. Further, we must be sensitive to the fact that any written communication we have with management may be subject to requests under the *Access to Information Act.* Accordingly, it is appropriate to have all reports and other significant communication approved by the audit Principal and reviewed by the responsible Assistant Auditor General, unless authority to sign the Auditor’s Report has been delegated to the audit Principal. This review and approval should take place ***before*** it is given to the audit entity. Such approvals help ensure that our written annual audit products meet appropriate quality standards.

ANNUAL AUDIT POLICY

All reports and other significant communication with the audit entity (e.g. Reports to the Audit Committee, management letters and other important correspondence) should be approved by the audit Principal and reviewed by the responsible Assistant Auditor General, unless authority to sign the Auditor’s Report has been delegated to the audit Principal, before they are presented to the entity.

2.115 The Office is taking steps to make our workplace a more bilingual environment and to ensure important communications with our clients are available in English and in French. In accordance with this initiative, all official correspondence to our entities should generally be issued in both official languages.

ANNUAL AUDIT POLICY

All reports and other significant communications with the audit entity (e.g. Reports to the Audit Committee, management letters and other important correspondence) should be provided to the entity in both official languages.

Public Accounts

2.116 For the annual audit of the Public Accounts of Canada, the term “audit entity” in the above two policies has three possible meanings and the policies should be applied as follows:

- *a separate department, agency, Crown corporation or departmental corporation that an entity team is responsible for auditing.* The entity team Principal and the responsible Assistant Auditor General should communicate with these entities.
- *the Government of Canada, specifically the Treasury Board, the Department of Finance and the Receiver General for Canada who are jointly responsible for preparing the financial statements.* The Public Accounts team Principal and the responsible Assistant Auditor General should communicate with these entities.

- *the Public Accounts Committee (PAC).* The Public Accounts team Principal and the responsible Assistant Auditor General are responsible for drafting all communications with the PAC, which would be approved by the Auditor General before being finalized and delivered.

Consultation

2.117 An important element of every annual audit is the informal and formal consultation that takes place within audit teams and between audits teams and Office specialists. When dealing with complex, unusual or unfamiliar issues, audit teams are expected to refer to authoritative literature and/or seek the assistance of Office specialists with appropriate competence, judgment and authority.

2.118 It is also appropriate to consult in regard to more commonplace situations. For example, it is important that we strive for consistency, to the extent considered appropriate, in such areas as:

- terms of engagement with our audit entities;
- accounting policies for similar transactions;
- our expectations with respect to compliance with authorities and "other matters";
- Office positions on issues that are conceptually similar; and
- wording of auditor's reports that we issue.

2.119 Achieving this consistency across our audit practice, with its more than 120 separate opinion annual audits, is beyond the practical capability of individual audit teams. Consequently, we need to rely on individuals with specialized knowledge and experience in these and other areas. Working with these specialists is another aspect of consultation that is important in order to meet the expectations of our *Quality Management System*.

2.120 Informal consultation is also an important element of our practice. This affords teams the opportunity to discuss matters with colleagues having similar audit entities (e.g. pilotage authorities, territorial governments) and /or similar accounting or audit issues (e.g. downsizing, accounting for capital assets) and benefit from their experiences.

2.121 The same principles of consultation can and should be applied to the way staff interact on annual audit teams. Staff should apply the collective knowledge, skills and experience that is available on the team to best advantage in resolving minor difficulties and in completing the audit. Consultation between team members is advantageous not only for reaching sound conclusions, but also for staff development. In this regard, the knowledge and experience of the responsible Assistant Auditor General and, where one exists, the Quality Reviewer, are particularly valuable.

2.122 There are a number of specialists within the Office that, depending on the nature of the matter, should be consulted. The specialists most commonly consulted include:

- Annual Audit Practice Team;
- Public Accounts (Section 6) team;
- Information Technology Team;
- Legal Services;
- Financial Instruments team;
- Quality Reviewers; and
- Assistant Auditor Generals with relevant expertise.

ANNUAL AUDIT POLICY

The audit Principal should consult with internal and external specialists and senior Office staff, as necessary, when dealing with unusual, complex or controversial issues, or other matters requiring specialized knowledge or experience.

2.123 The specific circumstances that should lead to consultation with Office specialists, the expected timing of such consultation and the related Office policies are described in *Chapter 7 - Consultation*.

Differences of Professional Opinion

2.124 In any professional organization, differences of opinion may arise from time to time. These are normally the sign of a healthy organization where creative thinking and constructive challenge are valued and shared. The Office has a strong corporate culture of collaboration and consensus building which encourages these behaviours.

2.125 Occasionally it is not possible to reconcile diverging opinions on audit matters. These disagreements can exist at many levels of significance, for example:

- in an individual audit section, where there could be differences of opinion regarding, for example, what the key controls are or whether a transaction was processed incorrectly;
- at the component level, for example, whether the detailed audit program provides sufficient, appropriate evidence to allow the auditor to conclude on fair presentation and compliance with authorities;

- at the accounting policy level, for example, whether a particular accounting policy is consistent with generally accepted accounting principles; and
- at the audit report level, for example, whether the auditor's report should express an opinion without reservation.

2.126 As well, disagreements can exist between colleagues on the audit team, between the audit team and specialists consulted within the Office, and between the audit team and other internal and external advisors.

2.127 The Office has developed an approach that should be followed when resolving differences of professional opinion. These are:

- differences of opinion within the audit team should be resolved, where appropriate, through discussion led by the audit Principal;
- differences of opinion between the audit team and internal or external specialists should be resolved, where appropriate, through discussions led by the responsible Assistant Auditor General, aided by the Quality Reviewer, where appropriate; and
- differences of opinion that cannot be resolved between the team and specialists are referred to the Auditor General, as appropriate.

2.128 In all cases, the audit file should reflect the various professional considerations raised, alternatives considered and the conclusion reached. The documentation should be prepared by a senior member of the audit team and should present the relevant facts in a constructive, comprehensive and authoritative manner that avoids comments of a personal nature. Documentation should normally be done in the form of an "Exception" in TeamMate.

Access to Audit Files

2.129 Audit files are the property of the Office and the information they contain is not generally available to others. Audit files may contain sensitive information about the audit entity that needs to remain strictly confidential, for example, information involving solicitor/client privilege, or the entity's evaluation as to the collectibility of specific customer receivables. They also may contain information about our own assessments and evaluations of potentially sensitive accounting and auditing matters that could prove embarrassing if they were read out of context. Additionally, files could contain classified information requiring security clearance levels in excess of those seeking access. For these reasons and others, access to Office files is normally restricted to internal use.

2.130 Access to our audit files to external parties is normally provided only in the following circumstances:

- when a successor auditor has been appointed, or when a new joint auditor has been appointed. This is normal professional practice where the interests of the client are best served by full co-operation between predecessor and successor auditors. Before any access is granted, there should be a clear understanding, in writing, of the terms and conditions under which access is granted. Successor auditors would normally be supervised as they conduct their review work on our files;
- as joint audits are being conducted. In such arrangements, both auditors are jointly and severally responsible for the audit. It is normal practice for all key sections of the files to be reviewed by both sets of auditors to ensure there is sufficient and appropriate audit evidence to support the audit opinion;
- when our audit files have been subpoenaed as evidence in litigation. Our audit files can and have been used as evidence in cases of litigation. Legal Services would normally be responsible for providing the subpoenaed information as and when required;
- at the client's request. Occasionally our clients request access to our audit files. Typically this relates to requests from internal audit or from managers wishing to be provided with our descriptions of their accounting systems. In these situations, the audit Principal should attempt to provide the information required by the client through means other than review of our audit files; and
- for external inspections conducted by the provincial institutes of chartered accountants. In these cases, access is coordinated through the Professional Practices Group in Ottawa, and otherwise through the regional Principals.

2.131 The audit Principal is responsible for dealing with the question of access to audit files and for ensuring appropriate security practices are adhered to, should access be granted. Consultation with the responsible Assistant Auditor General and with Legal Services should be considered where circumstances warrant.

Guidance and Tools

2.132 The Office methodology as described in this Manual is supported by a number of other sources of audit software tools, additional written guidance, and other materials. A brief explanation of each of these is provided below:

Audit Software Tools

TeamMate	TeamMate is an electronic toolset used to document our audits. The “Library” file provides the basic audit file structure with mandatory audit steps for the Entity Risk Analysis, planning, execution and reporting phases of the audit.
TeamStores	TeamStores is a comprehensive data base of audit procedures. These audit procedures are available: for common financial statement components; for unique aspects relating to the audits of financial-type institutions; for testing internal controls; and for other purposes. These steps and any accompanying guidance are imported into the audit file when creating tailored audit programs for specific financial statement components of the audit.
IDEA	IDEA assists auditors in extracting and analyzing data from client files, as well as in the planning, extraction and evaluation of statistical samples.

Additional Written Guidance

Audit Guidance	Audit guidance has been developed to provide direction to staff in selected areas, usually relating to executing and reporting the audit. The guidance provided is more detailed than the material provided in this Manual. Examples of guidance available on the Annual Audit INTRAnet site include: Reliance on Application Controls, Reliance on Management and Monitoring Controls and Analytical Procedures.
Templates	These documents and forms assist the auditor in completing all phases of the annual audit. Templates include material such as standard confirmation letters, engagement letters, solicitor-client privilege letters, management representation letters and reports to audit committees (or equivalents). These templates are available on the Office’s Annual Audit INTRAnet site.
Public Accounts (Section 6) Area in the Annual Audit Intranet Site	This database is available through the Annual Audit INTRAnet site, and provides access to all guidance, tools and other specialized material applicable to the annual audit of the Public Accounts of Canada.

One Pass Planning (OPP)	The Advancing Audit Practices Project INTRAnet site (under "Audit") and the background tabs and attachments in TeamMate provide a wealth of guidance on OPP, including articles on risk management, reporting templates and guidance on completing and documenting a One Pass Plan.

Other Materials

2.133 Other more general guidance materials are available from the Knowledge Centre, while specialized guidance may be obtained through Office specialists.

3 *Entity Risk Analysis*

What is “Business Risk”?

3.1 The concept of “risk” in a business environment is not new. However, the manner and the level at which it is viewed has evolved in recent years.

3.2 “Business risks” are risks to the achievement of corporate objectives. Business risks result from significant conditions, events, circumstances or actions that could adversely affect the entity’s ability to achieve its objectives. “Business risk” is the term currently being used by assurance standard setters worldwide.

3.3 Business risk assessment requires an appreciation of the risks facing **the business** as a whole. This can be contrasted to the risks facing individual business units or branches within the organization – which traditionally were the focus of risk management.

3.4 Our approach to “business risk” assessment is “top-down” requiring that requires the auditor to first gain a strong understanding of the entity’s core objectives and strategies, and to then identify the key risks to achieving those objectives.

3.5 Is “business risk” analysis appropriate for a public sector environment? The answer is quite clearly “yes”! Since entities in both the private and public sectors have corporate objectives, we can apply “business risk” analysis in a public sector environment. At the same time, we have to recognize that in the public sector, objectives tend to be broader in nature, more citizen-focused, less well defined in terms of expected results and occasionally, in conflict with one another.

3.6 The management of risk has evolved significantly, primarily in recognition of the rapidly changing operating environment facing many organizations. The formulation of business strategies and objectives is now occurring within an environment which is dynamic, interconnected, technology-driven, global, borderless and increasingly competitive. Government operations and government business-type entities are subject to most, if not all, of these same dynamics.

Business Risk from an Auditing Perspective - Overview

3.7 The adoption of a business risk approach from an auditing perspective is characterized by:

- looking at the business through independent, neutral eyes;

- seeking to understand management's objectives, not just financial objectives, to achieving their organization's public mandate; and
- identifying the significant risks that may prevent management from achieving its business objectives.

3.8 The challenge to the auditor when applying a business risk approach **in an annual audit context** lies in assessing the potential impact of the identified risks on the fair presentation of the financial statements.

3.9 The "corporate-level" view of business risk is in stark contrast to the "micro" level of detail at which inherent risk, control risk and substantive risk are assessed in the detailed audit planning for individual financial statement components.

Knowledge of the Entity and its Business Environment

General

3.10 The Office's methodology seeks to obtain as much inherent assurance from knowledge of the entity and its business environment, as is prudent and practical. In order to do so, the Office relies on the audit Principal, and the Director, to maintain a high degree of knowledge about the entity and its business environment. Their combined cumulative audit knowledge and experience is the basis for building an appropriate level of understanding of the entity, its corporate objectives and the risks related to achieving those objectives.

3.11 The audit Principal and Director update their knowledge on a yearly basis for the annual audit, and in more depth on a cyclical basis for One Pass Planning. The annual update involves interviews with senior entity officials and reviews of relevant documents prepared by the entity and others. In OPP years, these interviews would generally be expanded to include external stakeholders and others, such as industry specialists. The update process helps the audit Principal and the Director identify and understand the areas of risk to the entity and, ultimately, to direct audit effort accordingly.

3.12 The Office's expectations in this regard are consistent with professional auditing standards. In particular, they are consistent with CICA Handbook – Assurance Section *5140 General Assurance and Auditing* (Financial Statement Audits) and Section *PS 6410 Public Sector* (Value-for-Money Audits), which require that the auditor obtain an appropriate knowledge of the entity's business subject to audit.

Meetings with Entity Senior Management and Key Stakeholders

3.13 The audit Principal and the Director should attempt to meet with the President, Deputy Minister, Chief Executive Officer/Chief Operating Officer (CEO/COO) and other senior officials such as Assistant Deputy Ministers, Vice Presidents, the Senior Financial Officer, and others as appropriate. This provides the audit Principal and the Director an opportunity to understand the views of those responsible for managing the business affairs of the organization. Specifically, the meetings should address the following issues:

- understanding the entity's business objectives;
- management's view on its significant business risks, and the steps taken to identify, manage and monitor the business risks it considers most significant;
- key elements of the entity's long-term strategic plan linking the entity objectives to the expected corporate results;
- organizational values and standards of conduct and how they are supported by corporate policies, guidance, monitoring and enforcement;
- the organizational structure and the corresponding assignment of responsibilities and how this helps the entity to carry out its business objectives;
- the risk tolerance of the organization – in terms of the types of risks they are prepared to live with; and
- such other issues as time permits (for example, the individual's views on the significance to the entity of: its audit and review function, its accountability measures, performance reporting to Parliament, human resources issues, compliance with governing authorities, environmental issues, the adequacy of its financial resources and the significance of information technology solutions to its long term objectives).

3.14 The responsible Assistant Auditor General should always be made aware of the interview schedule for senior executive interviews, so that he or she can attend those of interest.

3.15 A description similar to the illustration below would be used to document the mandate of the audit entity in the TeamMate file.

> **Illustrative Example**
>
> **Mandate - Federal Power Inc**
>
> Federal Power Inc. (FPI) was created pursuant to the *Federal Small Communities Power Security Act*. It is mandated to provide a source of reliable, affordable power to small communities throughout Canada to encourage economic development while respecting the culture and values of northern residents.
>
> The *Act* also establishes an independent Public Utilities Board (PUB) to regulate the activities of the FPI. The PUB is also responsible for setting energy rates that meet the objectives of the *Act* while allowing FPI to earn a modest return on equity assuming it operates efficiently.

3.16 The audit Principal and Director should also meet with other senior entity officials outside the finance area, as time permits. At a minimum, discussions/ interviews should generally be conducted annually with the following individuals:

- Head-Internal Audit
- Head-Human Resources
- Chief Information Technology Officer
- Integrated Risk Management Operations Officer
- Relevant Operational and Support Managers

3.17 The most senior member of the audit team with specialized IT knowledge and experience would normally accompany the group interviewing the entity's Chief Information Technology Officer. In entities with complex IT environments or where operations are heavily IT – dependent, it may be appropriate to have a senior member from the OAG Information Technology Group attend the interview as well.

3.18 Prior to conducting any meetings with senior entity officials and external stakeholders, the audit Principal and Director should familiarize themselves with the previous year's Entity Risk Profile and the risk factors contained in the Office's Generic Government Risk Model (described later in this chapter).

3.19 After interviewing these officials, the audit Principal and Director should have a broad, strategic understanding of the entity's operations, business lines and overall control environment. They should also be able to identify internal and external challenges, opportunities and risks; understand what steps are taken by the entity to address them; identify those risks that appear to be well managed, and identify those areas where major control weaknesses may be evident.

Reviewing Key Entity Documents

3.20 To complete their understanding of the entity's business and risks, the audit Principal and Director should review key entity documents, starting with the entity site on the Office's INTRAnet. At a minimum the following documents, if available, should be reviewed:

- Enabling Legislation;
- Other legislation the entity is responsible for administering/enforcing including international agreements;
- Relevant Regulations, Directives and key Treasury Board Decisions;
- Annual Business Plan (e.g. Corporate Plan, Report on Plans & Priorities, Strategic Plan, Sustainable Development Strategy);
- Minutes of the Board of Directors or Executive Management meetings;
- Entity's own Risk Framework;
- Selected Internal Audit reports;
- Key information from the entity's own public website; and
- Annual report/Performance reports.

Annual Business Plan

3.21 Most entities are required to prepare and document annual business plans. The entity's annual business plan (Corporate Plan/Report on Plans and Priorities) typically provides a wealth of relevant information. These plans, or some variant, are prepared annually by departments, agencies, Crown corporations and most other entities for which the Office conducts annual audits.

3.22 The Plan will normally describe the entity's assessment of the risks and opportunities of its business environment, as well as its strategies for dealing with them and achieving its statutory goals and objectives. For most entities, a review of its annual business plan should be considered an essential pre-requisite to developing the Entity Risk Analysis.

3.23 When reviewing the full Corporate Plan of Crown corporations, it is important to note that Office security practices require this be done on Corporate premises, and that normally the auditor would not retain a copy of the full Plan, even if it is appropriately secured. (Note: Security issues are also discussed in *Chapter 8 - Practice Expectations Common to all Product Lines)*

3.24 Another important document that should be reviewed for government departments and agencies is their Planning and Reporting Accountability Structure (PRAS). The plans and priorities of these entities, as well as their performance reports, are based their PRAS, which must be approved by the Treasury Board.

3.25 Interviews with senior officials and the review of key documents should allow the audit team to identify what are often referred to as the “expected corporate results”. Knowing the expected corporate results helps the audit team to clarify what the organization believes it needs to accomplish in order to achieve its mandate and corporate objectives. The “business risks” to the organization can often be easily derived from a sound understanding of the entity’s expected corporate results.

Illustrative Example

Expected Corporate Results - Federal Power Inc.

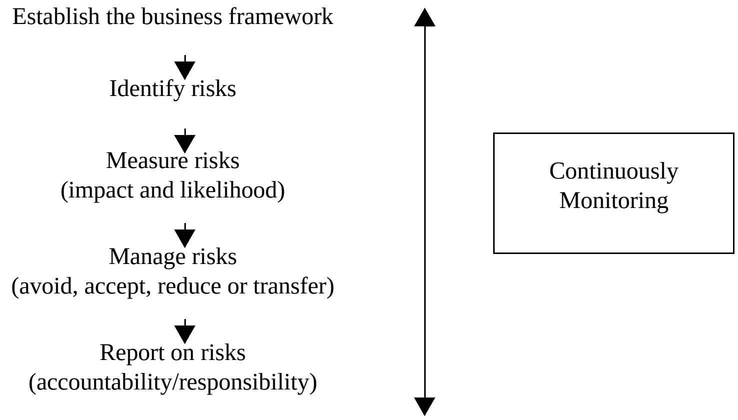
- Provide a reliable supply of energy to customers throughout the year;
- Operate efficiently to minimize the cost of energy to customers;
- Maintain steady, predictable energy rates that support economic growth and development;
- Respect the consultative and consensus-oriented culture of northern communities;
- Minimize the impact of power generation on the environment;
- Comply with all environmental laws;
- Provide a safe and stimulating work environment for employees;
- Encourage the responsible use of power and energy efficient practices by residential and industrial users; and
- Comply with directives and decisions of the Public Utilities Board.

Understanding the Entity’s Own Risk Framework

3.26 A risk framework is an integrated, structured approach to the identification and management of risk (including business risk). Its objective is to ensure that **all major risks** are identified and that a procedure is in place to continuously monitor the risk profile of the organization, to identify any changes in the entity or its environment that might require changes to risk management practices. Departments and agencies are required under Treasury Board policy to establish a risk framework.

3.27 A risk framework could go by a number of names and be made up of a number of components. Where a risk framework has been prepared by the entity, it will greatly assist the auditor in determining the business risks of the entity, identifying the mitigating controls to address those risks, and assessing potential financial statement impacts.

3.28 Generally speaking, a well-developed integrated risk framework exhibits the following characteristics (see the Treasury Board guidance on the development of an Integrated Risk Management (IRM) Framework):



Other Documents

3.29 Other documents may also be relevant and should be reviewed as applicable. Examples of other information that may contribute to a more comprehensive understanding of the entity's business and risks include:

- analyses of changes in the economic situation of the entity's clients or stakeholders;
- analyses of changes in the entity's major competitors and/or its key suppliers;
- significant economic developments affecting (or potentially affecting) clients and or stakeholders of the entity; both domestic and internationally;
- Parliamentary interest in the entity's operations;
- internal audit reports that have been issued in the year;
- the OAG's Environmental Petitions Catalogue and SD Strategy Commitments database; and
- newspaper or magazine articles related to the entity or its business.

ANNUAL AUDIT POLICY

Audit teams should only complete/update the Entity Risk Analysis after acquiring a sufficient understanding of their audit entity's business and the industry(ies) in which it operates to comply with the expectations of professional assurance standards and Office policies.

Documentation in TeamMate

3.30 It is not necessary to separately document the "key learnings" from each individual document or interview in the audit file. Recording the pertinent summary information in the Knowledge of the Entity Summary, the Entity Risk Profile, the Entity Control Profile and the Alignment of Business Risks with OAG Mandate Areas templates in the appropriate folders of the TeamMate file is sufficient. However the key issues identified from the review of the Minutes of the Board of Directors, Audit Committee and Executive Management Committee meetings should be carried forward and documented in the Annual Audit Planning folder of the file.

3.31 The audit Principal should consider retaining copies of key client documents and any additional analyses prepared by the audit team on the appropriate entity site on the Office INTRAnet.

Entity Risk Profile

General

3.32 The next step in completing the Entity Risk Analysis is to identify the risk factors that could have a significant impact on the entity's ability to achieve its objectives and meet its major stewardship responsibilities. In doing so, the auditor creates an "Entity Risk Profile".

3.33 Risk factors may be categorized in many different ways. One useful approach (although not the only one) is to think of risk factors in terms of *"opportunity", "hazard" and "uncertainty"*.

3.34 "Opportunity" risk refers to the implicit relationship between risk and return, and managing and capitalizing on the upside (for example, not realizing the benefits achievable through "Government On-Line"). "Hazard" risk refers to potential negative events such as financial loss or lawsuits. "Uncertainty" risk refers to the failure to react to events or information that is indicating action on the part of management is required, such as variances, (both positive and negative), between anticipated and actual results.

3.35 Risk factors often originate from sources that are *not* primarily controllable by the entity, but which may have a significant impact and to which the entity may (or may not) choose to respond/address. It is also helpful to consider the effects these factors may have on the entity's clients (for example the impact that shifting demographics will have on seniors' access to health care, or rules governing international trade).

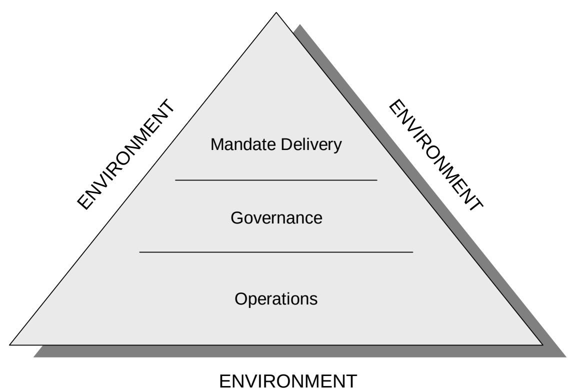
3.36 Individual entities will be affected by different combinations of risk factors. For example, policy organizations might have only a few "operational" risk factors, but many "governance" risk factors. Functional areas often must respond to risk factors that operate at a higher level, involving machinery of government and core values.

Generic Government Risk Model (GGRM)

3.37 A generic government risk model has been developed by Office practitioners to assist audit teams in identifying risk factors appropriate to their entity.

3.38 The Generic Government Risk Model incorporates information supplied by Office functional responsibility leaders, in a structure that corresponds to our statutory audit responsibilities for departments, agencies and Crown corporations. The GGRM provides audit teams with numerous risk factors we believe are applicable to our environment.

3.39 The GGRM is not an exhaustive listing of all possible risk factors. Based on Office's own cumulative knowledge and experience, it captures the most commonly encountered risk factors that can result in risk to the delivery of mandate, good governance, and operations.



3.40 The risk factors it includes provide a starting point for the development of an Entity Risk Profile. The risk factors in the GGRM represent events or circumstances that might be relevant to an entity and are intended as an aid to critical thinking. Individual entities may be subject to other significant risk factors not included on this generalized model.

3.41 Over time, more precise risk models are expected to be developed and made available to auditors.

3.42 In identifying the key business risks the auditor should be focused at a "strategic" level. Most organizations simultaneously manage numerous risks, and many of the risk factors in the GGRM could apply, in some way, to every entity. Focusing at too low a level could result in "failing to see the forest for the trees". It is important to identify only the **significant** risk factors appropriate for a given entity. This can be achieved by focusing on only those risks that have a high probability of curtailing the entity's ability to achieve key objectives and meet its major stewardship responsibilities.

Consultation with Specialists

3.43 Because of the pervasive impact of information technology on the operations of most of our entities, the IT specialist auditor on the team would normally be consulted in considering whether or not any specific IT-related business risk factors appear to be present in the entity. Other Office or external specialists may also be consulted, as considered necessary by the audit Principal. Office specialists include functional responsibility leaders, product leaders and subject matter experts.

