



Response to the 2010 Peer Review Report



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

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Ce document est également publié en français.

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Cat. No. FA3-58/2-2010E-PDF
ISBN 978-1-100-15801-3



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Introduction

At the request of the Auditor General of Canada, an international peer review team reviewed the Quality Management System (QMS) that the Office of the Auditor General of Canada (OAG) uses to manage its audit and assurance practices. The objective of the peer review was to provide an independent opinion on whether the OAG's QMS was suitably designed and operating effectively to provide reasonable assurance that the work of the OAG complied with relevant legislative authorities and professional standards.

The period under review covered audit and assurance engagements reported during September 2008 to October 2009. The review criteria were based on relevant legislative authorities and Canadian assurance and auditing standards. The peer review team was led by the Australian National Audit Office and also included representatives from the supreme audit institutions of the Netherlands, Denmark, Sweden and Norway.

The report entitled **International Peer Review of the Office of the Auditor General of Canada**, dated May 2010, concludes positively with respect to the design of the QMS. It also concludes that the QMS was operating effectively for the performance audit and special examination practices. For the annual audit practice, the report concludes that the QMS was generally operating effectively, but