Other Sources of Risk Factors

3.44 Other sources of information about risk factors are Internal Audit and external stakeholders. Discussions with these parties may provide additional insight into risk areas.

3.45 Other useful sources of potential risk factors may be industry publications and/or analyses performed by legislative auditors in other provinces/ countries.

How Many Risk Factors are Enough?

3.46 The number of significant risk factors identified will vary from entity to entity. As general guidance, the number could range between 5 and 20, but would normally be expected to be in the order of approximately 10 to 15.

Understanding the Entity's Control Environment

3.47 In order to comply with generally accepted auditing standards, the auditor is required to have an appropriate understanding of the entity's overall control environment. The control environment reflects management's philosophy, attitude and demonstrated commitment to establishing a positive atmosphere for the implementation and execution of well controlled operations. An understanding of the control environment is critical to making informed judgments about the broad level of risk of material misstatement in the entity's financial statements (or other performance information reports) and to assessing whether the entity's control environment appears to be conducive to a controls-reliant audit approach.

3.48 In other words, knowledge about the entity's control environment serves two purposes. It helps annual auditors assess whether a strategic approach based on reliance on controls is feasible. It also helps value for money auditors gauge control environment risk in developing potential lines of enquiry based on identified business risks.

Entity Control Profile

3.49 For all of our audits, we complete an assessment of the overall control environment in the entity. This assessment is documented in the Entity Control Profile folder of TeamMate. The results of this assessment are a key input in determining whether an audit strategy based on reliance on controls is appropriate. In making this determination the auditor should take a comprehensive, entity-wide perspective of controls.

3.50 There are fourteen principal control objectives that should be considered:

1) Organizational Objectives
2) Risk Management
3) Strategic Direction
4) Shared Values and Ethics
5) Organization and Responsibility (including the Board of Directors)
6) Audit and Review
7) Accountability Information
8) Reporting to Parliament
9) Human Resources
10) Corporate Assets
11) Compliance with Governing Authorities
12) Environment
13) Financial Resources
14) Information Technology

3.51 The nature of the information required to complete this profile document, though not highly detailed, requires the broad perspectives and insights of senior members of the audit team. The audit Principal should ensure that previous VFM, Special Examination and annual audit findings, as appropriate, are given due consideration when assessing each control objective.

3.52 To assist in the completion of the assessment of each control objective, a list of “consideration points” has been developed. These points are largely directed at the existence of high level management and monitoring controls. Most entities will not have, and should not be expected to have all of the suggested controls. The absence of some controls does not mean that a controls-reliant approach cannot be followed.

3.53 When making their assessment of the control environment, audit Principals should consider any mitigating factors for observed weaknesses, as well as the strengths noted. They should also consider the significance of the particular control objective in relation to the entity and its business. The audit Principal should ensure the key strengths, weaknesses and/or mitigating factors are documented in the Entity Control Profile. Teams are not expected to test these controls, or to provide assurance on their effectiveness. The assessments contained in the Entity Control Profile are to be based on the views of management and stakeholders, available documents and previous audit work.

Illustrative Example

Entity Control Profile – Corporate Assets Control Objective

Corporate Assets	**Reference to Previous Audit Findings:**
Management has established policies, practices and procedures that appear to provide assurance that corporate assets (financial and non-financial) are adequately managed (acquired, used, and controlled).	*This area was found to be well-managed in the last special examination.*

Preliminary View (Summary of interviews, documents reviewed, previous knowledge of the entity, assessment of control environment relating to the objective):

There are 4 key controls over the acquisition of major capital assets. These include an initial cost-benefit study, subsequent review and challenge by the Senior Management Committee, approval by the Board of Directors and agreement of the Public Utilities Board. Proposals to acquire generating and/or transmission assets must be based on a demand forecast study completed or updated within the last 12 months. Cost benefit analysis is done on a "life cycle costing" basis.

Long-term maintenance schedules are developed with a 20-year outlook, based on the life cycle costing assumptions underlying the cost-benefit study. These schedules are built into the annual corporate plans. Engineers visually examine all major generating/transmission assets annually, with comprehensive examinations every 3 years. The Maintenance Management System (MMS) prompts staff 1 month in advance of scheduled maintenance and records actual procedures performed and their costs. The MMS is updated, where necessary, following visual inspections.

Residual Risks Identified and Known Deficiencies:

The MMS does not "flag" high dollar repairs for review. There is a risk that significant maintenance costs should have been capitalized. The Comptroller's Office does not review these expenditures at year end.

3.54 Because of the pervasive significance of information technology to the management and control of operations, the information technology specialist team member should assist the audit Principal in completing the Entity Control Profile. Other specialists, generally internal, would be consulted as needed.

3.55 There are no specific guidelines to indicate when the overall control environment is significantly compromised due to identified weaknesses. As a result, the assessment of the quality of the overall control environment in the entity is a matter of professional judgment.

3.56 The Principal should assume that a controls-reliant approach is appropriate for annual audits, unless clear evidence exists to the contrary. Such evidence could include the existence of one or more of the following situations:

- pervasive lack of access controls in critical corporate operating and reporting systems;
- pervasive lack of management and monitoring controls throughout the organization;
- history of processing errors found as a result of our annual audit work;
- widespread disregard for spending authorities such as appropriations, votes or limits on major capital projects;
- widespread disregard for the protection of corporate assets (especially capital and technological); or
- history of senior management override of controls in financial systems.

3.57 If the audit Principal concludes that a controls-reliant approach is not possible, this conclusion should be reviewed by the responsible Assistant Auditor General.

Annual Audit Policy

The audit Principal should assess the entity's overall control environment and conclude whether it is conducive to a controls-reliant approach for the annual audit.

If the audit Principal concludes that a controls-reliant approach for the annual audit is not possible, this conclusion should be reviewed by the responsible Assistant Auditor General.

Alignment of Business Risks with OAG Mandate Areas

3.58 The goal of the Entity Risk Analysis phase of the audit is to identify the most significant business risks to the entity and map them to the appropriate Office mandate area(s). The resulting information is then used as:

- a basis for long-range entity planning, in a year where a One Pass Plan is required for departments and agencies, or for planning a special examination in a Crown corporation; and/or

- one of the inputs for the development of the strategic plan for an annual audit. In that case, the business risks deemed to be of significance to the annual financial statements of the organization, and those relating to compliance with authority, are considered in the development of the annual audit plan.

3.59 In order to identify the key entity "business" risk areas to carry forward, the auditor synthesizes the information and knowledge acquired in performing the previous steps of the Entity Risk Analysis.

3.60 Specifically, in making his or her judgments about the "business risks" to the entity, the auditor considers:

- the entity's mandate and objectives;
- the results it expects to achieve;
- risk factors that could compromise the achievement of the desired results;
- controls in place to assist in achieving the desired results;
- the cumulative knowledge and experience of the audit team; and
- past audit findings.

Illustrative Example

Identified Business Risks - Federal Power Inc.

- Price of diesel and natural gas to power generators;
- Weather (may affect delivery of diesel and/or water levels for hydroelectric generation);
- Economic dependence on a few large energy users (mining companies);
- Lack of interconnected power grid due to remote locations;
- Availability of qualified staff to work in remote communities;
- Uncertainty associated with a rate-regulated environment;
- Competition and/or alternative energy sources;
- Federal commitment to fund clean-up of environmental damage attributable to; periods prior to the creation of the Corporation;
- Credibility as a responsible and responsive organization with clients and stakeholders; and
- Self-governance aspirations of native people.

3.61 Principals are encouraged to validate the identified business risks with entity management. This does not mean, however, that the entity must agree with the team's assessments. In cases where entity management strongly disagrees with significant elements of the business risks identified by the team, the responsible Assistant Auditor General would be consulted. If the team intends to place the entity's business risks on the office's "entity site", then the team must obtain the approval of the client.

3.62 When the risk analysis is completed, the audit team would complete TeamMate template A.5.1 entitled "Business Risk Alignment" (see the example which follows). This template is designed to assist the auditor in mapping the identified business risks to the appropriate OAG mandate area(s). Our mandate areas for both departments and Crown corporations are grouped under five headings:

- Fairness of presentation of financial statements (Annual audits, including Section 6);
- Compliance with authorities;
- Value for money;
- Environment and sustainable development; and
- Performance information.

3.63 Relating business risks to the fairness of presentation of financial statements is an area requiring considerable judgment. Most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. However, not all such risks may represent risks of material misstatements in the current year's financial statements. Examples of some *general* conditions and events that, *if* linked to identified business risks, **may** indicate a risk of material misstatement include:

- operations in regions that are economically unstable;
- operations exposed to volatile markets, for example, futures trading;
- operations in an industry with a high degree of complex regulation:
- changes in the entity such as large acquisitions or reorganizations or other unusual events;
- installation of significant new IT systems related to financial reporting;
- complex processes related to accounting measurements;
- events or transactions that result in significant measurement uncertainty; and
- pending litigation and contingent liabilities.

3.64 Although it can be challenging to identify "business risks" to departments that are significant enough to lead to a material error in the summary financial statements of the Government of Canada, the following examples, using conditions and events identified above, illustrate how the concepts could be applied in practice:

Condition/Event Leading to "Business Risk"	Potential Implications to the Public Accounts of Canada
Operations in regions that are economically unstable may lead to loss of assets	*Loans to developing countries may not be collectible*
Funding cuts threaten a Department's ability to maintain its large inventory of capital-intensive assets (buildings, ships, infrastructure, etc.) in a functional state.	*Weak maintenance systems and practices may result in costly unplanned refits, shortened economic life and overvalued assets.*
Government indicates an intention to aggressively pursue the privatization and/or outsourcing of many operations.	*Estimations of the cost of the downsizing program(s) needed to eliminate redundant staff (buyouts, retirement incentives, etc.) may be understated or overstated*
Government admits full responsibility for the clean-up of all contaminated sites in the three territories	*Environmental management systems and practices may not be complete and/or accurate, resulting in inaccurate estimates of the liability for remediation costs.*

3.65 Auditors also need to be aware that there may be "business risks" that appear to be financial in nature, but whose real risks are in other Office mandate areas. A good example is "grants and contributions" programs, where experience has shown that VFM and compliance with authorities risks are very high, while financial risks are low.

3.66 Attention should be given to ensuring that all Office mandate areas are considered during the risk analysis process. In the past, entity planning focused primarily on value for money audit risks. However, under our current approach, the Office expects that *all* of our mandate areas will be given due consideration during the identification of key business risks, even though some may not turn out to be of strategic long-term interest at the time.

3.67 The relevance of an identified risk to an Office mandate area is not always readily apparent. However, it is important for the auditor to develop a clear rationale to justify the mapping. This rationale is essential to facilitate the development of the recommended audits (in the case of OPP) and to develop audit procedures to address the identified risks (in an annual audit).

Illustrative Example

Business Risk Alignment – Federal Power Inc.

Business Risk Description	**Alignment of Each Business Risk with OAG Mandate Areas**				
	Fairness of Presentation of Financial Statements	**Compliance with Authorities**	**Value for Money (Mandate delivery, E and E)**	**Sustainable Development**	**Performance Information**
Insufficient/ineffective capital asset maintenance and renewal practices	✓			✓	
Uncertainty associated with the outcome of regulatory hearings	✓		✓		
Limited storage capacity for diesel fuels			✓	✓	
Untested business continuity plans			✓		
Unexpected customer demands outstrip generating capacity			✓		
Lack of customer awareness regarding efficient use of energy			✓	✓	
Poor management of environmental liabilities				✓	
Failure to meet community expectations results in demands for “local” ownership/management			✓	✓	
Non-compliance with environmental laws and regulations		✓		✓	

3.68 A risk not considered significant in one year should not be precluded from consideration in future years. Since the Entity Risk Analysis is updated annually, a “watching brief” should be maintained on those business risks that could become significant in the future.

ANNUAL AUDIT POLICY

The audit Principal should approve the listing of the key business risks facing the entity and the mapping of those risks to the appropriate OAG mandate area(s).

The Entity Risk Analysis should be reviewed and approved by the responsible Assistant Auditor General, except in those entities where signing authority for the Auditor’s Report has been delegated to the audit Principal.

Updating the Entity Risk Analysis

3.69 The Entity Risk Analysis is not static – it should be updated whenever critical events take place that change the business risk profile of the entity, the way the entity manages and/or controls its risks, or that alter the mapping of identified risks to OAG mandate areas. The Entity Risk Analysis would also be updated should the auditor gain additional understanding of the entity that changes his or her assessment of its business risks or its overall control environment.

3.70 This reflects the principle that planning is an activity that continues throughout the audit, and that if circumstances change, then audit plans may have to change as well. For entities required to complete One Pass Plans, the impact of changes in the Entity Risk Analysis on the One Pass Plan should also be considered.

3.71 It is important to ensure that there is only one active Entity Risk Analysis being used by the entity team(s) at any given time. The Office wants to ensure that all audit products within a given entity are working from a common understanding of both the entity's "business risks" and its overall control environment.

4 Annual Audit Planning

Strategic Approach Summary

The Strategic Approach Summary is the first section encountered in the Annual Audit Planning module of TeamMate. It is a repository for key, summary-level strategic planning information.

General

4.1 The purpose of the Strategic Approach Summary is to capture, in one location, all of the key information and decisions underlying the development of the strategic approach for the audit. The audit Principal, the responsible Assistant Auditor General and where appropriate, the Quality Reviewer, review the Strategic Approach Summary.

4.2 The Strategic Approach Summary is intended to provide sufficient detail and rationale to guide the Director and the audit staff in the development of the tailored audit programs. It also provides summaries of the key business risks and other inherent risks that potentially could have a material financial statement impact, and the approach to be taken to address those risks. The summary should explain how materiality was established, highlight significant changes to the audit approach from that of the prior year and indicate key developments occurring at the entity since the time of the last audit. The summary describes the planned audit approach by business cycle, including information about the nature of extent of audit evidence to be derived from reliance on controls and the use of analytical procedures.

ANNUAL AUDIT POLICY

The audit Principal should participate directly in all key decisions involving development of the strategic approach to the audit. The strategic approach, and any significant changes thereto, should be approved by the audit Principal. Except when the Principal has been delegated signing authority for the audit, the strategic approach should also be reviewed by the responsible Assistant Auditor General before significant detailed planning and testing is carried out.

4.3 The Office wishes to move, as aggressively as possible, to controls reliance for most annual audits. We should expect that federal entities we are responsible for auditing have instituted proper internal controls that we could place reliance on. Where a controls reliant approach is not possible for the current year audit because key controls are absent or the performance of control procedures is not evident or properly documented we should be concerned. In such cases, the audit team should identify the controls and/or documentation procedures that would normally be expected in the circumstances, and explain to entity management how they should strengthen their internal controls. These suggestions should be presented to management in the form of a management letter and, if appropriate, to Parliament.

ANNUAL AUDIT POLICY

Where audit teams do not follow the Office's preferred audit approach of reliance upon controls as the primary source of audit assurance, the reasons for not following this approach should be documented in the Strategic Approach Summary.

Impact of Business Risk on the Audit Approach

4.4 As part of the Entity Risk Analysis, the audit Principal prepares a schedule aligning the entity's business risks with the various OAG mandate areas. In Annual Audit Planning, the business risks that impact on the fairness of the presentation of the financial statements, as well as those risks that threaten compliance with significant legislative authorities, must be considered in the development of the strategic approach to the audit. To ensure that the audit addresses these risks in an appropriate manner, the audit Principal should identify the affected component(s) and assertion(s), the potential impact and the likelihood of occurrence. Based on these assessments, the audit Principal should then consider the most effective audit approach to address the risk of misstatement in the financial statements (and any risks to compliance with significant legislative authorities).

4.5 Documentation of the impact of business risks on the annual audit should be limited to summary level information on the template provided in the TeamMate library. More detailed information about the risks themselves is documented in the Entity Risk Analysis section of the file.

Other Inherent Risk

4.6 In addition to the "business risks", the audit Principal should consider any other ***significant*** risks that may impact on the financial statements, and that should be addressed by the audit. The existence of potential "other inherent risks" may be indicated by significant fluctuations in component balances from the prior year, identified IT or business system risks, current year issues, changes in accounting policies or significant changes in estimates, and the prior year experience of error. As well, the presence of any of the engagement-specific factors such as those described in paragraph 4.38 may also be indicative of the existence of other inherent risks.

4.7 As with business risks, the audit Principal should identify the affected component(s) and assertion(s), the potential impact and the likelihood of occurrence. Based on these assessments, the audit Principal should then consider the most effective audit approach to address the risk of misstatement in the financial statements.

4.8 ***Identifying New and/or Emerging Accounting or Auditing Issues*** The audit Principal should ensure that the audit team has identified any new or emerging accounting or auditing issues that may impact the audit. These issues may result from business developments such as significant changes in the entity's asset base, changes in executive compensation packages and changes in contracting practices. Issues may also arise due to developments in the accounting and auditing profession such as new accounting pronouncements coming into effect for the first time, changes in generally accepted accounting principles for a particular industry or for government operations, or exposure drafts that could affect the way in which the entity accounts for its assets, its liabilities or its business activities.

4.9 The impact of any such developments should be reflected in the Strategic Approach Summary and also, to the extent considered necessary, in the detailed audit plans. Changes and/or new developments that may significantly affect the financial statements should normally be discussed with the senior management of the entity and with those having oversight responsibility for the financial reporting process (normally the audit committee or other appropriate body, such as the Treasury Board, the Receiver General for Canada or the Department of Finance).

4.10 We also need to be aware of any plans by the entity to make any significant changes in accounting policies, as this may have an impact not only on the financial statements but also on our auditor's report for those audit entities where we are required to opine on consistency. For example, this would apply to federal and territorial Crown corporations and the Public Accounts of Canada.

4.11 **Consultation with Specialists.** Assessing risk in specialized areas may be difficult, such as with financial statement components wholly or substantially composed of transactions involving financial instruments. In these situations, it may be appropriate to consult with Office specialists before finalizing risk assessments for the audit (refer to Chapter 7 - Consultations).

4.12 As with business risks, the documentation of the assessment of the impact of other inherent risks on the annual audit should be limited to summary level information on the template provided in the TeamMate library.

Preliminary Audit Strategy by Component

4.13 This section provides the reviewer with a very high level snapshot of the planned audit approach, indicating for each major business cycle the planned sources of assurance from controls, analytical procedures and substantive tests of details.

High Level Systems Overview Chart

4.14 The strategic approach summary should include a high level overview chart of all significant business systems that feed data to the general ledger. This gives the reader a sense of the number of major business cycles that will require audit attention, and a broad perspective of which of those systems are most significant.

4.15 The team may also choose to include individual business cycle control charts, to assist the reviewer in understanding the key management and monitoring and application controls in place for the major business cycles. These charts would most likely be included when the team expects that some level of reliance on controls is feasible

Audit Mandate

Terms of Engagement - General

4.16 The annual audits we conduct of the Public Accounts of Canada, the Territories, Crown corporations and other entities are designed to provide our opinion to readers on the fair presentation of the financial statements. Further, as Parliament's auditor, we have additional responsibilities conferred on us with respect to reporting on compliance with legislative authorities, and a general duty to also report on any "other matters" that, in our opinion, should be brought to the reader's attention. Accordingly, these legislative responsibilities must be explicitly taken into account in the planning, execution and reporting phases of the audit.

4.17 In all of our engagements, the Office and the audit entity should share a common understanding of the terms of the engagement — both our statutory audit work and any other work that may be performed.

4.18 Many of our audit engagements are statutory and of a long-standing nature. Even though we may believe that our audit entities have a clear understanding of the nature of our audit work, it is still important to set out, in a clear and unambiguous manner, the significant aspects of the terms of engagement. Communicating this information to senior management and to those having oversight for the financial reporting process helps each of them discharge their responsibilities and confirms their understanding of what an audit does and does not do.

4.19 Communication of this information is normally accomplished through a report to an Audit Committee (or equivalent), or through a formal engagement letter.

ANNUAL AUDIT POLICY

Audit teams should ensure that the terms of reference for the audit engagement, significant features of the audit scope and responsibilities assumed are clearly set out in a formal written communication with the audit entity (e.g. Report to the Audit Committee (or equivalent)and/or engagement letter).

4.20 For the annual audit of the Public Accounts of Canada, the Public Accounts team is responsible for establishing and communicating the terms of the engagement with the Government of Canada, specifically the Treasury Board, the Department of Finance and the Receiver General for Canada who are jointly responsible for preparing the financial statements.

New Engagements

4.21 Occasionally, we may be asked by a federal entity or by the Governor in Council to perform new audit work. Examples of this have included, for example, work on prospectuses and providing assistance in determining a fair division of assets between the Northwest Territories and the Nunavut Territory. In addition, new legislation may create corporate bodies for which we become the appointed auditor, for instance the Canadian Airline Security Transportation Agency created in 2001. In such cases, it is important to ensure that the terms of engagement are appropriate for the circumstances and, to the extent appropriate, consistent with that of similar work in other entities we audit. As well, there may be developments in the profession that need to be taken into account in establishing appropriate terms of engagement. Accordingly, there should be consultation with Legal Services (refer to *Practice Expectations Common to all Product Lines*) and with the Annual Audit Practice team.

4.22 Audit teams should not automatically accept new non-statutory engagements without appropriate internal consultation and approval by the Office’s Executive Committee. Factors such as cost, mandate considerations and independence issues all play a role in determining whether a new, non-statutory annual audit engagement will be accepted by the Office.

ANNUAL AUDIT POLICY

The audit team should consult with Legal Services and with the Annual Audit Practice Team on the terms of engagement of new or proposed annual audit engagements. Non-statutory audit engagements should be approved by the Office’s Executive Committee.

Consistent Application of Accounting Principles

4.23 Generally accepted accounting principles require entities to provide disclosure of changes in the application of accounting principles. If an entity has complied with this GAAP requirement, then generally accepted auditing standards would not require the auditor to report on this matter. Accordingly, in establishing the terms of engagement for a specific entity, we would not include a requirement to report on the consistent application of accounting principles unless it is required by legislation.

4.24 The basis for preparation of financial statements and our report thereon is often established in legislation. For federal Crown corporations, Section 132 (2) of the federal *Financial Administration Act* requires the auditor to report on whether the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Accordingly, we have a requirement to report on the consistent application of accounting principles for Crown corporations subject to 132(2) of the *FAA*.

Key Changes in the Audit Approach

4.25 This section of the Strategic Approach Summary is intended to indicate **significant** shifts in audit approach, such as a change from a substantive-based strategy to a controls-reliant one for a major business cycle. The information would be provided only at a very high level.

Materiality and Audit Risk

4.26 The Strategic Approach Summary includes the discussion of how planning materiality was determined for the audit, and the team’s assessment of “audit risk”. These concepts are discussed below.

4.27 **Materiality.** In performing an audit, we seek reasonable assurance that the financial statements as a whole are not materially misstated. In Paragraph 1000.17 of the CICA Handbook, materiality is defined as follows:

> “Users are interested in information that may affect their decision making. Materiality is the term used to describe the significance of financial statement information to decision makers. An item of information, or an aggregate of items, is material if it is probable that its omission or misstatement would influence or change a decision. Materiality is a matter of professional judgment in the particular circumstances.”

4.28 Although this definition does not tell the auditor how to determine materiality, it does indicate that:

- materiality should be determined from the point of view of the user, not of management or the auditor; and

- materiality should be determined without reference to audit risk, specifically, materiality should not be reduced on high-risk audits or increased on low-risk audits.

4.29 **Guidelines for determining materiality.** Materiality is always relative and always requires judgment; therefore it is usually not possible to lay down specific rules or absolute numerical measurements that will be valid in every case. Consequently, the materiality decision ultimately becomes a matter for the auditor's professional judgment. In determining his/her materiality for planning purposes, the auditor considers both quantitative and qualitative factors.

4.30 Quantitative materiality is normally determined by taking a percentage of an appropriate "base", which is generally one of the most significant financial results in the entity's statements. For entities in the public sector, total expenditure is often selected as the base. This recognizes that, in many cases, Parliamentary appropriations are determined based on these expenditures. In the Office, a quantitative estimate of materiality in the range of 0.5% to 2% of total expenditures is generally considered appropriate. For more commercially-oriented organizations such as enterprise Crown corporations, materiality might be determined using a base of revenues, operating income, or some other appropriate measure. The base selected and the threshold percentage applied should reflect, in the auditor's judgment, the measures that financial statement users are most likely to consider important.

4.31 In some cases, it is appropriate to have ***dual*** materiality. In other words, the auditor establishes one materiality for the income statement and a separate materiality for the balance sheet. This is typically the case in financial institution-type clients, where the balance sheet may be many orders of magnitude larger than the statement of operations. For such entities, the same concept as described above is applied. Namely, an additional "base" is selected from the balance sheet (e.g. total assets) and an appropriate percentage is applied to determine the quantitative measure of materiality (e.g. say 0.5% to 1% of total assets).

4.32 An auditor also considers qualitative matters before making a final determination of planning materiality. Although qualitative matters are more significant in evaluating misstatements, they also should be considered in establishing planning materiality. Factors such as a "bottom line" that is expected to be close to zero, expected "tight" compliance with restrictive covenants and the existence of statutory or regulatory reporting requirements that may be difficult to comply with are examples of matters that should be taken into account in the auditor's determination of planning materiality.

4.33 When materiality is reduced from one period to the next, the auditor needs to pay particular attention to the level of misstatement that may exist in balances representing opening equity. Those balances will have been audited to a higher level of materiality and may contain errors that could contribute to a misstatement in the current period.

4.34 The CICA has developed more detailed guidance that may be useful to the audit Principal. This is found in assurance and related services guideline AuG-31 "Applying Materiality and Audit Risk Concepts in Conducting an Audit" (January 2002)

4.35 **Audit Risk.** The audit risk is the inverse of overall audit assurance. It is the risk that, after completing the audit, misstatements aggregating to more than materiality will remain undetected in the financial statements. In practice, audit risk is unavoidable because we cannot obtain absolute assurance that all material misstatements are detected. Audit risk, as well as materiality, should be considered in:

- Planning the audit, and designing and executing auditing procedures; and
- Evaluating whether the financial statements taken as a whole are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

4.36 Audit risk is managed by varying the nature, extent and timing of the audit work, recognizing that it is inappropriate to strive for greater audit satisfaction than may be:

- Feasible, because of inherent imprecision within the financial statements.
- Justified, if the cost of greater audit satisfaction exceeds the value to users of the financial statements.

4.37 The audit Principal should always plan and perform the audit so that audit risk will be limited to an acceptably low level that is, in his/her professional judgment, appropriate for expressing an opinion on the financial statements and managing the risk to the Office of a wrong opinion. The Handbook suggests that, in those situations where the auditor wishes to express audit risk in quantitative terms, the risk should be limited to no more than 5%.

4.38 There are a variety of engagement-specific factors that may, individually or collectively, point to increased risk of material misstatements in the financial statements. These risks generally require special audit consideration in designing the planned audit approach for individual business processes and/or financial statement components.and Examples of such risk factors include:

- operating in regions of the world that are economically and/or politically unstable;
- operating in a specialized industry, or in an industry having unique accounting standards we have limited experience with;
- operating in an industry undergoing significant changes;
- significant presence in volatile markets (e.g. futures trading);
- recent financial performance “at the extreme” (good or bad);
- complex processes related to the development of accounting measurements (e.g. loan loss provisioning);

- existence of significant accounting estimates involving considerable management judgments or estimates;
- weak accountability regime in the entity or in the relationship with the responsible Minister;
- significant changes in one or more accounting policies adopted by the entity;
- existence of material contingent liabilities including environmental liabilities;
- strained client relations;
- unresolved issues identified in previous years, especially control weaknesses identified but not corrected by management;
- sophistication of accounting and management information systems;
- management integrity, turnover, and/or bias; and
- joint audit engagement.

4.39 Identified risks (in other words, “significant” risks that are other than “low risk”) should be documented in the planning file, and the affected assertions identified at the account balance or class of transactions level. The nature, extent and timing of the audit procedures intended to address these risks should also be indicated.

Compliance with Authorities

4.40 Regardless of the type of auditing for compliance with authority, it is critical that the auditor fully understand the authority framework governing the entity, the audit mandate, and the transactions subject to audit. Otherwise, there is a risk that the audit procedures will not be tailored to the specific needs of auditing compliance with authority or will be inappropriately executed.

4.41 For example, in the case of Crown corporations, the Office has interpreted its responsibility for reporting on compliance with authorities to be a separate opinion on compliance with specified authorities, as opposed to a derivative one. Accordingly, readers of our reports are looking for assurance that significant transactions (or events) that would reasonably be expected to come to our notice during the conduct of the annual audit have been assessed for compliance with governing authorities and that we have reported on all significant cases of non-compliance.

4.42 Some legislative requirements of the *Financial Administration Act* and other authorities are not necessarily related to individual financial statement components. For example, the provisions relating to the need to have corporate plans and budgets, internal audit function, and so on, do not directly affect the financial statements. Specific audit procedures may need to be applied as part of auditing these elements of compliance with authority.

Planning — An Ongoing Activity

4.43 Although the preparation of the Strategic Approach Summary is an important milestone, it should not be considered the end of planning. Planning is an activity that continues throughout the audit, responding to new circumstances such as unforeseen changes in the entity's business or its systems, or unexpected results coming to light during the testing phase of the audit. Whenever such developments occur, are significant and require a change in audit procedures, the Strategic Approach Summary should be updated accordingly. Significant changes to the Strategic Approach Summary should follow the same approval protocol as the original strategic approach.

4.44 **Communicating the strategic approach.** All significant elements of the strategic approach should be communicated to audit team members, including those from other product lines (e.g. VFM) as applicable. These planning elements should be included on the agenda and discussed at the team planning meeting. The "Team planning meeting" is described in more detail in the Engagement Management section of this chapter.

4.45 Office policies dealing with communications in the broad sense are discussed in the *Communication* section of this Manual.

Preliminary Analytical Procedures

4.46 While developing the strategic audit approach, the audit Principal and Director should identify relevant interim financial and non-financial performance information and perform selected preliminary analytical procedures. These analytical procedures will supplement the information gathered during the Entity Risk Analysis and provide useful information for developing the preliminary audit approach by cycle. These procedures may confirm the information collected for the Entity Risk Analysis or identify additional areas that need to be investigated and/or addressed during the audit. They may also contribute to a more comprehensive understanding of the entity's business and risks. To provide meaningful input to the planning process, these preliminary analytical procedures should be performed prior to finalization of the Strategic Approach Summary folder.

4.47 Analysis of interim **financial results** gives the audit Principal a perspective on the extent to which plans are being achieved, whether explanations from management are plausible, the impact and significance of potential new developments, and whether results are consistent with the auditor's expectations based on current and previously acquired knowledge. Analysis of **corporate performance reports** such as management variance analyses, year to date cash flow reports and key financial ratios may also add value.

4.48 Preliminary analytical procedures should not be limited to financial reporting information. Analysis of operational reports, including key performance indicators, may provide additional insights into business risks facing the entity and should corroborate the financial results to date.

4.49 Where these reviews reveal a significant change, unusual relationship or unexpected outcome not consistent with the audit Principal's expectations, additional work should be undertaken to assess any possible impact on the development of the Strategic Approach Summary.

Prior Year Issues

4.50 Audit staff can maximize audit efficiency by ensuring that the Cumulative Audit Knowledge and Experience, "CAKE", is taken into consideration when developing the strategic approach and the tailored audit programs. One important aspect of CAKE is "prior year issues". These issues include the planning points raised during the course of the prior year's audit, adjustments identified and made in the prior year's financial statements and any matters reported to management and/or to those having oversight responsibilities and/or Parliament. Such issues should be reviewed and incorporated into the plan of the current year's audit, as applicable.

The Auditor's Responsibility to Consider Fraud and Error

4.51 As a result of changing public expectations, more rigorous international standards, well publicized business failures and other factors, the CICA has revised important aspects of the auditor's responsibilities relating to the detection and reporting of fraud and error. In addition, the new standard has emphasized the responsibilities of legislative auditors, noting that "the use of public funds tends to impose a higher profile on fraud issues".

4.52 The CICA has expanded the definition of fraud beyond the traditional view of misappropriation of assets, to include "fraudulent financial reporting". Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements in order to deceive financial statement users. This definition also scopes in the intentional misapplication of accounting principles. Consequently, the auditor's assessment of the appropriateness of the accounting policies selected by management now takes on added significance.

4.53 The standards emphasize the need for professional scepticism throughout the audit. To ensure that audit team members are familiar with their professional obligations, there should be a Team discussion of the susceptibility of the entity to material misstatement resulting from fraud or error. Ideally, this discussion would take place at the initial team meeting held after the strategic approach has been completed (see "Engagement Management" in this chapter). The briefing should also include a discussion of where errors may be more likely to occur and/or how fraud might be perpetrated. Team members should be clear on the nature of related queries that should be made, who should make them and how the resulting information will be shared with the rest of the team members.

ANNUAL AUDIT POLICY

The susceptibility of the entity to material misstatements in the financial statements resulting from fraud, error, and the planned responses to the identified risks, should be discussed at a team planning meeting.

4.54 Although both management and those having oversight for the financial reporting process have primary responsibility for the prevention and detection of fraud and error, the auditor is expected to make specific enquiries of management during the planning of the audit. As part of the planning interviews, the auditor should:

- obtain an understanding of management's assessment of the risk of fraud;
- obtain knowledge of management's understanding of the internal controls in place to address the risk of fraud and to prevent and detect error;
- determine whether management is aware of any known or suspected fraud; and
- determine whether management has discovered any material errors.

4.55 These inquiries should extend beyond the financial function to cover a wide cross-section of operational and corporate management. If considered appropriate, the views of those having oversight responsibility for the financial reporting process should also be sought.

4.56 The auditor would also consider whether there are any other matters that should be discussed with those having oversight responsibilities, such as:

- concerns about management's assessment of the risks of fraud or error and the controls in place to prevent and detect them;
- a failure by management to address material weaknesses identified in the prior year's audit; and
- the auditor's assessment of the overall control environment of the entity.

4.57 On the basis of the information collected during the Entity Risk Analysis, applying the auditor's CAKE and considering any other work conducted to date, the auditor will consider whether any significant fraud risk factors exist in the entity. An extensive list of fraud risk factors and compensating audit procedures is available in the CICA Handbook (Assurance) - Section 5135 -*The Auditor's Responsibility to Consider Fraud and Error -Appendix.*

4.58 Auditors should discuss with the audit Principal the implications of any fraud risks or areas identified that are likely to result in errors and require an overall response in planning the audit. Where such fraud risk factors are identified, specific audit procedures would be designed to address the identified risks.

4.59 The Forensic Audit Team should be consulted whenever significant fraud risk factors have been identified and/or there is evidence to suggest there may be a need for specialized forensic audit procedures.

ANNUAL AUDIT POLICY

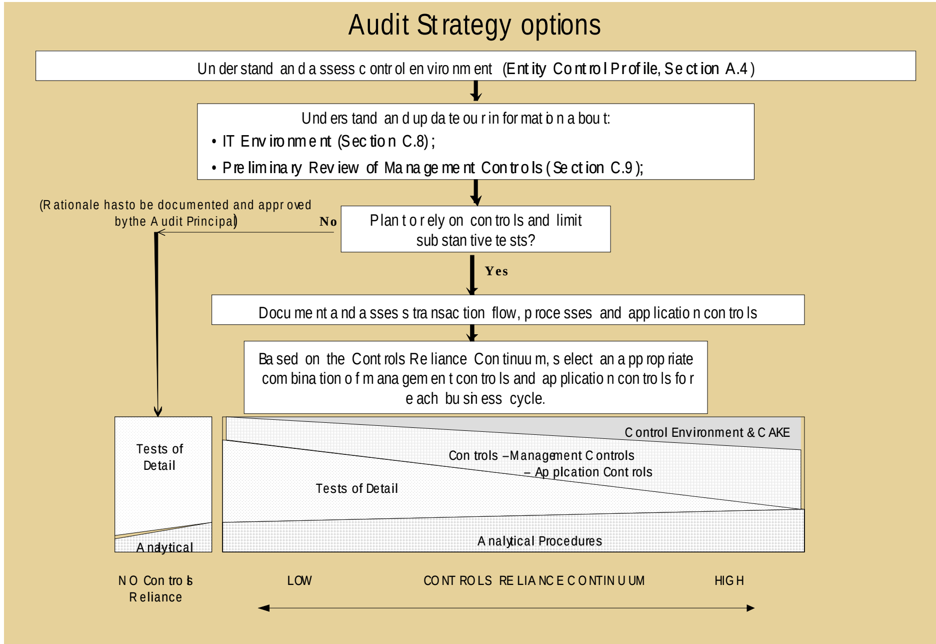
In planning the audit, the audit Principal should consider the risk of material misstatements in the financial statements resulting from fraud and error.

Strategy Development — General

4.60 In the planning phase of the audit, business risks that have a potential impact on particular financial statement components assertions are identified and assessed in order to ensure that audit efforts are focused on the key business cycles that support the financial statements.

4.61 This risk assessment determines the critical nature of these business cycles and the type of related controls selected for review, documentation, and evaluation.

4.62 The audit strategy is developed based on two key principles: first, we are committed to a controls-reliant approach whenever appropriate and practical; and second, controls reliance is determined as a point on a continuum, rather than as a discrete measure. These two principles provide the audit team with exceptional flexibility to design a controls reliant audit approach that takes into account the specific strengths of control systems in the entity, and allows for the maximum degree of assurance to be taken given the quality and audibility of the existing systems and practices. The concepts underlying this strategy development approach are indicated pictorially below:



Gaining Assurance through Reliance on Controls

4.63 In order to help achieve its objectives, all organizations institute controls. Internal controls assist management in safeguarding its assets, in optimizing the use of resources, in preventing and detecting fraud or error and in maintaining reliable business process systems. In the public sector, controls also exist to ensure compliance with authorities (Acts of Parliament, enabling legislation, regulations, etc.).

4.64 It is important during the planning phase to ensure that we have an up-to-date knowledge of each business system of audit significance, including an understanding of:

- the impact of the entity's business processes and how they have influenced the design of management and accounting business systems;
- the types of transactions and documents processed by the systems;
- the manner in which the transactions are initiated and processed; and
- how transactions and balances are assembled and summarized for financial reporting purposes.

4.65 Generally accepted auditing standards (GAAS) require the auditor to obtain an understanding of the control environment and the control systems that collect, record and process data and report the resulting information, even when no reliance is to be placed on controls. The levels of understanding required by GAAS are illustrated in the following table.

GAAS Requirements for Understanding Internal Control		
Knowledge Area	**Substantive Approach**	**Controls - Reliant Approach**
Control environment	✓	✓
Control systems that collect, record and process data and report the resulting information	✓	✓
Control systems that enhance the reliability of data and information		✓

4.66 Internal controls are important for mitigating the risks to the achievement of the entity's business objectives. Accordingly, it is important for any auditor undertaking a "business risk"-based audit approach to understand and assess them. Since many such controls are computerized, or heavily dependent on computerized systems, audit teams need to have members with specialized information technology knowledge and audit skills for this work.

4.67 Where the audit team can establish that controls are effective and operating throughout the year, a significant degree of audit assurance may be derived. Such evidence is generally derived more efficiently and effectively through reliance, than through any other audit technique.

4.68 Controls are found throughout the organization, ranging from very "low-level" controls at an individual transaction level to very "high level" governance controls addressing overall corporate performance. Higher level controls are generally more valuable from an audit perspective, because they provide assurance over the results of many transactions.

4.69 Consequently, in establishing which controls to rely upon, the auditor "drills down" through the organization, searching for the highest level controls that give him/her comfort over the financial statement component(s) in question.

4.70 The "level" at which we identify controls that have the potential to provide us with the comfort we require, determines the nature and extent of the audit procedures we must perform. Auditors and other team members with specialized skills and knowledge in information technology work together to identify the key controls, and to develop the necessary tests and other procedures to obtain the audit evidence and assurances we consider necessary.

4.71 The auditor may choose to rely on "lower level" controls even though higher level controls may exist. The controls actually chosen for reliance are affected by many factors, including the auditor's assessment of their effectiveness, the costs of obtaining the required evidence, previous experience with those controls and other factors.

4.72 In some cases, a combination of "levels of controls" may be selected. The choice of the type(s) of control(s) to be tested and the nature and extent of testing of each, depends on the auditor's assessment of the most cost-effective way to obtain the required audit evidence.

4.73 Controls may only be relied upon where our testing supports reliance. Accordingly, after identifying the key controls, we ensure that they support reliance by:

- satisfying ourselves that we have considered all key controls and identified the right ones for testing;
- applying all of our cumulative knowledge and experience with the entity;
- confirming how the controls are used/applied in practice; and
- evaluating whether the controls are actually effective.

4.74 We expect federal entities to have proper controls in order to help ensure that public monies are spent efficiently and effectively for their intended purposes. If the controls we expect are there, we should be relying on them. If there are no controls that can be relied upon, we should be very concerned. In such cases, we would identify the needed controls in a management letter, report to those having oversight responsibility for the financial reporting process, or a report to Parliament, and working toward reliance on controls in future years.

ANNUAL AUDIT POLICY

When a controls reliant approach cannot be adopted because of weaknesses in internal control, the nature of these weaknesses and our suggestions for strengthening them should be reported in a management letter.

Depending upon our assessment of the significance of these control weaknesses, we should also consider reporting them to those with oversight responsibility for the financial reporting process and, in extreme cases, to Parliament.

Reliance on Management and Monitoring Controls

4.75 In the planning phase of an audit when the audit Principal and Director determine the audit strategy and planned reliance on controls, they need to consider the extent to which they can place reliance on management and monitoring controls and the cost-effectiveness of relying on these controls.

What are Management and Monitoring Controls?

4.76 Management and monitoring (M&M) controls are review or analytical procedures that focus on the outputs of the entity's systems of internal control, and give management assurance that a group or class of transactions have been processed completely, accurately and in accordance with authorized procedures. M&M controls look at a cluster of transactions instead of looking at individual ones. They are usually applied outside the normal transaction to groups of transactions that have been processed (or partially processed). They are designed to monitor results against desired objectives and anticipated results.

4.77 M&M controls are either performed or reviewed by individuals independent of, or removed from, the processing function (e.g. the Accounts Payable manager may review the monthly reconciliation of the suppliers' account balances to the suppliers' invoices). They are generally analytical in nature and performed on a regular basis (e.g. quarterly, monthly). Functional managers outside the finance area sometimes perform such controls.

Are there different types of M&M Controls?

4.78 Types of management and monitoring controls include:

- **analytical procedures or "top level review"**: consists of senior management's review of actual performance with an established criteria (e.g. ratio analysis, comparison of actual to budget or actual to prior year);
- **systems analytics**: consists of reviewing various system generated reports and following up on unexpected variances or lack of variance;
- **review of reconciliations**: consists not only of performing reconciliations but also following up on unusual items and taking corrective action when required
  - internal reconciliations (e.g. reconciliations between sub-ledgers and the G/L);
  - reconciliations between accounting records and independent data (e.g. bank reconciliations, reconciliations between supplier balances and supplier statements).
- **review of key performance indicators**: consists in relating different sets of data (operating or financial) to one another; together with analysing the relationships; investigating unexpected results and taking corrective action (e.g. purchase price variances, percentage of returns to total orders).

Why should we audit M&M Controls?

4.79 Management and monitoring controls are efficient sources of audit evidence because they provide assurance at the component level (i.e. they tend to address several assertions at once), and are normally limited to a few key individual controls that are effective and in place throughout the period.

4.80 M&M controls provide assurance over a group of transactions as opposed to individual transactions, therefore the level of assurance derived and the level of coverage obtained is much greater than when application controls are tested and relied upon.

4.81 For some components, the existence of strong M&M controls may provide sufficient audit assurance without the need to test application controls. This is especially true when we consider our reliance on bank reconciliations as a control over cash receipts and cash disbursements. Testing bank reconciliations, which is an M&M control, provides assurance over cash transactions if it is done on a timely basis, is reviewed and approved by management and there is evidence of corrective action when required.

How are M&M Controls different from Application controls?

4.82 Management and monitoring controls should not be confused with application controls (which can be either manual or automated). Manual application controls are part of the procedures for processing transactions, often in combination with computerized controls. Management and monitoring controls involve the review of summarized information at certain points during the year (e.g. at month-end), after the processing of transactions has taken place and the taking of corrective action when required. They are considered to be “detective” controls because they are designed to detect errors that may have occurred, rather than prevent errors from occurring.

How do we decide which M&M Controls to test?

4.83 We should only select M&M controls which are sensitive enough to detect errors of audit importance. We should also select M&M controls which management monitors on a regular basis and for which deviations are followed up on. Key performance indicators which are not acted upon are not considered strong M&M controls and should not be relied on for assurance purposes.

4.84 We should also only select M&M controls which have been in place for the entire period. M&M controls which are not applied on a consistent basis cannot be relied upon. In selecting the M&M controls we should rely on, consider the following factors:

- The assertions and the risks addressed by the control;
- The quality of the control;
- The efficiency of relying on the control versus other methods of obtaining similar assurance for the assertions;
- The consistency in the application of the M&M control;
- The level of documentation or evidence supporting the application of the M&M control;
- The quality of the data used as an input for the M&M control which may imply that, in some cases, testing of the underlying application controls is required; and

- The sensitivity of the M&M control.

4.85 Determining which M&M controls to rely upon is not as difficult as for application controls. Application controls are often interdependent with a combination of complimentary controls providing control effectiveness. In these cases a combination of application controls must be tested together in order to place reliance. Management and monitoring controls can be selected for reliance regardless of whether other management and monitoring controls do or do not exist. Because management and monitoring controls operate independently of each other, each one can be considered individually.

Reliance on Application Controls

4.86 Application controls are manual or automated controls built into client systems. They are applied to individual transactions or to batches of similar transactions. We can rely on application controls by establishing that their design is appropriate to effectively detect and prevent errors and by obtaining assurance of the consistency of their operation over the period of reliance. Guidance in relation to Planning Reliance on Application Controls is available on the Annual Audit Intranet Site.

4.87 The audit team's IT and financial auditors are required to have a good understanding of the entity's information technology environment. This understanding is required because of the impact of the IT environment on the generation of key reports and the protection of electronic data with significant impact on the financial statements. Key information that the team needs to gather and document in TeamMate pertaining to IT Environment includes the following:

- understanding how the IT function is organized;
- understanding how management controls IT activities;
- understanding how IT supports the business;
- identifying the main characteristics of IT systems and environments that support the financial statements;
- identifying significant changes to these systems;
- understanding known problems with these systems; and
- assessing the impact of IT on the audit strategy and identifying matters worth reporting to the client.

4.88 In determining the audit strategy for each business cycle of audit significance (for example, revenues, expenditures, fixed assets, inventory, G/L and reporting), the financial and IT auditors on the team will consider the extent to which the team can place reliance on controls, and the cost-effectiveness of relying on controls.

4.89 In planning the audit, it is important that the IT and financial auditors:

- map activities and systems to the financial statements and identify business cycles that support them. This involves documenting, at a high level, the flow of information for key business cycles and the manner in which general ledger accounts are updated;
- determine which business cycles, systems, and related financial statement components the financial auditors wish to place reliance on, and the extent of reliance, as part of their audit plan;
- understand any key issues identified by internal users, management, and Internal Audit; and
- ensure that any significant IT matters affecting financial statement assertions are identified at this stage and that these matters are communicated to team members.

4.90 At the end of the planning phase, the team leader, in consultation with the IT auditor, will determine the feasibility and effectiveness of adopting a controls reliance approach to key business cycles and then document this decision in the strategic approach summary.

Year of No Systems Changes

4.91 Year of "no change" involves reliance on prior year's audit evidence in situations where application controls have not changed significantly. If the audit team can establish that the audit entity is continuing to use the same computerized application controls that were tested in a previous year, and the IT specialist team member concurs, it may be possible to limit the current year's audit work on controls in order to support reliance. (This approach is not generally appropriate for management and monitoring controls because the control procedures involve management analysis and corrective actions, which may change with management priorities and with changing business conditions. Similarly, a year of "no change" approach may not be used for manual application controls).

4.92 The auditor would need to perform the following to take advantage of a year of "no change" opportunities:

- through enquiry and discussion with appropriately senior client officials, establish that the controls have not changed significantly since the last detailed audit of the controls was performed;
- examine the general computer controls, which ensure that computer applications are properly maintained and data is protected, to verify that no changes have occurred, or alternatively, that the changes made have not significantly affected the key controls upon which the auditor relied previously; and
- at year-end, ensure again that no significant changes have been made to the key controls through enquiry and discussion with senior officials.

4.93 In general, year of “no change” techniques should only be applied where inherent risks are considered low and where the audit team has relied previously on the controls.

4.94 A year of “no change” audit approach does not alleviate the auditor of his/her responsibility to assess the integrity of general computer controls.

Compliance with Authorities

Crown Corporations and Other Entities

4.95 The Office has interpreted its responsibility for reporting on compliance with authorities to be a separate opinion on compliance with specified authorities, as opposed to a derivative one. Accordingly, readers of our reports are looking for assurance that significant transactions (or events) that would reasonably be expected to come to our notice during the conduct of the annual audit have been assessed for compliance with governing authorities and that we have reported on all significant cases of non-compliance.

4.96 It is critical that the auditor fully understand the authority framework governing the entity, the audit mandate, and the transactions subject to audit. Otherwise, there is a risk that the audit procedures will not be tailored to the specific needs of auditing compliance with authority or will be inappropriately executed.

4.97 Some legislative requirements of the *Financial Administration Act* and other authorities are not necessarily related to individual financial statement components. For example, the provisions relating to the need to have corporate plans and budgets, internal audit function, and so on, do not directly affect the financial statements. Specific audit procedures may need to be applied as part of auditing these elements of compliance with authority.

4.98 In developing the strategic direction, an assessment should be made of the risk of significant non-compliance with the identified governing authorities. A number of factors need to be considered when making this assessment including knowledge of the entity, past audit experience, and management’s attitude towards compliance. It is important to involve senior members of the audit team in making these judgments. For new or amended authorities, the audit Principal should consult with entity management to obtain a clear understanding of the implications to the entity and correspondingly to the audit approach.

4.99 The auditor should keep in mind the compliance with authority aspects of the audit throughout entity risk analysis, planning, execution and reporting phases of the audit. Accordingly, the auditor would consider the implications on compliance auditing in doing such things as gathering information on client accounting and information systems, assessing the control environment, developing detailed audit programs and assessing audit results. To the extent practicable, procedures for assessing compliance with authorities should be integrated with the audit procedures of the related financial statement component(s).

4.100 Building on the information gathered during the entity risk analysis, the audit Principal should ensure that:

- the relevant authority requirements have been identified (e.g. the FAA and regulations, enabling legislation, appropriation acts, by-laws of Crown corporations and any directives issued under section 89 of the FAA, etc.);
- the authority requirements have been reviewed and significant and/or high-risk ones identified; and
- the audit approach, including any specific procedures considered necessary for providing sufficient, appropriate audit evidence in relation to these significant authorities, have been included in the tailored audit programs for the relevant components to address compliance with authorities issues.

4.101 Specific guidance on significant requirements of the *FAA* and regulations and the *Canada Business Corporations Act* is available on the Annual Audit INTRAnet site.

4.102 Another important point to recognize is that the significance and/or risk associated with a particular authority can be quite different from that of a related financial statement assertion(s) for the same component. Consequently, there may be lesser or greater testing requirements for authorities than for financial statement assertions. For example, an entity's short-term investment program may be considered low risk for financial statement purposes, but there could be concerns that the corporate by-law governing the investing activities is not being complied with.

Public Accounts of Canada

4.103 In recent years, authorities work as part of the Section 6 audit was limited to ambit and limit of the vote. Now, however, additional work based on the assessment of the risk of non-compliance with significant "financial" authorities, will be implemented on an incremental and rotational basis. The key financial authorities for examination that would be expected in the public accounts audit are **primarily** the *Financial Administration Act* (*FAA*) and regulations and those aspects of the entity's enabling legislation, program legislation and related regulations that would reasonably be expected to fall within the scope of the auditor's examination.

4.104 The Central Team has created an inventory of government-wide financial authorities. From the authorities identified, a generic library of risks has been generated. Each year, a selection of the risks will be audited as part of a rotational audit approach to financial authorities, for example, on a five-year cyclical basis.

4.105 Entity teams are expected to complete their own inventory of financial authority risk factors based on their entity's enabling legislation and any related regulations. The entity Principals will be responsible for assessing which particular risks they believe are significant to their entity. This selection process will involve a risk analysis and an assessment of the potential for non-compliance. As a result of this work, the entity Principal will select additional authorities for examination on a rotational basis.

4.106 Entity teams should also complete a review of the results of any audit work performed by the Internal Audit Department touching on compliance with authorities. The entity teams will then design a detailed audit program, and after discussion with the Central Team, perform the associated audit work required and report on the results.

4.107 To ensure appropriate assessment of compliance with the ambit and limit of the vote, an authority component should also be included in any spending, borrowing or revenue transaction selected for substantive verification. The objective of this work will be to form a judgment as to whether the transaction met the intended purpose of the underlying authority. Where there is reliance on internal financial controls for purposes of the audit, compliance-with-authority components should be included in the tests of key controls.

4.108 Reporting will be on an exception basis for all compliance with authorities work. Specifically, cases of non-compliance will be considered for inclusion as "other matters", audit notes, observations of the Auditor General's on the Financial Statements of the Government of Canada, chapter material or management letter points, on a case-by-case basis.

ANNUAL AUDIT POLICY

Teams should design an effective and efficient approach to auditing "compliance with authorities", based on an assessment of significance and risk.

"Other Matters"

4.109 As noted in Chapter 2, annual auditors have a responsibility to identify and report on "other matters" falling within the scope of the audit that, in their opinion, should be brought to the attention of Parliament. During the strategic planning phase, the auditor should identify issues that may have the potential to be of significance and/or of a nature that they should be brought to the attention of Parliament. Such matters have not been defined in legislation – they are left to the judgment of the auditor(s).

4.110 What types of issues have the potential to be reported as "other matters" to Parliament? It would not be practical to attempt to describe all possible types of "other matters". The following list illustrates some of the types of issues that are significant and would merit reporting to Parliament as "other matters":

- significant transactions (especially those exceeding materiality) that, while permitted under enabling legislation, appear to be unusual or unexpected given the entity’s mandate;
- spending on initiatives that do not seem to have normal Parliamentary authority;
- operating activities that contravene accepted standards of government or corporate behaviour (e.g. payments to “agents” that appear to be excessive);
- major acquisitions made without due regard for economy (e.g. relating to investments, capital assets, etc.);
- exposure to significant losses that may have to be funded by the CRF;
- conduct, actions or transactions that could damage the reputation of Canada either domestically or internationally;
- non-responsiveness to recommendations made by the Public Accounts Committee or other standing committees;
- allegations of improprieties that are confirmed during an annual audit; and
- Corporate behaviour that appears to be inconsistent with traditional “public sector values”.

4.111 “Other matters” are unlikely to be clear-cut and may be open to more than one interpretation. Accordingly, a full understanding of the issues surrounding a potential “other matter” should be obtained and documented by the audit team. In many cases, “other matters” revolve around facts known to the entity. For example, the issue may be already reflected in corporate plans and budgets, and/or in one or more of the entity’s communications with Parliament. However, the auditor’s independence and objectivity may lead to viewing the known facts in a different light.

4.112 Office annual audit policies require the audit team to consult on significant, complex and/or sensitive issues. “Other matters” generally meet all of these criteria and, accordingly, there should be extensive consultation within the Office. At the early states of evaluating potential “other matters”, consultation would be expected with:

- the responsible AAG;
- the Quality Reviewer, if applicable;
- Legal Services;
- the Annual Audit Practice Team; and
- Functional Responsibility Leaders (FRLs) – e.g. the Principal responsible for the annual audit of the Public Accounts of Canada.

4.113 More detailed guidance may be found in *Audit Guidance on Reporting “Other Matters” in Annual Audits*, which is available on the Annual Audit INTRAnet site

The Quality Reviewer's Role in Planning

4.114 For certain audits, the Office has appointed a Quality Reviewer in order to provide an enhanced level of quality assurance. The role of the Quality Reviewer is to provide additional assurance that audits are conducted in accordance with professional and Office standards in key areas for engagements judged to be of higher audit risk to the Office. Quality Reviewers have been assigned to audits generally perceived to be: of higher risk; complex to conduct; sensitive in nature; or having complex accounting issues. Quality Reviewers have significant experience in the Office and have no direct involvement in the particular annual audit(s) they are assigned to. Accordingly, they provide an additional element of independence and objectivity in key risk areas related to planning and reporting the annual audit.

4.115 Through discussion with the team and through the review of key sections of the file (primarily the Entity Risk Analysis and Strategic Approach Summary folders) they will focus their attention on the following planning matters:

- the appropriateness of the business risks and other risks identified as having a significant financial statement impact;
- the team's assessment of the entity control profile (including any potential fraud risk factors);
- the appropriateness of the strategic approach to the audit, especially in relation to areas of higher risk or areas heavily affected by management judgments or estimates;
- the team's assessment of the impact of other inherent risks, including significant new accounting or assurance standards;
- whether the audit Principal or the individual managing the audit took appropriate steps to ensure that the team members are independent and objective.

4.116 In those rare cases where the Quality Reviewer and the audit team are in disagreement, the Assistant Auditor General or another AAG (independent of the responsible AAG) would be consulted.

4.117 The list of quality reviewers and their respective audit entities is found on the Office's Delegation of Signing Authority document, which is available on the Annual Audit INTRAnet site.

4.118 It is the audit Principal's responsibility to ensure that the Quality Reviewer is consulted on a timely basis, and receives the information needed to perform his/her review. The Quality Reviewer documents their concurrence with the overall audit strategy, and other relevant aspects of their responsibilities, in the TeamMate Strategic Audit Summary folder C.1.

ANNUAL AUDIT POLICY

On those audits for which a Quality Reviewer has been appointed, it is the audit Principal's responsibility to ensure that the Quality Reviewer is consulted on a timely basis, and receives the information needed to perform his/her review. Consultation on the development of the strategic plan should take place before significant fieldwork begins.

Engagement Management

4.119 Engagement management is a stream of logistical activities comprising planning, assigning the audit tasks at an appropriate level of detail, and managing the execution of the tasks efficiently to achieve engagement objectives. Effective engagement management requires a high standard of communication within the team and with the entity at all levels and throughout the audit process.

4.120 Engagement management encompasses many project management activities, of which the key elements requiring elaboration are:

- independence issues;
- staff performance and development objectives; and
- team planning meeting.

Independence Issues

4.121 Although inherently the Office has a significant degree of independence from its audit clients, it is nevertheless important to take appropriate steps to ensure that individual audit team members are (and are perceived to be) independent and objective. There are two primary steps that we use to ensure that audit team members are independent;

- our annual “conflict of interest declarations”; and
- rotation.

4.122 The audit Principal should satisfy him/herself that all team members have submitted their annual conflict of interest declarations (these are due April 1 of every year). In addition, the audit Principal should consider whether rotation of personnel on the engagement may be desirable, in order to ensure the continuing objectivity of the audit team. If rotation is desirable but not practical for an individual Team member, the audit Principal should consider how any associated risk should be addressed. It is good practice to ensure that the client has been informed where a change in key audit staff is anticipated.

4.123 Decisions regarding the need for rotation of the Office's most senior staff such as Principals and Assistant Auditor Generals, are made by the Auditor General, the Executive Committee and/or the responsible Assistant Auditor General, as appropriate in the circumstances.

Staff Performance and Development Objectives

4.124 Performance and development objectives should be set for all staff, below the Director level, prior to the commencement of the execution phase of the audit. The appropriate sections of the Assignment Planning and Assessment Form should be completed for each staff member. The staff goals and objectives should be prepared using the "SMART" guideline:

- **Specific -** Is it clear, specific, tangible? Does the employee know what to do to achieve this objective?
- **Measurable -** Is it measurable? At any time, can employees find out how far they've come and how far they have to go? Any quantity or quality reference points?
- **Ambitious -** Does it require stretching? Is it something the person could be proud to have tried or achieved?
- **Reachable -** Is it realistic? achievable? ambitious but reachable? special circumstances?
- **Time-bound -** Does the objective have a deadline? Are there milestones?

4.125 In order to prepare "SMART" objectives for staff, the following items should be developed and used as input:

- audit timetable;
- audit task plan; and
- audit time budget.

Team planning meeting

4.126 A key element of engagement management is the team planning meeting. Ideally, the team meeting would be held before the strategic audit approach is developed. This meeting should include all annual audit team members (including the team member with IT specialist knowledge), as well as others who might add value benefit from the discussion, such as VFM or team support staff for large or high risk audits. The responsible Assistant Auditor General should also be invited to attend the meeting, although his/her attendance is not essential.

4.127 An effective team planning meeting should be based on an organized agenda and attended by well - prepared team members. The primary purpose of the meeting is to share with team members the key audit strategy decisions regarding business risk, other inherent risk and the preliminary audit strategy by cycle. The audit Principal should encourage discussion and questions regarding the key strategy decisions, so that Team members leave the meeting with a solid understanding of the overall approach to the audit, and how their sections contribute to the achievement of the overall audit objectives. These decisions are documented in the Strategic Approach Summary folder of the file.

4.128 During the team planning meeting, the team should also agree upon common working practices, including documentation techniques for the engagement; for example, how lead schedules will be documented and included in the working papers, use of client prepared schedules, and the frequency of team briefing meetings.

4.129 In addition, the following important matters should also be discussed at the meeting:

- significant authorities to be audited;
- the existence of fraud risk factors in the entity;
- the nature and timing of working papers to be prepared by the client;
- use of specialists or reliance on the work of others;
- identifying the audit report signatory and whether a Quality Reviewer has been assigned to the audit; and
- audit completion deadlines (interim and year end).

Reporting to Those Having Oversight Responsibility for the Financial Reporting Process

4.130 When an identifiable body exists that has oversight responsibility for the financial reporting process (e.g. an Audit Committee or its equivalent), we should prepare a report setting out pertinent information concerning the scope of our annual audit, our planned approach, the matters of audit significance and matters that bear on independence.

4.131 Not all of our annual audit entities have a body charged with oversight responsibility for the financial statement reporting process. For those entities that do however, the audit team should prepare a suitable report. There are numerous examples in our practice where we report to other than an audit committee. For example, in the annual audit of the Public Accounts of Canada, the Office prepares a report outlining its planned approach to the Secretary of the Treasury Board, the Deputy Minister of Finance and the Receiver General for Canada. The team conducting the annual audit of the Canadian Food Inspection Agency reports to an Audit Sub-Committee of the Agency's Executive Committee. Some Section 6 entity teams are preparing similar reports for departmental audit committees, where our participation has been sought or agreed to by the entity.

4.132 The report should include a section that clearly sets out the level of responsibility assumed by the auditor in conducting an audit in accordance with Canadian generally accepted auditing standards. Matters that should be discussed include:

- the important role that the oversight body can play in the financial reporting process;
- the responsibilities of management in the financial reporting process;

- the fact that an audit is based on reasonable, but not absolute assurance that the financial statements are free of material error;
- the nature of the auditor's responsibilities, specifically with respect to the detection of fraud and error, compliance with authorities and "other matters";
- the general nature of the procedures performed during an audit (2nd paragraph of our auditor's report); and
- the inherent limitations of the auditor's assessments of internal controls in the entity.

4.133 The report should also communicate aspects of the auditor's approach that would be helpful to the oversight body in discharging its responsibilities. Such aspects could include:

- the general approach to the audit, including any significant changes from the prior year;
- the nature and extent of significant risks that might affect the financial statements;
- the specific financial statement components that have a higher risk of material misstatement, including the auditor's response thereto;
- the materiality level(s) on which the audit is based;
- the auditor's preliminary assessments of the overall control environment in the entity, its major business cycles, and the extent of planned reliance thereon;
- the auditor's perceptions of the entity's vulnerability to fraud and error;
- the effects of new developments in accounting standards, or legislative or regulatory requirements, on the entity's financial reporting;
- planned reliance on the work of internal audit and/or other specialists; and
- any other matters likely to be of interest to members.

4.134 The auditor should also discuss independence issues with this oversight body, particularly when it operates as an audit committee (or equivalent). Although inherently we have a considerable degree of independence, we should nevertheless confirm our independence. The auditor could also consider disclosing the processes followed by the Office to ensure that independence of individual auditors.

4.135 The report for discussion with the oversight body should be prepared and circulated to members of the committee well in advance of the meeting. Before the report is finalized, we should provide entity senior management with the opportunity to comment on a draft of the report.

4.136 The report on our plan and approach to the audit would normally be sent under the signature of the audit Principal.

4.137 In some circumstances, it may be appropriate to place relatively less emphasis on "boiler-plate" information, particularly where the audit committee is experienced. In such cases, the required "boiler-plate" information could be placed in an Appendix. Our planned audit approach and the matters of potential significance would normally be expected to be more susceptible to change, particularly the latter. In addition, personnel changes in the senior management category of the entity and indeed the membership of the oversight body also may experience change. For these reasons, it is important to ensure that our reports provide the information these oversight bodies require. In particular, we should provide them with a suitable understanding of both our audit approach and the issues expected to play a significant role in completing our audit and finalizing the entity's financial statements.

ANNUAL AUDIT POLICY

The audit team should communicate, on a timely basis, to management and to those having oversight responsibility for the financial reporting process, the planned approach and matters of potential significance related to the annual audit. Where an oversight body exists, this communication should be in writing, in both official languages.

4.138 Office policies dealing with communications in the broad sense are discussed in *Chapter 8 – Practice Expectations Common to All Product Lines*.

Tailored Audit Programs

4.139 Based on the strategic planning decisions finalized at the team planning meetings and documented in the Strategic Approach Summary folder, tailored audit programs are developed to reflect the strategic approach selected and to ensure that sufficient, appropriate audit evidence will be collected during the course of the audit. Tailored audit programs are critical documents, and should be reviewed and approved by the Director, in consultation (where necessary) with the audit Principal.

4.140 Tailored audit programs should be developed for each component of the financial statements. The major steps in preparing these programs are:

- developing audit objectives consistent with the strategic approach and direction approved by the audit Principal;
- identifying appropriate sources of audit evidence and ensuring that all assertions will be sufficiently addressed by the planned procedures; and
- determining the nature, extent and timing of specific audit procedures.

4.141 The Office has an extensive database (TeamStores) of generic audit procedures for common financial statement components, including those relating to financial institutions. TeamStores also contains audit procedures for testing internal controls relating to common business cycles. Assertions have been identified for each of these audit steps and in some cases, background information such as suggested analytical procedures is also available. These audit procedures can be selected and copied into the audit file from TeamStores as applicable. Alternatively, the auditor can develop audit steps specifically addressing the unique characteristics of the particular audit entity.

4.142 Detailed audit plans are also developed for auditing compliance with authorities. Authorities should not be considered as a separate, stand-alone aspect of our audit work, but rather as an integral component of it. Accordingly, where significant authorities have been identified during formulation of the strategic approach for specific financial statement components, the procedures for testing compliance should be integrated, where practicable, with the other audit procedures relating to that component. Generic procedures for auditing commonly-encountered authorities have been included in TeamStores.

ANNUAL AUDIT POLICY

The Director (or other individual managing the audit), in consultation with the audit Principal, should ensure that the audit programs are consistent with the approved strategic approach and should review and approve the tailored audit programs and any significant changes thereto.

Other Strategies

Reliance on Internal Audit

4.143 Where feasible, reliance on internal audit work is often a cost-effective source of audit assurance. Therefore, the internal audit function should be reviewed at the planning phase in order to:

- determine the extent to which the Office can rely on its work in setting the audit scope;
- co-ordinate audit work and avoid unnecessary duplication of effort; and
- determine whether detailed testing of the work carried out by internal auditors is required before placing reliance on it.

Pre-Year-End Testing

4.144 It is often possible to schedule portions of the audit work prior to the year-end date. Tests of internal control can often be conducted at a mid-point during the year, preferably not more than six months before year-end.

4.145 Where substantive tests of detail are planned, it is often advantageous to schedule as much testing of transactions and balances as possible before the year-end date (e.g. for confirmation of receivables/loans). Pre-year-end testing should be done as close to the year-end date as possible, generally not more than three months before the year-end. Proper roll-forward procedures (i.e. audit tests designed to cover the period between the date of the pre-year-end substantive testing and the year-end date) should also be undertaken. As a minimum, these should include:

- ensuring that key processing and management and monitoring controls continued to be effective throughout the roll-forward period; and
- substantive tests of detail for transactions exceeding materiality in the roll-forward period.

5 *Annual Audit Execution*

General Considerations

5.1 The objective of the Annual Audit Execution phase is to carry out the strategic plan that has been outlined in the TeamMate Annual Audit Planning folder, in accordance with Section 5100 of the CICA Handbook (Assurance) – Generally Accepted Auditing Standards. In particular, we want to ensure compliance with the examination standards specified in that section.

The expectations set out in these standards may be paraphrased as follows:

- The work should be properly executed;
- Staff should be properly supervised;
- Controls assurance should be obtained through tests of controls; and
- Sufficient appropriate audit assurance should be obtained to afford a reasonable basis to support the conclusions of the auditor.

5.2 In order for the work to be properly executed, each team member needs a general understanding of the overall audit approach, in order to appreciate how individual audit sections contribute to the overall assurance required for the audit as a whole. In addition, team members should understand the nature of any inter-section dependencies or, alternatively, of cross-component satisfaction where assurance derived from one section provides assurance for another section. This general understanding of the audit and its inter-related components is normally conveyed at the initial team planning meeting described earlier in *Chapter 4 – Annual Audit Planning.*

5.3 At an individual section level, it is equally important that the responsible auditor fully understands the objectives of the work to be performed and the time-frame in which the work is to be completed. In that regard, coaching by the supervisor plays an important role in conveying the necessary understanding. However, the auditor is also responsible for ensuring that they are completely familiar with the objectives of the work assigned to them, and how those objectives are to be achieved.

5.4 Supervision and coaching occur at various levels of responsibility within the audit team, and include:

- Ensuring that team members understand their assignments;
- Ensuring that the work is being carried out in accordance with the planned approach;

- Addressing and communicating significant issues that have arisen during the audit, assessing their implications, and assisting in their resolution; and
- Monitoring the progress of team members on their assigned sections.

5.5 Under the Office's approach, both the auditor and the supervisor share the responsibility for effective supervision and coaching. The supervisor provides timely support and guidance that facilitates the auditor "doing it right the first time". The auditor keeps the supervisor informed of progress on a timely basis and seeks guidance when appropriate. The two engage in regular "briefings" to successfully complete the work required in the audit section.

5.6 In formulating the strategic approach to the audit, the audit Principal and Director would have identified the business cycles for which controls reliance was sought, and developed a plan for obtaining the necessary assurance. That plan will require the auditor to document the systems of control over the business process, to identify the key controls, and to test those key controls in order to conclude that they operated effectively throughout the period of intended reliance. In so doing, the auditor would be in compliance with the examination standard.

5.7 To complete the execution phase of individual audit sections, work performed by auditors would normally be reviewed by more experienced team members, applying the principle of "review by interview". The responsibilities of the reviewer are to ensure that:

- the work has been performed in accordance with the plan;
- the work performed is adequate in light of the results obtained;
- the work has been properly documented;
- significant matters have been raised for further consideration,
- where appropriate, consultations have taken place and the resulting conclusions documented;
- the objectives of the planned procedures have been achieved; and
- the conclusions reached are consistent with the results of the work performed.

5.8 Normally, one detailed "review by interview" will suffice. Excessive reviews do not add value and are not conducive to conducting an efficient audit. However, in the case of higher risk sections, it is generally appropriate for the audit Principal or the Director to review the file, in addition to the review work done by the immediate supervisor. These additional reviews would also be conducted by applying the principle of "review by interview".

5.9 Satisfactory completion of the procedures described in the paragraphs above would normally provide assurance that sufficient, appropriate audit evidence had been obtained to afford a reasonable basis to support the conclusions reached in individual audit execution sections.

ANNUAL AUDIT POLICY

Detailed file reviews should be conducted only once, except for file sections considered to be of higher risk. File reviews should be conducted by applying the principle of "review by interview".

Techniques for Gathering and Documenting Audit Evidence

5.10 Various techniques are available to the auditor in conducting the examination phase of the audit. As described in the CICA Handbook:

> *"Sufficient appropriate audit evidence should be obtained, by such means as inspection, observation, enquiry, confirmation, computation and analysis, to afford a reasonable basis to support the content of the report."*

5.11 **Inspection and computation** are common methods of obtaining audit evidence. Inspection of documents and records provides varying degrees of reliability depending on the nature and source of the documents. Computation or recalculation provides a high level of assurance with respect to arithmetical accuracy. Inspection of physical assets provides highly reliable evidence of existence, some indication of value (if it does not appear damaged or obsolete) but not necessarily of ownership or value.

5.12 **Observation** of the application of a policy or procedure provides assurance of that procedure at a given point in time, but not necessarily of their performance at other times during the year.

5.13 **Enquiry and confirmation** range from written requests addressed to third parties to oral questions of individuals within the entity. Although enquiry has always been an integral part of audit, it is becoming an increasingly important method of collecting audit evidence due to the increasing use of "soft information" in financial statements. Specifically, "soft information" is based on estimates, expectations and assumptions. In addition, more reliance is placed on management controls where little documentation may exist to support the existence of the review being performed and follow-up action taken where results are out of line with management expectations. In such cases, enquiry may be the primary (or only) source of evidence that the controls are in place and working effectively.

5.14 Enquiry is used throughout the audit to:

- obtain knowledge of the entity's business;

- develop the preliminary audit strategy by cycle;
- collect specific evidence; and
- corroborate evidence collected by other means.

5.15 A solid understanding of the control environment is important in assessing the extent to which enquiry will be effective in obtaining reliable evidence. For example, in an environment in which management's integrity and trustworthiness are high, the auditor may be able to place relatively more reliance on enquiry. Accordingly, the completed Entity Control Profile provides important input to the decision as to the extent to which enquiry will provide sufficient, appropriate evidence.

5.16 In general, a number of factors must be considered when using enquiry as a source of audit evidence. As outlined in the *CICA Research Report on Audit Enquiry (2000)*, successful interviewing is based on a number of factors including asking the right questions, listening, and reading non-verbal cues. The Report also states that the effectiveness of an interview is improved with careful preparation and briefing beforehand, and debriefing and documentation afterward. The information gathered should be corroborated by information obtained through other enquiries and procedures or through dialogue with colleagues.

5.17 **Analysis** is used at various stages of the audit for different purposes. Preliminary analytical procedures are used when planning the audit to confirm the planned audit approach or to identify new risk areas that need to be addressed during the audit. [For further discussion see *Chapter 4 – Annual Audit Planning - Preliminary Analytical Procedures*]. At the Reporting and Completion phase of the audit, analytical procedures are used to assess whether the financial statements taken as a whole are reasonable and consistent with our knowledge of the business and the expected results for the year.

ANNUAL AUDIT POLICY

The audit should be executed in accordance with the plan set out in the Strategic Approach Summary. Significant changes to that plan should only be made after approval by the audit Principal

Compliance with Authorities

5.18 In testing specific authorities, it is important for auditors to recognize that either the authority has been complied with, or it has not. Unlike a detailed test of a transaction, where the valuation assertion may be understated or overstated by a wide range of values, a given authority normally has only two possibilities: complied with, or not complied with.

5.19 When identifying the significant authority requirements at the strategic planning phase, the audit team has already made a preliminary assessment of those instances considered reportable in either the auditor's report or in the management letter. Accordingly, it is important that, whenever a possible instance of non-compliance comes to the attention of the auditor, the following steps are taken:

- the auditor re-confirms their understanding of the authority requirement through discussion with the responsible Director and/or audit Principal;
- the facts of the matter are verified with the appropriate entity official(s) and, where appropriate, with other involved parties; and
- the existence of any other evidence pertinent to the matter is confirmed.

5.20 In carrying out testing for assessing compliance with authorities, the audit team would follow the general direction set out in the Strategic Approach Summary and complete the specific procedures developed for the detailed audit plans. Responsibilities are shared by all audit team members with respect to understanding the intent of all authority instruments being tested, and how the planned audit procedures provide assurance in support of the conclusion on compliance.

5.21 Consultation with Office specialists may also be required. The particular specialist(s) that should be consulted will vary depending on the circumstances, but could include one or more of Legal Services, the FRL Authorities, the Annual Audit Practice Team, the Fraud Awareness Functional Responsibility Leader and the Quality Reviewer.

Reliance on General Computer Controls

5.22 It is important that the team's IT auditor documents, assesses and tests the adequacy of general computer controls for the technical infrastructure supporting IT systems for each business cycle where higher level assurance from controls reliance is required.

5.23 The key areas for the IT auditor's review include:

- controls over program maintenance activities and upgrades to the client's operating systems;
- database administration procedures;
- information security for related systems including policies and procedures, Internet security, monitoring of security;
- computer operational controls (assess the controls in place for day-to-day operations);
- change management controls (including systems development and program maintenance processes); and

- a review of reports relating to general computer controls completed by the client's internal audit department and the conclusions reached therein.

Document, Assess and Test General Computer Controls

5.24 After reviewing general computer controls, the IT auditor documents his or her review and provides a conclusion on the adequacy of these controls.

5.25 If the IT auditor's conclusion is that the general computer controls are not adequate, the IT auditor clearly articulates the impact that the control weaknesses would have on the audit. This impact should be communicated to the individual responsible for managing the audit.

5.26 Based on the impact of noted weaknesses, the team's IT and financial auditors may need to determine if compensating controls at the business cycle level mitigate the effects of these general computer control weaknesses.

ANNUAL AUDIT POLICY

The general computer controls should be tested whenever a predominantly controls-reliant audit strategy is being adopted. An IT auditor should generally be responsible for performing this work.

Reliance on Management and Monitoring Controls

5.27 In the execution phase of an audit, the team needs to document, assess, and test the management and monitoring (M&M) controls that it intends to rely upon.

How do we test M&M controls?

5.28 The type of testing depends on the category of the control, e.g., system analytics requires different testing than an analysis of performance against budget. Typically, testing would include:

1) Understand and document the policies and procedures related to the analysis. Confirm the process, the data used and the length of time the controls have been in place.
2) Interview the individuals who perform the analysis, those who review and approve variances or exceptions and those responsible for the reports used. Ask them to walk you through the process to confirm our understanding and to ensure consistency in the process. We should question the client's personnel at each point in the process to ensure they understand the reasons for the controls and that they are looking for the appropriate type of information to identify deviations or unusual results.

3) Review the documentary or other corroborating evidence that demonstrates that the analyses were reviewed by management in accordance with established policies and procedures. Note that “review” constitutes inspection of evidence of several applications of the control, but not agreeing to supporting documentation or testing any data. When reviewing the corroborating evidence, we should confirm with the personnel involved the purpose of their review and the specific things they look for when performing the exercise.
4) Inquiry and review of follow-up and corrective action. It is not sufficient for management to say they have looked at the M&M control and its results. In order for the control to meet our objectives, management also has to analyze results, take corrective action when unexpected variances arise and follow-up to ensure steps have been taken to remediate to the situation.

5.29 Instances of the application of the M&M control being tested should be reasonably distributed throughout the period of intended reliance. If the source of the information used in the analysis is not audited (e.g. “black book systems”), additional testing must be conducted before reliance can be obtained from the analysis.

5.30 More detailed guidance on identifying and auditing management and monitoring controls is found on the Annual Audit INTRAnet site.

Reliance on Application Controls

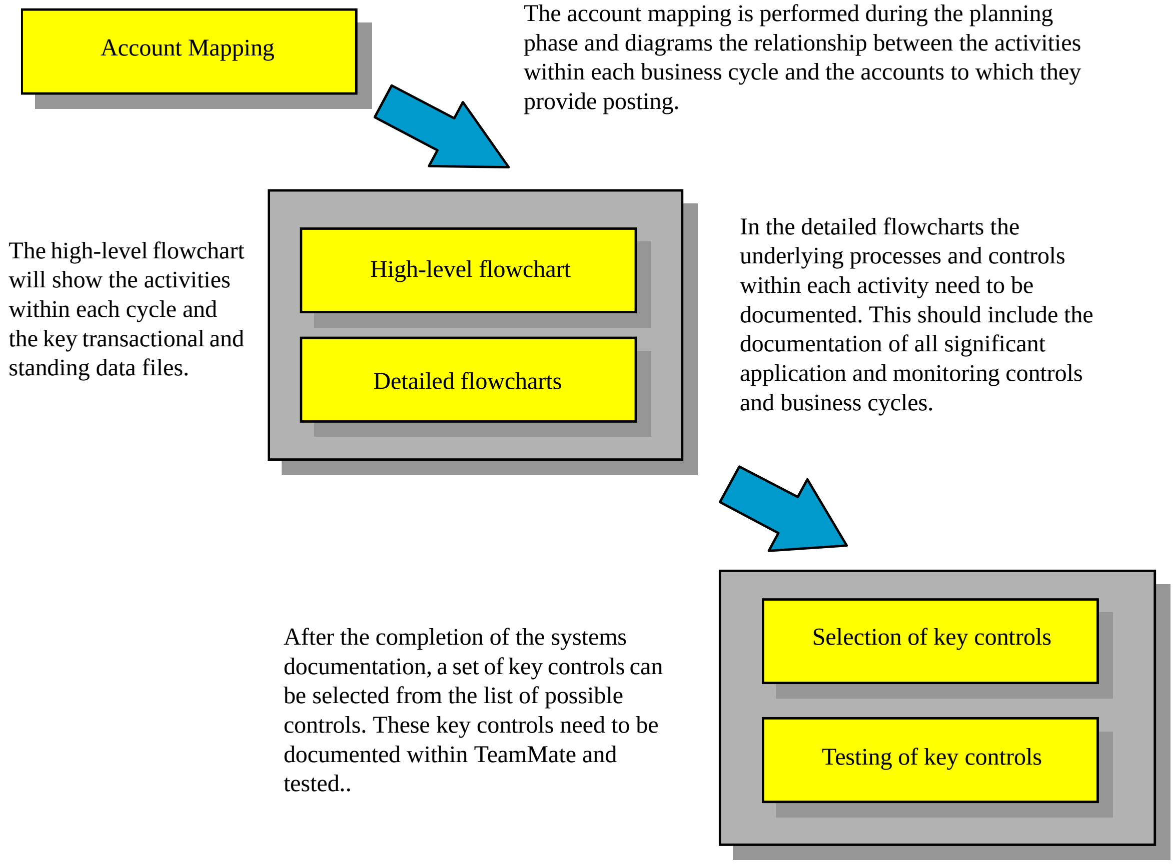
5.31 When an audit team adopts an approach from the higher end of the controls reliance continuum for a business cycle, it will need to document, assess, and test general computer and application controls. When controls reliance is at a lower level and sufficient assurance for a business cycle can be obtained from M&M controls, testing the operation of general computer controls is not required.

Document, Assess, and Test Application Controls

5.32 If the general computer controls are adequate, the IT and financial auditors should work together to document, test, and assess the key application controls in each business cycle where reliance on controls is planned. The application controls tested could include those addressing non-financial information that is an integral component of a “business cycle”, for example, where this information is used by the auditor for analytical review purposes.

5.33 When reviewing application controls, the audit team needs to understand how the systems are used to support the business cycles and to consider any issues noted by management, Internal Audit and business cycle owners.

5.34 An illustration depicting a review of application controls is outlined below.



5.35 Four key tasks need to be completed in a review of application controls. These include:

- documenting high level transaction flows;
- identifying the key controls that ensure the completeness, accuracy and validity of transactions;
- testing of key controls and reaching a conclusion on the adequacy of the key application controls; and
- assessing the overall adequacy of the application and general controls (collectively).

Documenting high-level transaction flows

5.36 Documentation of the application controls at a high level is required in order to identify key transactions (inputs/processes), master files (maintenance activities), interfaces with other modules/systems, and management reports (outputs). This information should be obtained from existing systems documentation and interviews with business cycle owners.

Identifying key business cycles and application controls

5.37 In the planning phase of the audit, business risks that have a potential impact on particular financial statement components assertions are identified and assessed in order to ensure that audit efforts are focused on the key business cycles that support the financial statements.

5.38 This risk assessment determines the critical nature of these business cycles and the type of related controls selected for review, documentation, and evaluation.

5.39 In the examination phase, an audit program for assessing application controls needs to be developed that reviews and evaluates controls for each key business cycle. The assessment involves:

- developing a detailed understanding of the key business cycles;
- identifying specific risks (access, input, rejections, processing) for each process;
- determining the control objectives (completeness, accuracy, validity, restricted access) required to mitigate the risks identified;
- identifying, documenting, and assessing the key controls designed within each business cycle to meet the control objectives that have been identified; and
- linking the key controls to the audit assertions.

Testing and reaching a conclusion on the adequacy of key business cycle controls

5.40 Application controls can be manual or system-based (automated controls). Only the key application controls required to meet the audit assertions are tested as well as those required to ensure that proper access privileges are in place.

5.41 Testing can consist of enquiries, observation, inspection, and limited re-performance. Based on the result of the tests, an overall assessment of the adequacy and effectiveness of the controls for audit reliance purposes is documented.

5.42 Where control weaknesses in application controls are noted, compensating controls must be identified and tested. If compensating controls are not found, substantive procedures are required to address critical financial statement component assertions.

Assessing the overall adequacy of the application and general controls (collectively)

5.43 The findings for both the general computer controls and the application controls are then summarized and the overall adequacy of controls is assessed. A summary of audit findings and recommendations for improvement is prepared and communicated to management.

5.44 More detailed guidance on reliance on application controls is available on the Annual Audit INTRAnet site.

Analytical Procedures

5.45 Section 5300 of the CICA *Handbook* defines analytical procedures as techniques by which the auditor:

- studies and uses meaningful relationships among elements of financial and non-financial information to form expectations about what the recorded amounts should be;
- compares such expectations with the recorded amounts; and
- uses the results of the comparisons to help determine what, if any, other audit procedures are needed to obtain reasonable assurance that the recorded amounts are not materially misstated.

5.46 Analytical procedures, therefore, are **substantive** procedures involving a comparison of the recorded amount being audited to an amount that the auditor expects. The auditor’s expectation of the amount is derived from his/her knowledge of relationships between the amount being audited and some other independent data. The data used in arriving at the auditor’s expectation of the amount may be financial or non-financial and may originate from within or outside the entity being audited. Analytical procedures vary from simple comparisons, such as the current year’s amounts (or ratios) with prior year’s amounts (or ratios), to complex analysis using advanced statistical techniques and computer audit software, such as multiple regression analysis software.

5.47 The Office categorizes analytical procedures as follows:

Category	Well-suited to Public Sector?	Description	Some Key Factors to Consider
Single Component Comparisons	Yes	There are two types: • a comparison of recorded amounts against budget amounts; and • trend analysis, comparing current amounts to comparable amounts from the prior period.	If Budget: • Can budget be relied on? • Who reviews the budget? • Is the budget updated throughout the year? If Prior Year: • Has the nature of the business changed (major clients, product mix, etc.)? • What have been the economic trends in the intervening period?
Systems Analytics	Yes	Systems analytics involve the identification of unusual items within accounts rather than an analysis of the account balance taken as a whole. They include scanning or analysis of entries in transaction listings, subsidiary ledgers, general ledger control accounts, adjusting entries, suspense accounts and reconciliations.	• What is significant or unusual? • What volume of activity is normal/ expected? • What is the nature of the transactions going through the account?
Independent Tests of Reasonableness (Predictive Analysis)	Yes	These involve the creation of an expectation using operating or external data (independent of the accounting process) as well as financial data to predict an amount under examination, for example, using employee head counts and average remuneration statistics to predict payroll expense.	• Can the balance be predicted using an external factor? • How relevant is the external data source to the entity's business? • Can we rely on the accuracy of internally generated operational statistics?
Cross Component Comparisons	No	These involve the analysis of the relationship of two or more financial statement variables. Usually this is referred to as ratio analysis. Examples include accounts receivable turnover and gross margin analysis.	• Relationships between components. • Changes in entity policies (i.e. credit policies). • Knowledge of what events impact the numbers. • Changes in the business environment.

Category	Well-suited to Public Sector?	Description	Some Key Factors to Consider
Regression Analysis	No (except for payroll)	Regression is a statistical technique that involves analyzing the known behaviour of variables and developing an equation (model) that explains the average relationship between these variables. A regression model is similar to an independent test of reasonableness, but it is more objective and provides a reliable estimate of an acceptable range of fluctuation. For example, historical monthly staffing by level is regressed against average monthly salary levels to develop a model that predicts payroll expense.	• Many of the factors relating to independent tests of reasonableness apply to regression as well. • If there is a history of errors in the data used, the formula will incorporate them and predict poorly.

5.48 Factors that affect the degree of substantive assurance that can be derived from a particular analytical procedure are:

- the sophistication of the procedure used;
- the plausibility and predictability of the underlying relationship between the amounts used for comparison; and
- the extent to which the data used are independent, verifiable, relevant and reliable.

5.49 It should be emphasized that the Office is looking for rigorous, thoughtful, quantitatively-based analyses that provide substantive assurance. A five-step approach has been developed to help guide auditors in developing a suitably rigorous approach:

5-STEP APPROACH	
E **D** **C** **I** **D**	1. Develop an **expectation**; 2. Define a significant **difference** (e.g. 50% of planned precision for annual data, 20% of planned precision for monthly data); 3. Perform the **calculation**; 4. **Investigate** significant differences (explaining to at least one-half of whatever you defined as a significant difference); and 5. **Document** the procedures performed.

5.50 Strong support and involvement is needed from the audit Principal and Director to ensure that the analytical procedures used are conceptually sound and take into account all factors that could or should result in large changes in specific components.

5.51 More guidance on the use of analytical procedures may be found on the Annual Audit INTRAnet site.

Substantive Tests of Detail

General

5.52 Substantive tests of detail are useful sources of assurance when a combination of reliance on controls and analytical procedures still does not provide the level of assurances considered necessary, **or** in unusual circumstances where a controls-reliant approach is either not feasible or is not considered to be cost-effective. The nature and extent of the assurance required from tests of details should be determined after considering matters such as the control environment; CAKE; reliance on monitoring, application and general computer controls; and the ability to develop effective analytical procedures.

5.53 The most common "tests of details" are as follows:

- Confirmations (e.g. accounts receivable);
- Observation of the items comprising an account balance (e.g. inventory observations);
- Inspection of documents (reviewing a lease contract to assess if it is capital or operating); and

Agreement of transaction details to supporting documentation (e.g. audit sampling testing).

5.54 Substantive tests of details are often the most appropriate way to test compliance with authorities. This relates, in large part, to the fact some authority requirements do not lend themselves to a controls-reliant approach, for example the requirement for Ministers responsible for Crown corporations to table before Parliament a summary version of the corporation's Corporate Plan.

5.55 The primary disadvantage of substantive tests of details is that they may be a less efficient way to obtain assurance than through the use of other techniques.

Other Selective Testing Procedures and Audit Sampling

5.56 The remainder of this section deals with selective testing procedures and audit sampling testing. Under the Office's methodology, there are three primary techniques for selecting transactions for detailed testing:

- Targeted testing (e.g. high value and/or high risk);

- “Top-Up” testing (e.g. small judgmental selections); and
- Representative sampling (e.g. DUS).

5.57 **Targeted testing.** Targeted testing involves selecting items of a particular size or with particular characteristics, where those items are not representative of the population as a whole. Items may be selected in the following ways:

- Coverage - A coverage-based selection recognizes the size of items making up the population and gives greater emphasis to higher value items. For example, if a population contains 5 items that comprise 80% of the total value of the population, a high level of assurance can be obtained in relation to existence and accuracy by selecting just the 5 items. However, where material monetary understatement is equally likely to be found in small value or "no-value" recorded amounts, a test targeted on coverage alone is not appropriate. Generally, any item that, individually, has a high risk of containing an error exceeding materiality should always be examined.
- Weighting – The selections may also be “weighted” - for example, tests for completeness of trade payables might be weighted by selecting larger suppliers rather than large payables balances.
- Risk – The selections may also be based on other criteria, such as items we perceive to be higher risk. For example, termination payouts related to downsizing may be targeted to validate entitlement and the appropriateness of the amount paid.

5.58 It is important to note that “targeted” testing does not purport to be representative sampling. Consequently, if errors are found, they should not be projected.

5.59 In rare cases, it may be appropriate to obtain a significant portion of our audit assurance from targeted testing. This would be the case where controls reliance was not considered practical or cost-effective **and** targeted testing provided a great deal of coverage. The table below provides some “rules of thumb” that would support moderate to extensive levels of assurance from targeted testing:

“RULES OF THUMB”

Assurance Required	**Required Level of Audit Work**
Moderate	Targeted selection with a coverage by $ value of between 40% and 80%. ***Note:*** If the remaining unaudited coverage is greater than twice materiality then the total selection should be at least 30 items.

Assurance Required	Required Level of Audit Work
Extensive	Targeted selection with a coverage by $ value of 80% or more (including all items greater than materiality) and remaining unaudited coverage is not greater than twice materiality.

5.60 **“Top-Up” Testing.** “Top-Up” testing is a form of judgmental selection designed to provide **low** levels of substantive assurance. “Top-Up” testing is appropriate when reliance on controls, analytical procedures and targeted testing have provided most, but not all, of the assurance considered necessary by the audit team. Since targeted testing is generally preferable to “top-up” testing, the audit team would ensure that the maximum benefit had been obtained from targeted testing before it turned to “top-up” testing. “Top-Up” testing would also be appropriate where a particular residual risk needs to be addressed, but the risk applies to a relatively small element of a financial component. For example, a “top-up” sample of overtime payments might be appropriate where the overtime population is relatively homogeneous, as “targeted testing” might be ineffective in such circumstances.

5.61 “Top-Up” testing is **not** an appropriate technique to use when the **primary** source of audit evidence for a significant financial statement component is substantive tests of details. In such circumstances, the auditor would apply dollar unit sampling (see below), after taking into account targeted testing parameters. “Top-Up” testing would also **not** be appropriate if it was providing the majority of assurance relating to a residual risk whose population was more than two times materiality.

5.62 **Selection sizes** for “Top-Up” testing can range from **12 to 20 items**. Deciding which end of the range is appropriate will depend largely on our CAKE and the other testing being performed. For example, if this test is providing a significant portion of our **substantive** assurance (perhaps because targeted testing is not practical), then we are likely to need to be at the higher end of the range. Conversely if the test adds to assurance gained from a variety of other tests, the lower end of the range will be more appropriate. Over time, as our CAKE increases, (and other factors remain unchanged) we should be able to move towards the lower end of the range (i.e. from 20 towards 12).

5.63 “Top-Up” testing is designed to corroborate earlier findings. If errors are found in “top-up” testing, the auditor would want to reassess the results of earlier testing, or expand testing until a conclusion could be reached on the risk of a material error being present.

5.64 **Representative (Statistical) sampling.** In rare cases, we may find that it is either impossible or too costly to attempt to obtain audit assurance primarily from a combination of reliance on controls and analytical procedures. In such circumstances, we would look to statistical sampling based on “dollar unit sampling” (DUS) techniques. If substantive tests of details are to be our primary source of audit evidence, the Office requires that a statistical sampling approach be applied.

5.65 When a DUS sampling approach is selected, the audit Principal should expect his/her staff to have defined the following items before carrying out procedures:

- the purpose (objective) of the procedure, including the assertion(s) being addressed;
- the population from which the sample will be selected;
- what will constitute an error; and
- the confidence level (i.e. sampling risk) for the procedure

5.66 Two other important sampling inputs are materiality and planned precision. Materiality, defined in the strategic planning phase, relates to the maximum allowable error. What the auditor normally plans to do is perform enough work to conclude that, based on the results of all the audit tests, the chance of the maximum possible error exceeding materiality is less than or equal to the ultimate audit risk the auditor is willing to assume.

5.67 This means, for example, that the auditor cannot simply equate the net most likely errors to materiality; there must be an allowance for further possible errors. This allowance is referred to as the “precision”. Planned precision is determined at the strategic planning phase, as illustrated below:

Planned Precision Illustrative Example		**Overstating (Understating) current year’s income**
Materiality for the engagement		$ 300,000
1) Expected aggregate errors in current year’s net income (Net of the reversing impact of prior years’ errors)	$ 50,000	
2) Cushion to allow for fact that current year-end audit results may exceed those anticipated in (1)	20,000	70,000
Planned precision (should normally not be less than half materiality, in this case $150,000)		$ 230,000

Statistical Sampling - Extent of Testing Decisions

5.68 The extent of testing will be performed at one of two levels: moderate or extensive. These options are outlined in the table below::

"RULES OF THUMB"	
Assurance Required	**Required Level of Audit Work**
Moderate	Representative sample (normally statistical via DUS) using a 70% confidence level.
Extensive	Representative sample (normally statistical via DUS) using a 90% confidence level.

5.69 Errors identified during the testing of a DUS-based sample should always be projected to the population subject to testing, using the appropriate methodology. Generally, most teams make use of IDEA for this purpose.

Documentation of Audit Testing

5.70 In all cases, it is important to appropriately document the *nature* of the tests performed (what kind of test was performed, what kind of evidence was sought), the *extent* of the test procedures (how deeply the auditor probed, how many tests were performed, what portion of the fiscal period was covered by the tests), the *timing* of the test procedures (when the testing was performed), the *results* of the tests and other procedures and the *conclusions* reached by the auditor.

5.71 Ideally, the auditor includes as much of this information as possible in the detailed audit procedure steps. In that way, when the TeamMate file is "rolled over" for the subsequent fiscal year's audit, as much information as possible is retained in the file. Should the same audit procedures be appropriate in the next audit, the auditor will only need to document the *results* of the tests performed and the *conclusions* reached by the auditor. Such practices promote the execution of an efficient audit.

5.72 Documentation practices should be consistent with the "re-performance principle". For example, if an auditor reviews all receivables at year end in excess of $100,000 that have been outstanding for more than 120 days, the individual receivable balances reviewed would not have to be listed in the audit file, because exactly the same review could be re-performed by another auditor, simply by obtaining the client's aged accounts receivable schedule from the client's own files and records. However, if a "top-up" test of details of 12 judgmentally-selected overtime payments to staff was performed, each overtime payment audited would have to be identified in the audit file, because another auditor would be unable to "re-perform" the testing on exactly the same population.

5.73 Documentation of the audit file on the basis of the “re-performance principle” must consider the quality of the client’s file and documentation retention policies and practices. The audit team should ensure that they are familiar with the client’s practices in this regard, and adjust their file documentation practices accordingly.

ANNUAL AUDIT POLICY

The individual managing the audit should ensure that team members are familiar with the file retention and documentation policies of the client, and the implications (if any) for documenting their work in accordance with the “re-performance principle”.

ANNUAL AUDIT POLICY

The documentation of audit tests and other procedures should be consistent with the “re-performance principle.” Sufficient information should be documented to identify the transactions or controls tested; the nature, extent and timing of the tests or other procedures performed; the results achieved; and the conclusions reached by the auditor.

6 Annual Audit Reporting and Completion

Evaluating Audit Results

Audit Differences Identified in the Financial Statements

6.1 As the fieldwork is being completed, the audit team should be accumulating and summarizing non-trivial errors found during testing. The purpose is to estimate the likely aggregate misstatement in the financial statements. The likely aggregate misstatement is estimated by summing:

a) misstatements identified as a result of performing specific auditing procedures other than representative (statistical) samples;
b) projections of misstatements identified as a result of performing auditing procedures on statistical samples;
c) disagreements with accounting estimates;
d) disagreements about the fairness of accounting principles applied; and
e) the net effect of uncorrected misstatements in opening equity.

6.2 For the annual audit of financial statements that apply the recommendations of the CICA Public Sector Accounting Handbook, PS 2120, *ACCOUNTING CHANGES*, a different approach to the treatment of errors on the overall error evaluation is required. A discussion paper on the impact of PS 2120 can be found on the Annual Audit INTRAnet Site, under Conduct of the Audit — Public Accounts (Section 6), FRL Guidance.

6.3 The Office has designed a "*Summary of Unadjusted Differences*" template in order to present non-trivial unadjusted differences in such a way that facilitates evaluating whether, in relation to individual amounts, subtotals, or totals in the financial statements, they materially misstate the financial statements as a whole. The audit Principal should review the Summary of Unadjusted Differences and ensure that the audit team has properly accumulated and evaluated the results.

6.4 The audit Principal should always consider qualitative factors when evaluating the impact of unadjusted differences. Qualitative factors may, in certain circumstances, result in misstatements of relatively small amounts having a material effect on the financial statements. For example, misstatements that have the effect of altering performance trends, turning operating losses into operating income or that increase management's compensation could well be considered material, even though they might be less than our quantitative measure of materiality.

6.5 The audit Principal should also give due consideration to further possible misstatements, possible overall management bias in accounting estimates, significant changes in bias from one period to the next, and the potential impact on future years' results of differences identified in the current year.

Evaluating Compliance with Authorities and "Other Matters"

6.6 All potential cases of reportable non-compliance with authorities should be referred to the audit Principal for assessment and resolution. Such situations often involve legal interpretation of the relevant facts of the case, and this will normally require consultation with Legal Services. Responsibility for ensuring that Office protocol is followed, and that resolution of the matter is properly documented, rests with the Director and the audit Principal (refer to consultation methodology and policies in the *Chapter 7 - Consultation*).

6.7 Non-compliance with authorities is considered significant and reportable where there is a serious deviation from legislative and other authorities with respect to purpose, monetary limits and other restraints.

6.8 Although compliance is normally a yes–or–no situation, the authority paragraph in the auditor's report refers to compliance "in all significant respects". The auditor, therefore, has to assess the significance of the non-compliance situations identified, and the attitude of the entity, as not all instances of non-compliance will necessarily be reported. The following factors need to be considered when evaluating the significance of a non-compliance situation:

- the significance of the deviation in relation to the dollar materiality of the transaction(s), as it may or may not be advisable to report a deviation involving small monetary amounts;
- the importance of the deviation considering the organization's legislative mandate;
- the level of importance of the authority (non-compliance with a statutory requirement is likely to be more serious than non-compliance with a by-law);
- the pervasiveness of non-compliance. For example, a situation reported only in the management letter in previous year(s) is escalating and the entity does not intend to take corrective action;
- the motivation behind the deviation, as an accidental happening, may be dealt with differently from a voluntary and deliberate non-compliance;
- the clarity of the situation. For example, a "borderline" case when there are diametrically opposed legal opinions from the entity and the Office;
- the need for reporting the situation to Parliamentarians, after giving consideration to any public or parliamentary sensitivity or known need;
- the corrective action, if any, taken by the entity (e.g., an unauthorized transaction that is subsequently approved retroactively may not warrant disclosure); or

- the impact of reporting, as the perceived role of the Office as an agent of change may influence the entity or the government to react to and change the unwanted situation.

6.9 Issues that may be "other matters" are also generally complex and difficult to evaluate. Generally, a process similar to that recommended for evaluating compliance with authority issues should be followed. That is:

- the facts should be reconfirmed through discussion with the client;
- there should be consultation with specialists in the Office, as appropriate;
- the critical factors used in arriving at our conclusion should be explained; and
- the "other matter" and its final resolution should be properly documented.

Reporting Compliance with Authorities and "Other Matters" — Crown Corporations and Other Entities

6.10 Reporting the results of auditing compliance with authority must be in accordance with the legislative audit mandate or the terms of the engagement. For Crown corporations, significant non-compliance with the authorities specified in the *FAA* would be reported in the compliance paragraph as a reservation. Significant non-compliance with other authorities would be reported as an "other matter".

6.11 The standard Office wording of auditor's reports for Crown corporations is used where there are no reservations.

6.12 Depending on the significance of the non-compliance situation and results of discussions with the entity, any reservation of opinion could be presented in one of the following ways:

- a description of the situation in a separate paragraph between the opinion on the fairness of the financial statements and the opinion on compliance with authority, with an "except for" and reference to the reservation paragraph in the opinion on compliance paragraph; or
- a brief description of the non-compliance situation in the compliance paragraph, with the use of "except for".

6.13 It is advisable that any situation of non-compliance not included in the auditor's report be included in the management letter and fully discussed with management and those having oversight responsibility for the financial reporting process (such as an audit committee).

6.14 The audit team would also consider the appropriateness of developing an Audit Note for potential inclusion in an Auditor General's periodic Report (refer to *Chapter 8 - Practice Expectations Common to All Product Lines*) based on the instance of non-compliance referred to in our Auditor's Report.

Reporting Compliance with Authorities — Public Accounts of Canada

6.15 The results of all compliance with authority work carried out by the Office should be considered in assessing audit assurance on the compliance related information included in the Summary Financial Statements of the Government of Canada.

6.16 All compliance with authority work, whether under value–for–money audits or Crown corporation and other separate opinion audits, provides audit assurance on this information.

The Auditor's Responsibility to Consider Fraud and Error

6.17 The auditor should communicate, on a timely basis, with appropriate levels of management regarding any fraud, suspected fraud or non-trivial errors identified during the course of the audit. The auditor should also consider the need to communicate these issues to the body having oversight responsibility for the financial reporting process. The auditor should consider communicating these matters to those with oversight responsibility for the financial reporting process regardless of whether or not the error was corrected or whether or not the fraud or suspected fraud has a material impact on the financial statements.

6.18 The auditor should always inform such a body (audit committee or equivalent) of those misstatements identified during his/her examination that management declined to correct because they were considered immaterial, individually or in aggregate, to the financial statements taken as a whole. The auditor would also communicate, where appropriate, any concerns of a reporting nature that might be construed as "fraudulent financial reporting".

6.19 Opportunities identified by the auditor to help strengthen the organization's risk assessment processes (as they pertain to the prevention and detection of fraud and error), the related control framework and cultural values would be communicated to the entity in the form of a management letter.

Final Analytical Procedures

6.20 Prior to issuing our auditor's report, final analytical procedures should be performed. These generally consist of a high level review of the financial statements and related management performance reports (which could include non-financial information) in order to provide assurance that the financial statements, taken as a whole, are consistent with our knowledge of the business, the results of our audit procedures and management's own analyses.

6.21 Final analytical procedures normally confirm judgments made during the audit. However, the auditor should be alert for unusual or unexpected balances or relationships which might indicate that additional audit procedures are warranted because, for example:

- planning materiality may have been set too high (e.g. planning materiality was based on budgeted expenditures and actual expenditures are significantly lower);
- component balances expected to be insignificant may have become material since the planning phase of the audit; and/or
- changes in one or more component balances may indicate a heightened risk of fraud or the presence of error.

6.22 Before undertaking significant new audit work, the audit Principal and/or the Director would seek to obtain adequate explanations and/or corroborative evidence to explain these unexpected results (where appropriate).

The Quality Reviewer’s Role in Reporting

6.23 Through discussion with the audit team and through the review of selected key documents, Quality Reviewers focus their attention on the following reporting matters:

- Appropriateness of key judgments made by the audit team and positions taken on complex, controversial or politically sensitive issues;
- Nature and extent of consultation by the audit team;
- Financial statements and note disclosures, including the selection of accounting policies;
- Significance of any disagreements between entity management and the audit team relating to matters discussed in the report;
- Appropriateness of the content of planned communications to management, those having oversight responsibility for the financial reporting process, responsible ministers and/or the legislature; and
- Appropriateness of the Auditor’s Report.

6.24 In those rare cases where the Quality Reviewer and the audit team are in disagreement over a significant matter, the AAG or another Assistant Auditor General (independent of the responsible AAG) would be consulted.

6.25 The work of the Quality Reviewer should always be completed before the Auditor’s Report is finalized. It is the audit Principal’s responsibility to ensure that the Quality Reviewer is consulted on a timely basis and receives the information needed to perform his/her review. The nature, extent and timing of the Quality Reviewer’s work and his or her conclusions are documented in the Report Clearance Summary folder D.4 in TeamMate.

ANNUAL AUDIT POLICY

On those audits for which a Quality Reviewer has been appointed, the audit Principal is responsible to ensure that the Quality Reviewer is consulted on a timely basis and receives the information needed to perform his/her review. The consultations with respect to the execution and reporting phases of the audit should be completed before the issuance of the Auditor's Report.

Annual Audit Practice Team (AAPT) Review

6.26 The Annual Audit Practice Team (AAPT) financial statement review has two broad objectives: to ensure that there is a consistent approach to significant audit issues throughout the Office; and to ensure that auditor's reports conform to professional reporting standards and are appropriate to the financial statements presented.

6.27 AAPT's specific responsibilities are to assess:

- the clarity, accuracy and completeness of the financial statements and accompanying notes;
- the appropriateness of the financial statements presented in meeting the needs of the entity's users and conforming with all legal and professional reporting requirements; and
- the appropriateness of the Auditor's Report.

6.28 To facilitate AAPT's review, the audit Principal is responsible for performing an initial review of the draft financial statements and Auditor's Report. Subsequent to his/her review, the audit Principal will provide AAPT with the following:

- draft Auditor's Report;
- draft financial statements, including notes;
- access to the TeamMate file to review the Report Clearance Summary folder;
- internal consultations;
- draft report (if prepared) to those having oversight responsibility for the financial reporting process;
- information on the resolution of issues raised in prior years' AAPT comments that were deferred; and
- final analytics.

6.29 AAPT will review the appropriateness of the draft Auditor's Report, taking into account the financial statement presentation and format; the accounting principles followed; the clarity, accuracy and completeness of notes to the financial statements; and other information presented to them. Based on the results of their review, AAPT will prepare a memorandum to the audit Principal summarizing the results of the review and providing advice in areas where AAPT believes the statements and/or the Auditor's Report could be improved. When there is mutual agreement on the issues raised in the AAPT review memorandum and the financial statements have been finalized, the audit Principal and AAPT co-sign it. If the audit Principal declines the advice offered in areas considered by AAPT to be critical, then the audit Principal, after consultation with AAPT, will present the relevant facts to the AAG, and the Auditor General as appropriate, for resolution.

6.30 Consultation with the AAPT and related policies are discussed more fully in *Chapter 7 - Consultation* of this Manual.

ANNUAL AUDIT POLICY

T**he audit Principal should consult with the Annual Audit Practice Team on the draft Auditor's Report, draft financial statements, and matters of significance related to our report. The audit Principal should document his/her disposition of any advice received from the Annual Audit Practice Team prior to recommending signature of the Auditor's Report.**

The Public Accounts of Canada

6.31 The Auditor General's Independent Advisory Committee provides an independent review of any new notes or significant changes to the Summary Financial Statements of the Government of Canada.

Sensitive Issues

6.32 Certain sensitive issues should be brought to the attention of the Auditor General prior to the signing of the auditor's report. These sensitive issues would include such matters as proposed reservations of opinion, significant non-compliance with authorities, proposed "other matters", management estimates that have a significant impact on the reported results of operations, controversial professional positions or other matters with the potential for broader implications beyond the audit entity alone.

ANNUAL AUDIT POLICY

The audit Principal and the responsible AAG should consult the Auditor General on any proposed reservations of opinion, "other matters", or any other sensitive issues, prior to the signing of the Auditor's Report.

Report Clearance Summary

6.33 The Report Clearance Summary folder in TeamMate provides a framework for the audit Principal to document completion and clearance of an annual audit (or of a special audit engagement) and a basis for the necessary reviews and approvals. Within the Summary folder, the audit Principal should:

- **highlight** significant events underlying the entity's financial performance during the year;
- describe any relevant new or emerging accounting or auditing standards and their current and/or future impact on the entity;
- provide **summarized** information on the overall unadjusted differences;
- identify the business cycles where audit assurance was obtained from reliance on controls, or where substantive steps were taken to move to controls reliance in the future;
- describe any significant areas where consultation was required during the course of the audit;
- provide an overview of audit performance; and
- establish the budget for next year's audit.

The report to those having oversight responsibility for the financial reporting process may also be referenced, to the extent that this information is included there.

6.34 The information contained in the Report Clearance Summary folder should be prepared at an appropriately high level of aggregation. Discussion and review of this information should be conducted using "review by interview" and limited additional documentation would be provided. Key discussion points and any additional steps required as a result of review should be noted in the appropriate section of the TeamMate file.

6.35 The Report Clearance Summary is normally prepared under the direction of the audit Principal. The Quality Reviewer (if any) should be consulted before the Summary is finalized and presented to the delegated signatory. If the signatory is the Auditor General, the responsible Assistant Auditor General should also approve the Summary. The signatory should be provided with a replica copy of the Reporting and Completion folder, to facilitate their review.

6.36 The AAPT is also to be provided with a TeamMate replica copy of the Report Clearance Summary along with the draft Auditor's Report and the Financial Statements and notes. Where there are unresolved differences of opinion between the audit team and the AAPT, the AAPT should be provided with the opportunity to review and provide comments on the Summary before it is finalized.

6.37 For the annual audit of the Public Accounts of Canada, only one Report Clearance Summary is prepared, under the direction of the Public Accounts team Principal. Entity teams may be requested by the Public Accounts team to provide specific information for inclusion in the Summary. In those rare cases where there are unresolved differences of opinion between the Public Accounts team and the entity team, the entity team should be provided with the opportunity to provide comments for inclusion in the Report Clearance Summary.

Recommendation for Signature

6.38 The audit program in the Report Clearance Summary folder contains the recommendation by the responsible individual(s) that the delegated signatory sign the Auditor's Report as presented. The audit step provides standard wording and specifies matters on which explicit representations are required. The individual responsible for giving final clearance to the auditor's report is determined according to the Office's approved Delegation of Signing Authority, which is available on the Annual Audit INTRAnet site.

6.39 Those reviewing and approving the Report Clearance Summary want to know quickly whether there are any exceptions to the standard representations made in the Summary. Therefore, the standard sign-off as included in the standard TeamMate Library file should always be used, with any exceptions clearly identified, ideally through the use of coloured text.

ANNUAL AUDIT POLICY

The audit team should document the completion of the audit and their recommendation to sign the Auditor's Report in the Report Clearance Summary folder. The Summary should be approved by the individual with delegated signing authority for the auditor's report.

Signing the Auditor's Report

6.40 The Auditor General has approved a Delegation of Signing Authority for the auditor's reports of the Office's annual audits. The signed Auditor's Report should, in most cases, be scanned into the electronic file and the original retained on the paper file we maintain for each annual audit.

ANNUAL AUDIT POLICY

The audit team should obtain the signature for the Auditor's Report in accordance with the Delegation of Signing Authority approved by the Auditor General for annual audits.

Management Letter of Representation

6.41 A letter of representation should be obtained for every audit, and should bear the date of substantial completion of fieldwork. A template for a generic management representation letter is available on the Annual Audit INTRAnet site.

6.42 Changes in the CICA Handbook – Assurance in 2002 relating to the *Auditor's Responsibility to Consider Fraud and Error* resulted in the addition of four specific management representations relating to fraud and error. These representations have been included in our standard Office template which is available on the Annual Audit INTAnet site. The additional requirements ask management to:

- acknowledge its responsibility for the implementation and operation of internal controls that are designed to prevent and detect fraud and error;
- indicate that, in its view, the impact of uncorrected errors identified by the auditor is immaterial, both individually and in aggregate, to the financial statements taken as a whole;
- confirm that it has disclosed to the auditor all significant facts related to frauds or suspected frauds known to management that may have affected the entity; and
- confirm that it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

ANNUAL AUDIT POLICY

The audit team should obtain a letter of representation from the appropriate level of management as at the date of substantial completion of fieldwork.

Reporting to Those Having Oversight Responsibility for the Financial Reporting Process

6.43 The audit Principal should prepare a formal written report to the body having oversight responsibility for the financial reporting process, outlining the results of the examination of the entity's annual financial statements and discussing all matters likely to be of significance or concern to the body's membership.

6.44 One area of particular significance to the fair presentation of financial statements is the quality of the accounting principles selected by management. To assist the body having oversight responsibility for the financial reporting process, the auditor communicates his or her professional judgments on the qualitative aspects of those accounting principles having a significant impact on the entity's financial reporting results.

6.45 The auditor would also communicate matters arising from the audit that, in the auditor's judgment, are important and relevant to the oversight body.

6.46 Some of the more important areas to discuss normally include:

- reconfirmation of our independence;
- our results in relation to each of the matters of significance identified in our planning report;
- the results of our procedures in areas involving significant management judgments and estimates (often included in the bullet above);
- any concerns or issues we identified relating to asset or liability carrying values;
- any concerns or issues we identified in relation to the recognition (or non-recognition) of significant revenues and/or expenses;
- an explanation of the auditor's report being submitted; and
- results of our review of the annual report.

6.47 Other areas that should be brought to the attention to those having oversight responsibility for the financial reporting process are:

- Instances of fraud identified during the audit;
- Instances of illegal, or possibly illegal acts;
- Misstatements identified during the course of the examination that management declined to correct because they were considered immaterial, individually or in aggregate, to the financial statements taken as a whole;
- Any significant errors identified during the course of the audit that were corrected by management but which could indicate the existence of serious control weaknesses;
- Any concerns of a reporting nature that might be construed as "fraudulent financial reporting".
- Any other areas of significant disagreements with management;
- Significant weaknesses in internal control identified by the auditor; and
- Related party transactions not in the normal course of operations and which involve significant judgments by management concerning measurement or disclosure.

6.48 The report to the oversight body should be provided to senior management of the entity for review and comment prior to being finalized.

ANNUAL AUDIT POLICY

The audit team should communicate in writing and on a timely basis with those having oversight responsibility for the financial reporting process. Our report should describe the results of the audit and any significant observations and/or recommendations arising from it, as well as other information required by generally accepted auditing standards.

Meeting the Audit Committee "in camera"

6.49 It is good practise for the auditor to meet with the audit committee without the management present, as this allows for a full and frank discussion between the auditor and the audit committee. We should encourage these "in camera" sessions as a normal and constructive practice.

Review of the Annual Report

6.50 Whenever our Auditor's Report is to be included in an annual report or other published document, we should arrange to read the other information to ascertain that, based on our audit of the financial statements, we believe it to be free of any material misstatement of fact or material inconsistencies with information appearing in the financial statements. Where we believe that it is materially misleading or inconsistent, we should attempt to convince management (or the directors) to correct the other information. If the required corrections are not made, it may be necessary to refuse to sign or to withhold the use of our report. This review should be completed while the annual reports or other documents are in draft form, in order to permit any concerns the auditor may have to be acted upon before the document is finalized and printed.

6.51 Many audit entities now post their annual reports, including their audited financial statements, on the Internet. For those entities, it is important to ensure that they have appropriate controls in place to ensure that the financial statements posted to the Internet are accurate and complete, and to prevent unauthorized changes to information.

6.52 The auditor should also take appropriate steps to ensure that the audit entity has accurately reproduced the financial statements, including the Auditor's Report, on the Internet. More guidance on Annual Reports on the Internet is found on the Annual Audit Intranet Site.

6.53 We should ascertain early in the audit whether the client intends to post the audited financial statements on the Internet, and ensure that they are aware of the associated risks and need for adequate control procedures.

Management Letters

6.54 During our audits we frequently identify opportunities where audit entities could improve their systems of internal control and/or strengthen their financial and reporting practices. These observations are important to entity managers, and the auditor has a professional obligation to ensure that the appropriate level of management is made aware of them. This may be done orally or via a management letter.

6.55 Where important internal controls either do not exist or are ineffective, our management letters should include specific suggestions on how to strengthen internal controls in the entity, in order to facilitate more effective management and eventual reliance. Consideration should also be given to reporting the issue to Parliament.

6.56 The implementation of a business risk based methodology provides us with an opportunity to add value to our management letters. By having an improved appreciation of the broader level risks facing the entity, we will be in a good position to identify other issues of interest to management.

6.57 Examples of the types of value-added matters we could expect to be bringing to management and Parliament's attention include:

- Significant business risks that the entity does not appear to be managing;
- Risk management strategies that do not appear to be effective;
- Identification of key performance indicators that would enhance management controls over operations; and
- Best practices in similar organizations that the entity should contemplate implementing in its operations.

6.58 Management letters may be written in point-form or in long-form. Individual management letter points should include a clear description of the observation, the consequences of the observation, recommendations for improvement and comments of managers responsible for taking corrective action.

6.59 Management letters should normally be prepared under the signature of the responsible audit Principal. Management letters should be reviewed by the responsible Assistant Auditor General whenever the Principal is ***not*** the delegated signing authority for the engagement.

6.60 Management letters that are not timely do not serve the interests of our clients or meet our own expectations. A draft management letter should normally be issued within one month of the date of the auditor's report.

6.61 Matters significant enough to be reported should be followed up in subsequent audits.

ANNUAL AUDIT POLICY

The audit team should communicate to management, on a timely basis, the results of the audit and any significant observations and recommendations that came to our attention. This communication should be in the form of a management letter, in both official languages, unless another form of communication is approved by the audit Principal.

6.62 Office policies dealing with communications in the broad sense are discussed in *Chapter 8 – Practice Expectations Common to All Product Lines*.

Other Audit Completion Activities

This section briefly describes some of the more important tasks included in the "Audit Completion Activities" folder.

Confirm Strategic Approach

6.63 In this section, the audit Principal confirms that the audit findings have met the objectives set out in the strategic audit approach, and that:

- There were no significant risks identified that were not already included in our planned audit approach;
- The results of tests of controls support the intended level of reliance;
- Substantive procedures provided the planned level of audit assurance; and
- Any unusual observations made while performing the final analytical procedures have been satisfactorily addressed.

Final Meeting with Entity Management

6.64 The audit principal and/or the Director should meet with entity management at the conclusion of the audit. The meeting should involve a brief "lessons learned" discussion where both the auditor and the client would discuss aspects of the audit that were well executed and where opportunities for improvement exist, from both perspectives. The audit team should also have a preliminary discussion with client officials about the opportunities for improvement that were identified during the course of the audit, and provide an indication of when a draft "management letter" will be provided.

Staff Assessments

6.65 The Director would ensure that the Assignment Planning and Assessment Forms for each team member were completed in a timely fashion. Performance would be assessed in relation to the objectives established at the beginning of the audit. The value of performance feedback to staff is heightened when it is delivered as soon as practical after the completion of the audit.

Post Mortem Team Meeting

6.66 As soon as possible after the completion of fieldwork, the audit Principal and/or Director should organize a “post mortem” team meeting. The main purpose of the “post mortem” meeting is to identify opportunities to enhance the efficiency and effectiveness of the audit, while the experience is still fresh in team members’ minds. A secondary purpose is to ensure that the audit files are properly closed out and archived.

6.67 Potential agenda items for the “post mortem” meeting could include:

- planning points for next year (see below);
- possible methodology improvements;
- opportunities to improve the efficiency of the audit;
- proposed contents of the management letter;
- business developments that may have an impact on next year's audit;
- possible changes to audit timing and/or staffing levels;
- relations with the client;
- results of the Audit Committee meeting(s); and
- opportunities to improve audit quality and/or quality management issues.

“Planning Points” for Future Audits

6.68 Planning points raised during the current year’s audit to be considered for the following year should be documented in the form of an “exception” and clearly identified in the exception categories as a “planning point”. In the following year, reviewing “planning point” exceptions will quickly and easily highlight all such suggestions identified during the audit.

6.69 In order to maximize efficiency, “planning points” should be acted on as soon as possible following completion of the audit, while the issues they are intended to address are fresh in minds of those preparing the suggestions.

Signed Financial Statements and Auditor’s Report

6.70 The individual managing the audit should ensure that a copy of the final signed financial statements and Auditor’s Report are sent to the Annual Audit Practice Team.

7 Consultation

7.1 We operate in a complex environment that requires teamwork, specialized knowledge and the wisdom gained from the experience of others. The Office's *Quality Management System* explicitly recognizes the contributions and strengths various groups in the Office may bring to bear in conducting quality annual audits, by establishing general standards regarding whom should be consulted and when. It is rarely possible for one individual, or even a very strong audit team, to know everything that is required in order to ensure that all aspects of our *Quality Management System* have been adhered to in a given annual audit. As well, the profession has long recognized the value of "sober second thought" and independent review and challenge of contentious, difficult and/or complex issues. For these reasons, consultation is an important element of almost every annual audit.

7.2 The Office has a history of working together and utilizing the knowledge and collective expertise of its staff. We have a strong corporate culture whereby difficult and/or contentious issues are resolved in a collaborative and consensus-building fashion. Our quality management system works in concert with this culture by requiring consultation in high risk situations or in situations where audit teams could not reasonably be expected to have the requisite expertise to deal with specialized issues.

ANNUAL AUDIT POLICY

The audit Principal should consult with internal and external specialists and senior Office staff, as necessary, when dealing with unusual, complex or controversial issues, or other matters requiring specialized knowledge or experience.

Auditor General on Sensitive Issues

7.3 Certain sensitive issues should be brought to the attention of the Auditor General prior to the signing of the auditor's report. These sensitive issues would include such matters as proposed reservations of opinion, significant non-compliance with authorities, proposed "other matters", management estimates that have a significant impact on the reported results of operations, controversial professional positions or other matters with the potential for broader implications beyond the audit entity alone.

ANNUAL AUDIT POLICY

The audit Principal and the responsible AAG should consult the Auditor General on proposed reservations of opinion, “other matters” or any other sensitive issues prior to the signing of the Auditor's Report.

Quality Reviewers

7.4 For certain audits, the Office has appointed a Quality Reviewer in order to provide an enhanced level of quality assurance. The role of the Quality Reviewer is to provide additional assurance of the quality of key judgments for audits of higher risk to the Office. Quality Reviewers have been assigned to audits generally perceived to be: of higher risk; complex to conduct; sensitive in nature; or having complex accounting issues. Quality Reviewers have significant experience in the Office and have no direct involvement in the particular annual audit(s) they are assigned to.

7.5 Quality Reviewers provide an additional element of independence and objectivity in key risk areas involving development of the strategic approach and audit reporting and completion. In order to maintain their independence and their objectivity, Quality Reviewers provide advice but do not make decisions. Accordingly, they are **not** considered to be part of the audit team.

7.6 Quality Reviewers are generally assigned to audits where one or more of the following factors are present:

- Highly visible entity or having broad accountability to the public;
- Sensitive audit due to recent Parliamentary interest in the organization;
- Use of specialized accounting principles;
- Management judgments and estimates play an important role in valuation of significant financial statement components;
- Recent history of difficult and/or contentious audit issues;
- Significant turnover in the audit team;
- Delegation of signing authority to the Principal for the first time; and
- Other specified risk factors.

Responsibilities of Quality Reviewers

7.7 Quality Reviewers are required to review the Entity Risk Analysis folder in TeamMate, the Strategic Approach Summary folder, and elements of the Annual Audit Reporting and Completion folder including the Report to the Audit Committee (Audit Results), the Report Clearance Summary, the financial statements and the proposed Auditor’s Report.

7.8 The Quality Reviewer focuses on the identification of audit risks, the appropriateness of the entity's accounting policies, the application of significant new accounting standards, presentation and disclosure matters, and the appropriateness of the Auditor's Report.

7.9 The specific responsibilities of the Quality Reviewer are to consider the:

- Significant business risks identified by the audit team;
- Completeness of the planning process;
- Suitability of the audit approach, particularly in higher risk areas;
- Appropriateness of key judgments made by the audit team;
- Nature and extent of consultation by the audit team;
- Financial statements and note disclosures, including the selection of accounting policies;
- Significance of any disagreements between the entity and management relating to matters discussed in the auditor's report;
- Appropriateness of the content of planned communications to management, responsible ministers and/or the legislature; and
- Appropriateness of the auditor's report.

These responsibilities are carried out primarily through discussion with the audit Principal and through review of selected working papers.

Assignment of Quality Reviewers

7.10 The key attributes of quality reviewers are:

- Familiarity with the subject matter;
- Independence and objectivity;
- Sufficient experience and authority; and
- Capability.

7.11 In order to provide a reasonable measure of independence and objectivity to the Quality Reviewer, the following characteristics would generally preclude an individual from being assigned as a Quality Reviewer on a particular audit where:

- The individual was a member of the entity audit team within the past two years;
- The individual reports to the responsible Assistant Auditor General for the audit;
- The individual does not have recent audit experience relevant to the nature of the assurance engagement in question.

The Annual Audit Practice Team (AAPT)

7.12 There are four major services provided by the AAPT. The main client of the AAPT is the signatory to the Auditor's Report. The signatories are served by the following activities undertaken by the AAPT:

- providing assurance that there is a consistent approach to significant audit issues throughout the Office;
- providing assurance that the accounting policies are in accordance with Canadian generally accepted accounting principles (or, in rare cases, in accordance with the stated basis of accounting)
- providing assurance that the auditor's reports conform to the professional reporting standards and are appropriate to the financial statements presented;
- assisting teams in identifying sources of specialized industry knowledge; and
- providing advice on the application of the Office's methodology, guidance and tools.

7.13 The AAPT also works with the teams to resolve complex issues as they arise. Consultation generally begins with the audit team providing AAPT with a description of the issue, a summary of research done by the audit team, alternatives considered and the audit team's proposed course of action. Complex accounting questions may be referred to specialists under contract with the AAPT. The AAPT also reviews "pro-forma" financial statements during the interim audit to avoid the peak periods in February, March, May and June.

7.14 Other key points of the audit where consultation with the AAPT is expected are discussed below.

Terms of Engagement

7.15 One area where consistency is important is in establishing terms of engagement for our annual audits. There are numerous pieces of legislation that mandate annual audit work to be performed by the Office. To the extent permitted by the wording of the legislation, we should strive to establish a consistent understanding with audit entities in relation to the terms of our annual audit engagement. The AAPT (in consultation with Legal Services) is uniquely positioned to provide advice in this area.

7.16 Occasionally we are given a mandate by Parliament to undertake new annual audits, for example through the creation of new agencies or federal corporate bodies. The Governor in Council may also request the Office to perform annual audit work pursuant to Section 11 of the *Auditor General Act*. As well, audit entities may ask us to undertake work that is in addition to our normal mandate. In these circumstances, consultation with the AAPT and with Legal Services should take place (see *Chapter 8 - Practice Expectations Common to All Product Lines*).

7.17 Consultation is important to ensure that:

- an appropriate legal basis exists for the proposed audit work;
- recent developments in the profession have been considered; and
- new or proposed engagements are conducted on a basis similar to other engagements in our portfolio, where appropriate.

ANNUAL AUDIT POLICY

The audit team should consult with the Annual Audit Practice Team on the terms of engagement of new or proposed annual audit engagements.

Planning

7.18 At the planning stage, the AAPT can provide valuable input in helping the team assess the significance of potential reporting issues the audit team has identified, and in suggesting how the issues should be conveyed to those having oversight responsibility for the financial reporting process. The AAPT can also assist the team in performing a preliminary assessment of issues early in the audit, and identifying the nature and extent of additional information needed to finalize Office positions on such matters.

Access to Specialized Knowledge/Expertise

7.19 Our portfolio of clients is unique, and we have many entities operating in specialized industries where the only comparable organizations are in the private sector. As well, these entities may follow unusual or unique accounting practices. In situations where the audit Principal needs access to additional sources of industry information in order to acquire an appropriate knowledge of the business, the AAPT can help identify specialists and sources of industry information, internally and externally.

Review of Financial Statements and Auditor's Report

7.20 In its review of the financial statements and the Auditor's Report, the Annual Audit Practice Team is responsible for assessing the consistency of accounting and reporting matters across the Office's portfolio of clients. In carrying out this responsibility, the AAPT also provides advice to the audit Principal on:

- the clarity, accuracy and completeness of the financial statements and accompanying notes;
- the appropriateness of the financial statements presented in meeting the needs of the entity's users and conforming with all legal and professional reporting requirements; and
- the appropriateness of the Auditor's Report.

7.21 To facilitate the AAPT's review, the audit Principal is responsible for reviewing the draft financial statements and Auditor's Report. The team should only forward the full financial statements to the AAPT once their initial review has been completed and they have discussed any necessary changes with the audit entity. The audit entity should also be made aware that further changes to the financial statements may be required pursuant to the AAPT's review.

ANNUAL AUDIT POLICY

The audit Principal should consult with the Annual Audit Practice Team on the draft Auditor's Report, draft financial statements, and matters of audit significance related to our report. The audit Principal should document his/her disposition of any advice received from the Annual Audit Practice Team prior to recommending signature of the Auditor's Report.

Advice on the Application of Methodology, Guidance and Controls

7.22 The Annual Audit Practice Team is responsible for the development, implementation and monitoring of the Office policies, methodology and supporting guidance and tools for annual audits. Their application to individual audits requires professional judgment and is the responsibility of the respective audit teams. However, it is anticipated that situations will arise in which additional guidance and advice will be beneficial. Audit teams are encouraged to seek the advice of the Annual Audit Practice Team and their colleagues in dealing with difficult audit issues. The Public Accounts team principal is responsible for methodology, supporting guidance and tools unique to the conduct of the Section 6 audit.

Involvement of Specialists — General

7.23 Generally accepted auditing standards (GAAS) require that the auditor and other persons performing the audit should collectively possess adequate knowledge of the subject matter of an audit. Bringing the appropriate expertise to bear in an audit may be essential to developing a sound strategic approach, and to carrying out detailed planning, testing and reporting.

7.24 The need, if any, to involve specialists and the type of specialists will vary considerably from audit to audit and is a matter of professional judgment. The decision as to whether or not to involve specialists in an audit should be made by the audit Principal in consultation with the Director. There are two particular specialists in the Office with whom consultation should be considered for all audits: the Information Technology team, and the Financial Instruments team.

Information Technology (IT) Audit Specialists

7.25 The Office's annual audit methodology generally requires an individual with specialized knowledge and expertise in information technology to be a member of all audit teams. As team members, they are involved throughout the audit, beginning with the Entity Risk Analysis phase and continuing up to the Reporting and Completion phase. Accordingly, consultation with IT specialists is an integral and ongoing element of most annual audits. The expected involvement of IT auditors is described in *Chapter 2 – General Audit Management Issues*.

ANNUAL AUDIT POLICY

The audit Principal should ensure that the audit team has members with sufficient specialized information technology knowledge and audit skills. An Information Technology Specialist is a member of the audit team for all entities with Enterprise Resource Planning or other significant computer systems.

7.26 Consultation with senior members of the IT Group may be required from time to time, for example where very specialized knowledge is required, where complex issues have been identified or where client expectations are very high. The decision to seek additional specialist input would normally be made by the audit Principal, after discussion with the team's IT specialist.

7.27 The IT team is also available to support IDEA data extractions for the purposes of carrying substantive tests of detail and/or systems analytics. The IT team can be contacted to provide more information on the use of IDEA.

Financial Instruments (FI) Accounting and Audit Specialists

7.28 Whenever the audit entity is involved with complex financial instruments (swaps, foreign exchange exposures, derivatives, lending or insurance operations, etc.), it may be appropriate to consult with the FI team. The FI team has the necessary expertise to provide advice with respect to the inherent risks posed by specific financial instruments, the controls that should be in place governing their use, and the appropriateness of the information provided to senior management and the Board. As well, the note disclosure requirements associated with financial instruments may be quite complex. Consultation at an early stage may contribute to ensuring that reporting considerations are properly addressed well before the reporting phase of the audit is reached.

7.29 The need for involving FI specialists on individual audits is a matter of professional judgment. The decision as to whether FI expertise is required should be made by the audit Principal in consultation with the Director.

Legal Services

7.30 Audit Principals should consult Legal Services on matters that present legal risks for the Office. Matters that might require input from Legal Services include situations when:

- there are questions involving the mandate of the entity;
- potential legal issues are identified by the audit team;
- legal advice forms the basis of a reservation in the auditor's report, for example, relating to non-compliance with authorities or an "other matter";
- advice destined to the Auditor General dealing with legal matters is included in annual audit documentation such as the Report Clearance Summary;
- substantive discussions are planned with the Department of Justice or the legal services units of an entity;
- a Principal intends to refer in the auditor's report to a legal opinion obtained by the audit entity; and
- requests for new work or services are being considered.

7.31 Further information concerning consultation with Legal Services may be found in *Chapter 8 - Practice Expectations Common to All Product Lines*.

Consultation and the Annual Audit of the Public Accounts of Canada

7.32 The annual audit of the Public Accounts of Canada is the largest annual audit in Canada. As might be expected, it has some unique characteristics that differentiate it from other annual audits. One of these unique characteristics deals with consultation. Because of the way that the audit is structured, involving entity teams and the Public Accounts team, two types of consultation typically occur:

- between the entity teams and the Public Accounts team; and
- between the Public Accounts team and the other Office specialists.

7.33 The Principal of the Public Accounts team is responsible for the audit of the Public Accounts of Canada and development of the overall audit strategy as set out in the strategic approach for the annual audit of the Summary Financial Statements of the Government of Canada. As well, the Public Accounts team has its own specialists assigned to various aspects of the Public Accounts audit. Accordingly, questions that entity teams would normally direct to specialists in the Office would first be referred to the Public Accounts team Principal (or his/her delegate) for resolution. Depending on the circumstances, the matter may be referred to other specialists on the Public Accounts team or to Office specialists who are independent of the Public Accounts team. In general, entity teams would not refer matters to Office specialists without first discussing them with the Public Accounts team Principal.

7.34 The Public Accounts team may also find it necessary to refer matters to Office specialists. In those cases, the Public Accounts team would be expected to follow Office consultation practices.

The Auditor General's Independent Advisory Committee

7.35 The Independent Advisory Committee (IAC) is a standing committee of external advisors to the Auditor General. The IAC is made up of members of the accounting profession in Canada with senior competence, with a mandate to provide advice to the Auditor General on his/her annual audits of the Public Accounts of Canada, Crown corporations and other entities. In this respect, the IAC provides advice to the Auditor General on the form and content of her Auditor's Report on the Summary Financial Statements of the Government of Canada and on the development of Office positions on accounting and financial reporting issues of Office-wide significance. When considered appropriate and/or necessary, matters affecting an individual audit of a Crown corporation or other entity may also be referred to the IAC for advice, as well as VFM chapters with major themes or issues falling within the purview of the Committee. Finally, the IAC also assists the Auditor General in monitoring developments in the accounting and auditing profession and considering their impact on the work of the Office.

7.36 It is not the responsibility of the IAC to approve materials presented for review. Rather, the purpose of the Committee is to provide an independent perspective on significant accounting and auditing issues. This ensure that, when the Auditor General takes a position, she is aware of the opinions and views of a broad spectrum of other knowledgeable individuals in the profession.

7.37 Audit Principals who wish to refer matters to the IAC, should first consult with the Secretary to the IAC (the Principal, Annual Audit Practice Team). Further information about the IAC is available on the INTRAnet – OAG - Committees.

Documenting Consultation

7.38 Consultation should be properly documented in our TeamMate files. This not only provides evidence that Office policies were complied with, but also provides background information and analysis of issues/options that may have continuing relevance. Proper documentation is also an important principle underlying generally accepted auditing standards. The audit team is responsible for ensuring that the results of consultations have been appropriately documented.

ANNUAL AUDIT POLICY

The audit team should document the results of all significant consultations in TeamMate.

8 Practice Expectations

Introduction

8.1 Although many practices are similar in purpose across product-lines, they often are sufficiently different in application to warrant tailored discussion in each product-line manual. This allows a full description of the audit processes, and facilitates the use of the individual manuals. For example, compliance with authorities is common to all product-lines, but the approach to auditing and the weight given to these matters varies in different types of audits.

8.2 This section describes the practice expectations that are truly common to all product-lines. Many of these expectations are guided by other Office policies, such as the Code of Professional Conduct or the Office Security Policy.

How to use this section

8.3 ***Should*** statements are expected practices, and require Assistant Auditor General (AAG) approval to override. Expectations derived from other Office policies are linked electronically to the other policy statements.

8.4 This section sets out these common expectations under the following headings:

- Audit management
- Project management
- People management at the team level
- Continuous improvement

Audit management

Authority: requests for services or audits

8.5 In recent years, the Office has developed a more interactive relationship with parliamentary committees, audit committees and management in our efforts to promote answerable, honest and productive government. As a result, there have been an increasing number of requests for audits and other services from the Governor in Council, parliamentary committees, audit committees and management. While it may be desirable to accommodate these requests, the Office has limited resources. It is important that such work does not negatively impact on our primary mission of carrying out independent audits and examinations for the House of Commons.

8.6 Requests for services or audits need careful consideration as to the appropriateness, legality, and resource implications of such requests.

8.7 Where requests for work are received, audit Principals ***should:***

- Obtain the approval of the AAG/CESD before making any commitment to the requesting organization;
- Refer requests for work requiring authority under Section 11 of the *Auditor General Act* or under the Financial Administration Act to Legal Services; and
- After authorization to accept the request, confirm in writing the terms and conditions of the work to the requesting organization.

Access to Information

8.8 The *Auditor General Act* and the *Financial Administration Act* provide for access to information needed to report, as required by the acts. The acts entitle the Auditor General to free access at all convenient times to this information. The Auditor General is also entitled to receive from members of the public service and Crown corporations, where she is appointed auditor or special examiner, such information, reports and explanations, as the she deems necessary. The Auditor General decides the nature and type of information needed to fulfil the responsibilities set out in legislation. These are very strong provisions, which prevail against all other acts of Parliament, unless they expressly limit access and refer to the appropriate sections of the *Auditor General Act* or *Financial Administration Act*. Further details on this can be found in the “Guidance for the Access to Entity Information”.

8.9 At the same time, however, the Office also has an obligation to ensure that it does not disclose, or act in a manner that unintentionally results in the disclosure of entity information that would not otherwise be accessible.

8.10 **Office requests for Cabinet documents**. Required information may sometimes be contained in Cabinet documents, which are confidences of the Queen’s Privy Council of Canada. These documents are classified and are among the most sensitive documents held by the government. They include submissions to and decisions by Cabinet and Cabinet committees, Cabinet agendas and draft legislation. Requests to obtain these documents are handled by the Subject Matter Expert (SME) for Access to Information.

8.11 Audit Principals ***should*** consult with the SME for Access to Information when requesting Cabinet documents.

8.12 Information requested is to be germane to the fulfilment of audit responsibilities.

8.13 **Restrictions to access.** Government officials recognize their obligation to co-operate with the Office and normally provide information on request. Staff encountering problems with access ***should*** not agree to any restrictions on the right to information without consulting the SME for Access to Information and the AAG/CESD. Denial of access to information constitutes a serious matter that is normally reported to the House of Commons.

8.14 **Solicitor/client protected documents**. The Office has entered into an agreement with the Department of Justice, as a result of the Professional Institute of the Public Service (PIPS) decision of the Federal Court (Trial Division). The Court decided that because a department had surrendered voluntarily to the Office documents that were solicitor/client protected, the privilege had been automatically waived.

8.15 At the beginning of an audit, the responsible AAG/CESD ***should*** send a letter to inform the audit entity that disclosure of documents to the Office is in compliance with the *Auditor General Act* and the *Financial Administration Act* and a solicitor/client document given to the Office during an audit does not constitute a waiver by the entity. This will allow the entity to preserve the solicitor/client privilege while meeting the information needs of the Office.

8.16 Information that deals with matters covered by solicitor/client privilege ***should*** not be divulged without the express consent of the audit entity to waive this privilege.

8.17 **Disclosure of audit information.** The Office is not subject to the *Access to Information Act*. This means that members of the public or third parties cannot obtain access to audit report drafts, working papers or other information held by the Office.

However, it is the policy of the Office that we will release certain non-audit and administrative information upon request. We will not release audit information. All requests for documents or information are to be referred to the SME for Access to Information. More details on this can be found in the "Policy on the Release of Information Under the Control of the Office of the Auditor General".

8.18 The most effective means to ensure that report drafts and audit information are not released is for the Office to have them in its direct possession. Therefore, the Office makes an effort to prevent the copying of and to secure the return of drafts or other potentially sensitive documents given to audit entities, for example during report clearance. Such documents are considered "controlled documents" and are to be handled in accordance with the Office security policy and the procedures below.

The only approved means for the transmission of controlled documents is by paper copy. Audit staff ***should***:

- review and follow Office security policy and the guidelines on disclosure of audit information;
- print or copy onto the Office's special red-bordered paper all Office-generated drafts or other potentially sensitive documents to be given to audit entities or other government institutions;
- number each copy when multiple copies are provided;
- limit the number of copies provided to the minimum possible;
- indicate at the time that they are given to the entity that they should be returned to the Office;
- keep a record of to whom such documents are given;
- request their return once the entity has no further need of them;
- keep a record of which copies are returned.

At times, an entity may **choose** to destroy the copies of the 'controlled document' that are within its possession instead of returning them to the Office. In such cases, the Principal will request that the entity provide the Office with a certificate that it has destroyed the copies of the document.

In the case of an entity not returning all of the documents as requested or not providing a certificate of destruction, Principals should inform their Assistant Auditor General and the Value-for-money Management Committee (VFM-MC) to keep them aware of the situation.

8.19 In spite of these precautions, Office documents occasionally become public both before and after publication of the associated Office report. Any Office staff who become aware that a document has or is about to become public are immediately to inform their Principal, the Director, Communications and the Subject Matter Expert (SME), Access to Information. Further, this would include Principals informing their Assistant Auditor General, who communicates the situation to the VFM Management Committee (MC). In the case of a document that was provided to an entity which is about to be made public, Principals should communicate with their contact in the entity in order to effectively manage the situation from both the Office and entity perspective. All questions concerning the document are to be referred to the Director, Communications.

Further guidance on access to information can be obtained from the SME, Access to Information. Also, the Office's security policy, and the "Guidelines on disclosure of audit information" provide additional details on this.

Security of information

8.20 The Office meets the highest standards of professionalism and integrity and seeks to develop a relationship of respect and trust with those it audits. An important ingredient of those standards and principles is ensuring the security and confidentiality of both client and internal information.

8.21 The *Code of Professional Conduct* requires that all staff be familiar with the security aspects of their work, accept security as an important individual responsibility, and follow the principles set out in the Security Policy and Guidelines issued by the Office.

8.22 The Security Policy and Guidelines indicate that audit Principals are responsible for:

- acquiring an understanding of the security classification system in their audit entities;
- communicating the requirements to team members; and
- ensuring that the safeguards for the storage of and access to information are equal to or higher than those required by the audit entity.

8.23 The “Security Policy and Guidelines” provides more details.

Consultation with Legal Services

8.24 Legal Services is responsible for providing legal advice and counsel to the Office. This includes providing advice on:

- legal issues arising in the course of audits;
- the engagement of outside legal counsel; and
- in-house legal issues in areas such as personnel relations, labour relations and contracting.

8.25 Audit Principals ***should*** consult Legal Services on matters that present legal risks for the Office.

8.26 Matters that might require input from Legal Services include situations when:

- potential legal issues are identified by the audit team early in the audit process;
- legal advice forms the basis of an audit report to be made available outside the Office or where any advice destined to the Auditor General or the Executive Committee deals with legal matters;
- substantive discussions are planned with the Department of Justice or the legal services units of an entity;
- an audit report proposes changes or revisions to legislation, to ensure that it is appropriate and consistent with previous recommendations made by the Office;
- a Principal intends to refer in an audit report to a legal opinion obtained by the audit entity;
- requests for new work or services are considered; and
- third party references are made in reports.

8.27 Before making any reference in audit reports to a legal opinion, audit Principals ***should*** draw the matter to the attention of the Deputy Minister or the equivalent level in the audited entity and send a copy of the pertinent sections of the report to the client's legal services unit, and seek a waiver to the privilege.

Legislative Strategy: Guidelines for Seeking Legislative Amendments

Introduction

8.28 The government at times introduces legislation that has an impact on the role of, or that should include a role for, the Auditor General. This includes new legislation or amendments to current statutes that could result in a contraction, alteration or expansion to the mandate of the Auditor General. It is essential that our views be known in these circumstances, while preserving our independence from government policy-making,

As discussed under *Knowledge of Business*, Principals are expected to be conversant with the proposed legislative initiatives of the departments, Crown corporations, commissions and other agencies that they audit, as an essential component of knowledge of the business. This involves the following actions:

- A verbal or written request by the principal for information on legislative initiatives;
- Obtaining copies of draft legislation from the Internet (if available) or by direct request to the entity.

Draft legislation goes through many iterations, and the drafting period provides the most appropriate time for our views to be considered. The Principals ***should*** notify their AAG/CESD and Legal Services of: proposed legislation and seek direction on the nature and extent of representations to be made to departmental and entity officials; and, situations where departments refuse to provide drafts of proposed legislation pertinent to our work. Some draft legislation is more closely guarded, or falls into the definition of "cabinet confidences". Although not listed in the Order in Council governing our access to cabinet confidences, Legal Services can assist in discussions to obtain limited disclosure of those portions that deal with our Office. Even if our representations are unsuccessful, they will allow us to understand the government's policy position.

If officials are not favourable to our proposed changes, a decision could be made to have the Auditor General write or meet with the sponsoring Minister to express her views and emphasize the seriousness of the matter. This step also puts the Minister on notice of the Auditor General's position and what her public stance on the issue would be, if asked by the media or Parliamentarians.

Effecting changes to legislation after it has been tabled is much more difficult, and normally requires the approval of the Committee reviewing the Bill. Changes may be proposed by the government or by committee members, provided they are within the general scope of the legislation. Any attempt by teams to amend legislation after it is tabled ***should*** involve the Auditor General, Parliamentary Liaison, and Legal Services. Representations can be made to the Minister, in the hope of having the government sponsor the suggested changes. Alternatively, Parliamentary Liaison can arrange an appearance before the committee reviewing the legislation. This is a last resort, since political motives could be ascribed to such an appearance, with a detrimental impact upon the credibility of the Office.

Co-ordinating work with the Regional Offices

8.29 Many entities have highly decentralized operations in order to provide services to the various regions of the country. The Office has established regional Offices to ensure a first-hand knowledge of the decentralized operations, a relationship of respect and trust with regional entity management and the most cost-effective use of resources.

8.30 Both the entity and regional Principals ***should*** ensure high levels of co-operation, co-ordination and liaison between regional and entity teams. This can include situations involving the regional office in entity planning, designating regional staff as liaison with an audit entity, promoting two-way communication on emerging audit issues, giving early notice of planned field trips, and utilizing regional staff, when dealing with matters located in the regions.

Conflict of interest, fraud or other illegal acts

Under revision

8.31 (The Executive Committee is considering proposed wording for this section)

Carrying out surveys

8.32 Surveys are increasingly becoming part of the auditors tool kit, particularly in the case of VFM audits and studies. Surveys are used to ask individuals about factual situations, their views and perceptions and their actual behaviour. As well, survey methods can be used to enhance other audit techniques. The Office defines a survey as the administration of a standardized procedure, such as a questionnaire or a structured interview to obtain information on 25 or more individual cases, with the intention of making aggregated statements about the matters surveyed.

8.33 Audit Principals ***should*** consult with the SME, Surveys in planning survey-related activities. A “Guide on Conducting Surveys” is available to assist auditors.

Audit notes

8.34 Audit notes are an important part of the Auditor General’s report. The audit notes chapter represents an alternative reporting mechanism for matters of significance that come to the attention of audit teams. Audit notes may be identified during any of the various types of audit work carried out on any Office product. Usually audit notes report on a single subject which must be within the mandate of the Office. (November 2003)

8.34.1 The auditor needs to consider the following guidance when proposing a potential audit note. An audit note needs to be:

- of a nature and significance worthy of being brought to Parliament's attention;
- of a timely nature for Parliament;
- based on a revenue, expenditure or authority matter;
- reportable (no policy or security concerns);
- auditable, i.e. appropriate audit criteria available, availability of adequately qualified internal and/or external resources;
- ideally a single, succinct subject issue or one time event (capable of being reported in no more than 6 pages);
- preferably systemic of a larger matter;
- designed to report either positive or negative findings; and
- cost effective to develop and report. (November 2003)

8.35 The audit notes chapter author is responsible for producing the chapter and for supporting the work of the Audit Notes Committee. The Audit Notes Committee's role is to:

- provide overall direction for the preparation and submission of proposed notes;
- ensure that a quality reviewer is appointed to each approved audit note;
- support the activities that contribute to the production of the chapter; and
- review and approve notes for inclusion in the chapter; and
- approve the Final Approval Form for each audit note. (November 2003)

8.36 Audit teams are to be alert to the possibility of potentially significant issues and devote appropriate effort to investigate such matters. When developing and reporting audit notes, audit teams ***should*** comply with the Value-for-Money Audit Policies, except those requiring recommendations on corrective measures. (November 2003)

8.37 Nevertheless, the Office encourages audit teams to make recommendations and obtain entity responses for audit notes, where appropriate. Where recommendations are not appropriate, the audit team needs to make every effort to obtain entity comments for inclusion in the audit note. (November 2003)

8.38 The Audit Notes Committee sends out annual guidelines requesting the submission of audit notes, establishing a timetable for submissions and providing general direction. (November 2003)

Restrictions in public reporting

8.39 The *Auditor General Act* requires the Auditor General to “call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons.” Classified information may be critical for developing and supporting certain audit observations. In these circumstances, audit entities may express concern that such information, included in audit reports or other communications with the public, may be harmful to the national interest, and may request that it not be disclosed.

8.40 Audit Principals ***should*** assess with their AAGs whether requests to restrict reporting are valid, and seek the authority of the VFM-MC/CESD or Auditor General before agreeing to remove significant material from the report on the basis that it might be harmful to the national interest.

Reports to entity management

8.41 During the course of an audit, the audit team may identify situations, including weaknesses in controls, opportunities for improvement, deficiencies, or work well done that are not significant or of a nature to warrant reporting to Parliament or to the Boards of Directors of Crown corporations. However, the observations may be useful to entity management. Auditors may communicate these observations, either orally or in writing, to the appropriate level of entity management. Written audit reports or other written forms of communication that are left with the entity are subject to access to information in the entity. Reports to entity management ***should*** be approved by the entity principal; reviewed by the AAG/CESD; discussed with entity management; communicated clearly; and issued on a timely basis.

Third party references

8.42 Organizations or individuals that are to be cited or discussed in the reports of the Auditor General should be advised in writing on a timely basis of the nature and substance of the proposed reference and asked, where appropriate, to verify the accuracy and completeness of the statements made concerning them.

Third parties receive this notification where they are identified in the report, or are identifiable. Such notification enables the Office to fulfill its duty of care to third parties to ensure that the references are accurate and fair, besides promoting the objectivity of and underlying evidence for the reports. A third party is defined as any organization or person outside the department or agency that is the subject of the report. Any reference to third parties should respect their legal rights, particularly with respect to reputation and confidential information.

Consideration should be given to the merit of disclosing the names of third parties, in the context of promoting transparency and clarity to the extent permitted under the law. The media is necessary for the publication and dissemination of the issues raised in our reports and where the release of third party names is permissible under the law, and does not detract from audit objectives, disclosure should take place. The objective of such disclosure is the promotion of good communications, consistent with responsible reporting of our message.

There are three situations where the names of third parties may possibly be disclosed:

- in the body of the Report itself;
- before a Parliamentary committee; and
- in response to a question from the media.

The decision to disclose will be influenced to a great extent by:

- the type of third party reference (sample or case illustration); and
- the actual identity of the third party — government department, provincial agency, corporation or individual.

Different legal and transparency considerations will apply depending upon the nature of the third party information to be disclosed and the identity of the third party.

Given that management letters are subject to disclosure under the *Access to Information Act*, the same principles and procedures apply when third parties are mentioned in these letters.

Audit Principals ***should***:

- ensure appropriate third party notifications are sent out on a timely basis, and
- be familiar with the detailed Office Guidelines on Third Party References;
- consult Legal Services for guidance where they have concerns with the legal implications of comments pertaining to third parties or difficulties obtaining clearance.

External communications

8.43 It is expected that all Office communications with Parliament and other stakeholders are clear, persuasive and effective. Other key expectations are explained in the following paragraphs.

8.44 **Testimony at standing committee hearings**. Once the reports of the Auditor General and the Commissioner of the Environment and Sustainable Development are tabled in the House of Commons, they are referred to the Standing Committee on Public Accounts or the Standing Committee on the Environment and Sustainable Development. Committees consider the reports and examine certain matters contained in the reports at committee hearings. The committees frequently call members from the audited entity to testify. The Auditor General/CESD and members of her staff are also present and may be required to make an opening statement about the audit issues and to respond to questions from members. More frequently, these and other standing committees are requesting the Office to appear before the Committee to discuss and answer questions about audit reports.

8.45 The Office has been encouraging AAGs/Principals to spend more time with committee staff in order to obtain a better understanding of concerns and interests of the Committee and to explain the role of the Office and the value of using Office products. How the committees deal with an audit observation can have an important impact on the corrective actions taken by the audited entity.

8.46 **Public communications**. The Director, Communications is responsible for co-ordinating public communications activities, including responding to media and public inquiries. Public communications includes any matter imparting knowledge that could only have been acquired while working for the Office of the Auditor General.

8.47 **Spokespersons for the Office.** On tabling day of her report and during the following week, the Auditor General is the only spokesperson for the Office unless otherwise approved. At other times, the Auditor General may designate other staff members to respond "on the record" to the media about audits under their direction. A list of these designates will be published before each tabling. Similarly, the Commissioner of Environment and Sustainable Development is the only spokesperson for the Office on tabling day of her report and during the following week. At other times, the CESD may designate other staff members to respond "on the record" to the media for material within her report. Designated staff members who are contacted by the media for background information on their chapter inform the Director, Communications once they have responded.

8.48 Requests for interviews with media representatives ***should*** be channelled through the Director, Communications.

8.49 **Other public communications.** Office staff members are in a unique position of having access to information and insight into government operations. As a result, they are often asked for their views on matters that are both work-related and non-work-related. Staff ***should***:

- inform their Principal or a higher level person to whom they report if they intend to deal with the media on a non-work-related topic and might be identified as an employee of the Office.
- obtain the approval of the AAG/CESD before accepting invitations to speak, teach, or lecture on work-related topics.
- obtain the authorization of AAG/CESD, in consultation with the Director, Communications, to publish work-related articles, and include in the article a disclaimer that the views expressed do not necessarily represent the views of the Office.

8.50 **Serving on professional practice committees.** Members of the Office often serve on committees of professional or international organizations that are involved in standards or audit practice development initiatives. Although officially they may be serving in a personal capacity, there is an obligation to not only present their personal point of view but also the Office position.

8.51 Members of the Office serving on outside committees involved in standard or audit practice development ***should:***

- inform themselves of the Office position on issues they deal with at external committees, by consulting with the appropriate members of the Office, including FRLs, PL-VFM and SMEs;
- notify the Practice Development Committee (PDC) chair of any significant variances of positions taken by the committee with those of the Office; and
- inform the PDC about substantive issues arising from committees that relate to and have a significant impact on Office methodology and practice.

8.52 **Preparation for tabling and standing committee hearings.** Parliamentary Liaison is responsible for co-ordinating effective Office participation at committee hearings. This includes arranging and co-ordinating the preparation for scheduled hearings; briefing meetings, as required, with members of the Office staff, committee staff and committee members; and post-meeting reviews to identify opportunities for future improvements.

8.53 The "Policy for the Media Relations Program" and the "AG Briefing Notes" describe practice expectations in these areas.

8.54 DELETED.

Project management

VFM audits, studies and audit notes should be managed as projects

8.54.1 Good project management is an integral part of our VFM Quality Management Framework (QMF) and is one of the key elements that contribute to a quality product. For VFM products, two concepts are considered necessary for effective project management. Firstly project management provides the necessary structure, discipline and care to facilitate the process leading to a quality VFM product. Secondly, effective project management requires strong leadership and active supervision to reach its full potential.

8.54.2 Project management means that a person or a group of persons are applying processes and knowledge, using tools and techniques, and ensuring that appropriate resources are available to effectively and efficiently complete a project. Our VFM QMF indicates that project management should provide assurance that the audit team delivers the audit on time, in accordance with OAG policies, principles and values and that audit costs are justified.

8.54.3 An audit project is a unique undertaking that has a beginning, an end and, with specific resource allocation, is designed to attain specific goals. In our context, each of our three VFM products, namely VFM audits, studies and audit notes, is a project.

8.54.4 Our current *Roles and Responsibilities Framework* identifies the audit Principal as having the lead role for the management of a project. Such responsibilities can be delegated if the Principal wishes. Key responsibilities and critical success factors for effective project management include:

- Communicating effectively with the team members and internal and external stakeholders and keeping the organization informed of progress as required;
- Supervising, motivating and coaching team members and demonstrating leadership;
- Managing internal and external stakeholders expectations;
- Ongoing monitoring of project status, and
- Solving problems and completing the project successfully.

8.54.5 Sections 2.11 to 2.16 of this manual also details more responsibilities for the different team members.

8.54.6 In the VFM audit context the key elements of project management are: initiation, planning, monitoring/control, and completion. These elements provide the project manager with the necessary structure to bring the project to a successful completion.

Initiation

8.54.7 VFM audit projects initiating phase starts once the One-Pass Planning (OPP) exercise has identified the areas that deserve attention. From the OPP, the team will propose audit projects. As part of the annual audit planning exercise, or exceptionally for an individual audit, the Executive Committee at this point approves or rejects the audit project. If approved, the operational planning exercise determines the timing of the audit. For more on the planning process see chapter 2. Not all projects will originate in the OPP exercise. Some, such as audit notes or special requests, can come unexpectedly. Still, all audit projects need approval before proceeding.

Planning

8.54.8 Defining or refining project objectives and selecting the best of the alternative actions to attain those objectives are the essence of planning. A detailed work plan outlining costs and proposed schedule is essential. Important dates are mapped out for completing significant parts of the project.

8.54.9 Three critical phases of a VFM audit require effective planning: (1) overview/survey, (2) examination, and (3) reporting. The level and detail of planning should be commensurate to the level of complexity, duration and risks of the audit to be undertaken.

8.54.10 Consequently, a team can chose to conduct an overview phase to gather information to better understand the entity it is about to audit. This would apply in the case of complex audits such as a Tier II for example, or where a completely new team is engaging in an audit of an entity with which they have no familiarity.

8.54.11 If, however the team has some knowledge of the entity needing to be updated, or if there is little need to gather overview information because the team is up to date, the team would proceed to planning and conducting the survey phase.

8.54.12 The planning for VFM projects starts once they have been approved. At that point, the PX in consultation with the AAG/CESD assembles a team to conduct the planning phase of the audit [the overview (if any) and survey phases]. The Competence of the Audit Team policy in Chapter 3 of the VFM Audit Manual states that “the team must have collective knowledge of their subject matter and auditing proficiency necessary to fulfill the requirements of the audit”. As noted in section 3.5, resources include not only OAG staff, but also specialists that might be hired to fill a knowledge gap. One of the key challenges for most audits is obtaining appropriate resources. The PX has the responsibility to inform the AAG/CEDD, if from his or her point of view, the appropriate resources are not available and the survey ought to be delayed.

8.54.13 Before the survey phase begins, the audit team prepares a survey plan[1](or a chapter proposal if no overview was conducted). We expect a survey plan to include elements such as the matters of potential significance to explore, the timeline within which is it to be completed, and the resources needed to do it. This plan is discussed with and approved by the AAG/CESD and he/she is to approve significant changes to it. For more on the survey phase, see chapter 4.

8.54.14 Once the team has completed the survey work, the AAG/CESD has approved the survey report, and the advisors have provided their advice to the team, the audit team develops an examination plan. This plan provides the basis for effective project management from the end of the survey phase all the way through the end of the reporting phase.

1. See para 4.17 for more on chapter proposals.

8.54.15 The Principal should engage all team members in developing the plan with a view to building common understanding and commitment. The examination plan details the scope of the audit, the audit objectives, the criteria, the approach and the methodology for each issue area, line of inquiry or program component, depending on the audit. The plan also identifies audit staff and contractors, and final estimated costs in terms of hours and contract and travel dollars. A summary of the examination plan ***should*** be sent to the VFM Management Committee for approval and confirmation of resources and budget.

8.54.16 At this point, the project manager reviews the audit team profile needed for the examination phase. This may differ significantly from the survey phase team profile. Specialists may need to be hired to ensure that relevant knowledge and expertise is available. Through discussion with the AAG/CESD, the PX determines if he/she has the right people to fulfill the audit objectives and that these people are available. If for any reasons the PX or the AAG/CESD feels that the appropriate resources are not available to conduct the audit, he/she ***should*** document it. This can happen when the appropriate resources cannot be obtained or, if during the course of the audit, the appropriate resources leave the team. Should this occur, the issue ***should*** immediately be drawn to the attention of the VFM Management Committee. The examination phase ***should*** only proceed once the Principal and AAG are assured that the team needed to meet the objectives of the audit is appropriate, available and ready to go.

8.54.17 The audit project management key milestones established for the audit form the basis for setting key project management deadlines throughout the audit. It is strongly advisable that the team build time for translation, approval and possible delays in their own schedule in order to meet the deadlines.

8.54.18 The reporting phase requires a planning effort similar to that of the other phases. As budgets are finalized at the time the examination plan is prepared, the planning of the reporting phase happens as part of the examination plan exercise. Activities such as the development of a general outline for the audit report, a strategy for clearance of facts as well as time for clearance, and the briefing of the AG are good illustrations of the need for planning. For more on the requirements related to reporting, see section 5 of the Manual as well as the audit project management key milestones. Guidance is available to assist audit teams in meeting reporting and communications requirements.

8.54.19 There are electronic tools available to assist in the various steps of the planning phase. A tool guide[2] with the tools currently on hand is available to assist program managers. In addition, in its quality assessment/help checklists, the VFM QMF lays out all required elements of a quality VFM audit. This can be a useful tool to plan an audit as well as to ensure quality throughout the life of the project.

2.To be developed.

8.54.20 In addition, when planning the audit, the expectation is that the team members will have taken into account all those standards that apply in the context of the audit. As well, special care needs to be taken when using specialist to ensure that he/she has all required skills and knowledge to be able to fulfill his/her responsibilities (guidance on use of specialists to be developed).

Monitoring/Control

8.54.21 As the team carries out the phases of the project, the project manager prepares periodic progress reports, formally or informally. The project manager also assesses team member performance and we would expect the project manager to do this assessment formally at the end of the project.

8.54.22 Control involves the assurance that project objectives are being met by regularly monitoring and gauging progress. This helps to identify variances from the plan so that the project manager can take corrective action when necessary. Furthermore, reviewing key milestones and status reports (budgets versus actual) are important to ensure that the project is working according to plan, is on time, within budget and heading in the right direction. Monitoring provides the project manager with the opportunity to ensure that the limited resources are used properly and if needed, to reallocate resources. Any significant changes to the examination plan should be approved by the AAG/CESD and the VFM Management Committee.

8.54.23 There are various electronic tools available to a project manager in the Office to monitor costs, slippage, and other budget items. A tool guide[3] with the tools currently on hand is available to assist program managers.

8.54.24 As an essential part of effective project monitoring, the project manager must ensure proper supervision of all its team members, including specialists hired to assist in the audit. We expect project managers to provide guidance to the team, monitor their progress as well as make the appropriate correction to the course of the audit when necessary. Clear direction is fundamental to ensuring that each team member knows what the expectations are in terms of his/her work. More detailed expectations are listed in paragraph 3.12 of the manual section on Audit Conduct.

Completion

8.54.25 The completion of the project and the settling of any remaining items occur when the project manager brings his/her project to an orderly end. For our VFM practice, the reporting phase, tabling and its related activities allow for the completion of the audit project. Therefore, completion includes such things as substantiation, report preparation and approval, communications strategy, briefing of the AG, tabling preparation and tabling.

3. To be developed.

8.54.26 Once the audit is completed and the report tabled, the project manager should prepare an accountability report within one month of tabling. The accountability report assesses the success of the project against the examination plan. It answers questions such as:

- Was the audit completed on budget and if not were the changes justified and approved?
- Were the key milestones met? (September 2003)

8.54.27 In summary, the accountability report provides an early assessment of the efficiency of the audit. It can also provide a brief self-assessment of how well the Principal managed the project. The accountability report ***should*** be presented to the AAG/CESD for review. A final copy ***should*** be sent to the VFM Management Committee. Another copy is to be forwarded to the Comptroller's group. In addition, the Professional Practices Group (PPG) collects lessons learned through discussion with chapter authors once the report is tabled. (September 2003)

8.54.28 In conclusion, these project management processes are continuous and overlapping with varying degrees of intensity during each phase of the audit project. By going through this process at each phase, the project team can constantly ensure that the objectives of the project are being met and that the project is still relevant. Not all elements of this process need to be documented. However, project managers are expected to document key audit decisions.

People management at the team level

8.55 In the Strategic Plan, the Office sets out its vision and its commitment to the highest standards of professionalism and integrity. The Office wants to create a work environment where employees can take pride in the Office and its products and feel responsible for its success.

8.56 The Office values its employees and recognizes that they are the most important element in meeting its goals. The aim is to have a respectful workplace that develops highly skilled, motivated, and productive individuals, while maintaining the flexibility and diversity required to achieve our Plan in a cost-effective manner. Audit teams are where the majority of the Office resources are used and are the front lines in terms of operations. It is important that teams operate in an environment that encourages personal growth and fulfilment of aspirations.

8.57 DELETED.

8.58 To ensure that we live up to our commitment to our people, the Office has established a number of expectations to govern the way we manage people at the team level. Persons supervising others are expected to:

- be role models in action and in words and consistently practice sound leadership;
- exhibit and encourage openness, patience, trust and teamwork;

- clearly define the work assigned, the purpose of the work, and employees' functions, responsibilities and authority, and explain how the assigned work fits into and contributes to the accomplishment of the overall objectives of the audit;
- coach staff to achieve higher performance. Coaching involves ensuring that expectations are clearly set out, transferring skills to staff, working with people having problems, providing skill and development opportunities, following up and providing feedback, recognizing good performance, and giving encouragement;
- maintain both formal and informal channels of communication to keep staff informed about the Office vision, focus areas, VFM quality management framework, Office and team quality improvement initiatives; new or innovative audit practices; and other issues affecting the individual, team, or Office as a whole;
- ensure that any barriers between audit teams and functions are reduced and promote teamwork and open communications up, down and across the organization;
- involve team members, whenever practical, in solving problems and in initiatives to improve quality and encourage them to suggest innovative ideas; and
- identify individual and team training and development needs and respond to these needs through training, work assignments and counselling on performance progress.

8.59 The Human Resources group can help with a complete description of people management expectations.

Continuous improvement

8.60 Quality is a basic operating principle of the Office. Quality involves every aspect of the Office's operations including its leadership, the focus on client needs, management of our people, audit practices and other processes, and our system for measuring performance. Quality is not a static condition. It requires a commitment from every staff member to continuous improvement.

8.61 A critical feature of the VFM quality management framework is the process for measuring, in a comprehensive way, how well we're doing in achieving our goals. This is achieved through a variety of review mechanisms.

Review policy

8.62 It is the policy of the Office that a practice review and internal audit program be in place to provide, to the Auditor General, timely information, advice and assurance about whether OAG management systems, both for audit and support activities, are suitably designed and effectively operated to support the achievement of OAG policies, principles, values, vision and overall Strategic Plan. The OAG Policy on Practice Review and Internal Audit specifies the operating principles and responsibilities for review.

The review continuum

8.63 Review is carried out in several ways, but all based on the audit policies, quality control criteria, and other practice expectations in place within the Office. All levels of review are designed to provide assurance that practices meet accepted standards, and to help the Office continuously improve the quality of its products.

8.64 **Team self-assessment.** Audit teams can review audit practices through post-audit discussions and using available Self-Assessment Checklists. Checklists act as reminders to support the team in producing a high-quality audit. They can provide a blueprint for corrective actions during the course of the audit, provide a barometer to measure the quality of the audit, expedite future internal practice and external reviews, and identify opportunities to improve team and Office practices.

8.65 **Practice reviews.** The Professional Practice Group carries out practice reviews of a sampling of audits in order to obtain a perspective on the quality of audit and management practices. It also carries out reviews of areas of higher risks across all audits. The scope of the practice reviews encompasses all aspects of the audit process. Practice reviews are designed to contribute to continuous improvement by creating the opportunity for audit teams and the Office to learn from experience.

8.66 **Internal audit.** Internal audits of administrative functions are carried out using the same auditing standards that the Office uses when conducting audits in the government. Internal Audit advises management of significant risk areas within the Office and the extent to which they are being well managed. It provides information, analysis, assessments and recommendations to assist management in the discharge of its responsibilities.

8.67 **External reviews**. The Office periodically appoints an external organization to carry out a review of its practices in order to confirm internal assessments and to obtain a truly independent assessment.

Other Inputs to Continuous Improvement

We also undertake a variety of approaches to help us to identify opportunities to improve VFM practices, including the elements described below.

8.68 **Client and stakeholder surveys**. The Office periodically obtains feedback on its performance through consultation with its clients and stakeholders. Previous surveys have asked Crown Corporation Audit Committee Chairs and CFOs and MPs and Senators for their view's on the Office's work.

8.69 **Benchmarking and collaboration.** The Office maintains relationships with provincial audit offices and audit offices in other countries. Practices are shared through exchange of information and conferences and symposia and well as through relationships with representatives from these other audit offices. The Office also keeps informed of new developments in the field of auditing through its participation in organizations such as the Canadian Council of Legislative Auditors (CCOLA), the CCAF-FCVI Inc., the International Organization of Supreme Audit Organizations (INTOSAI) and the Canadian Institute of Chartered Accountants (CICA).

9 *Quality Management System (QMS)*

Elements of Our Quality Management System (QMS)

9.1 The Office established the elements of its *Quality Management System (QMS)* based on existing standards of the American Institute of Certified Public Accountants, guidance for developing Quality Control Systems in Public Accounting published by the CICA (1993), input from a major public accounting firm regarding "best" practices in managing quality of annual audits, and input and advice from its senior annual audit practitioners. The QMS is made up of the following elements:

- **Audit Management** — The steps that must be undertaken to conduct a quality audit in accordance with generally accepted auditing standards, applicable legislation and Office policies, practices and procedures;
- **People Management** — The way in which we help staff achieve our goal of conducting quality audits, developing their full potential as professionals and contributing towards developing a highly motivated audit organization;
- **Continuous Improvement** — The creation of an audit culture that constantly seeks to improve itself and provide more value added to Canadians and our audit entities.

9.2 These elements, their related criteria and key instruments employed in the *QMS*, as it applies to our annual audit practice, are described in table at the end of this section.

Reasonable Assurance

9.3 The Office's Quality Management System is designed to provide "reasonable" assurance, in light of the likelihood and magnitude of potential risks, that it conducts annual audits in accordance with applicable legislative requirements, professional standards and Office policies. Reasonable assurance recognizes that the cost of managing risks should not exceed the benefits likely to be derived.

9.4 As such, reasonable assurance involves a satisfactory level of confidence under given considerations of cost, benefits and risks — it does not mean absolute assurance of all aspects of quality for each individual audit.

Ongoing Improvement of the Quality Management System

9.5 Continuous improvement activities are part of every quality management system. A continuous improvement process will ensure that our quality management system continues to evolve to reflect the current environment within which the Office operates.

9.6 A continuous improvement process typically contains six activities that operate in an interactive manner: various forms of review to assess product or process quality; identification and documentation of lessons learned; development of an inventory of improvement initiatives; practice improvement studies to propose reinforcements to approaches; formal documentation of standards and expected practices; and development initiatives to build staff awareness of new standards and expectations. These activities apply equally to all elements of the Office's *Quality Management System.*

Key Elements of the Annual Audit Practice
Quality Management System

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that	Key Instruments Employed
Audit Management		
1. Authority	The Office only undertakes audits where it has the authority to do so and, in those limited circumstances in which the Office can exercise discretion in accepting an engagement, they pose no undue risk to the Office.	• *Auditor General Act* • *Financial Administration Act* and Entity Specific Legislation • Annual Audit policies and guidance • Legal Services team advice and support • Approval by Executive Committee

Quality Management Element	**This element of the Office's Quality Management System should provide reasonable assurance that**	**Key Instruments Employed**
2. Independence, objectivity and integrity	Personnel are free of any obligation or interest in their audit entities; personnel are honest and candid at all times with due regard for confidentiality of the audit entities' affairs; and personnel maintain an impartial state of mind when carrying out audits.	• *Auditor General Act* • Office Code of Conduct • Annual Audit policies and guidance • Conflict of interest declarations/re-certification and related guidance • Legal Services team advice and support • TB Conflict of Interest and Post Employment Code for the Public Service
3. Conduct of the audit	***The Office has in place an appropriate audit methodology, recommended procedures and practice aids which are intended to result in efficient audit approaches that produce sufficient, appropriate audit evidence at the appropriate time in order to allow the Office to meet its reporting responsibilities.*** Communication of matters of significance takes place throughout the audit process between audit teams and management of the audit entities.	• Annual Audit policies and other Office guidance • Annual Audit Manual • Guidance on the OAG Annual Audit INTRAnet site • Software support tools (TeamMate, TeamStores and IDEA) • Product Leader, Annual Audit (and where appropriate, the Product Leader, Public Accounts) to provide advice • Methodology review and update mechanisms for Annual Audit policies, methodology and guidance • Annual accounting and auditing update course

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that	Key Instruments Employed
4. Consultation	When dealing with complex, unusual or unfamiliar issues, audit teams refer to authoritative literature and seek the assistance of Office specialists and/or individuals from outside the Office with appropriate competence, judgment, and authority.	• Annual Audit policies and guidance • Quality Reviewers • Subject matter experts such as Financial Instruments, Information Technology and Legal Services teams to provide advice and support • Centralized AAPT financial statement review function • Independent Advisory Committee • Annual Audit INTRAnet site and library resources including electronic databases
5. Security, access, and file retention	Personnel have security clearance appropriate for the nature of documentation that they will be required to access; there are appropriate restrictions on the access to audit files (electronic and hard copy) and related audit reports; and audit files are retained for an appropriate length of time.	• Annual Audit policies and guidance • Security policies and guidance • Security review and update mechanisms • Security Officer in place • Security clearance procedures • Managing audit records guidance

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that	Key Instruments Employed
People Management		
6. Resourcing	***Audit teams possess the required qualifications and competencies to enable them to carry out audits.*** Personnel assigned to specific engagements have the appropriate degree of technical training and proficiency to carry out the work.	• Annual Audit policies and guidance • Human Resources policies and guidance • Annual Audit Group Scheduling Co-ordinators • Group HR Champions • Centralized Human Resource function
7. Leadership and supervision	***Managers provide an appropriate level of leadership and direction and foster an environment in which all team members are encouraged to perform to their potential and to ensure that audits are properly carried out.*** Personnel are properly supervised and coached in their work.	• Annual Audit policies and guidance • Human Resources policies and guidance • Office Mentoring Program • Coaching, Briefing, Review by Interview • Annual Senior Practitioner's Forum course • PD Curriculum

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that	Key Instruments Employed
8. Performance management	Personnel receive timely and constructive feedback on their performance. Personnel have access to counseling, guidance and monitoring to help them manage and develop their careers. Personnel selected for advancement are competent and fully qualified to fulfil the responsibilities that they will be called upon to assume.	• Annual Audit policies and guidance • Human Resources policies and guidance • Centralized Human Resource function • Performance Management System including assignment and annual objectives and appraisals • Counseling, guidance and monitoring processes • PD Curriculum • Promotion processes
9. Professional development	Personnel undertake professional development through such means as on-the-job training, formal courses, self-directed studies, and internal and external assignments.	• Human Resources policies and guidance • Centralized Professional Development function • Professional development through such means as on-the-job training, annual staff updates, formal courses, self-directed studies, and internal and external assignments • Library resources • Self-Learning Center • Counseling, guidance and monitoring processes

Quality Management Element	This element of the Office's Quality Management System should provide reasonable assurance that	Key Instruments Employed
10. Respectful workplace	Personnel demonstrate and encourage in others those behaviours that lead to a respectful workplace which develops highly skilled, motivated and productive people who contribute to fulfilling the mission of the Office. Personnel respect and value diversity in the Office.	• Human Resources policies and guidance including Discrimination and Harassment Policy and Health and Safety Policy • Centralized Human Resource function • *Official Languages Act* and *Employment Equity Act* • Justice Canada mediation program • Harassment coordinators
Continuous Improvement		
11. Practice review	The Office carries out internal reviews of its Annual Audit Practice to assess the extent to which its practice meets these Quality Management Criteria for the Annual Audit Practice. Audit experience is assessed and opportunities for practice improvements are identified and implemented	• Practice review policy and program • Internal audit

Appendix 1: Updates to the Annual Audit Manual

Update: No. 2 May 2005		
Para #	**Effective date**	**Highlight**
2.41	May 2005	The Office generally assigns responsibility to a Principal for all products associated with an entity. This could result in instances where a non-accountant Principal is responsible for an attest or Public Accounts audit. This new Annual Audit Policy is designed to address risks associated with audits where non-accountant Principals are responsible for an attest or Public Accounts audit.

Update: No. 1 October 2004		
Para #	**Effective date**	**Highlight**
6	September 2004	The first annual audit policy regarding deviations from Office policies or generally accepted auditing standards (GAAS) has been changed. It now requires the team Principal to obtain prior approval from the responsible Assistant Auditor General and the Chair / Vice Chair of the AASEMC, through the Product Leader – Annual Audit or Public Accounts, regarding the proposed deviation.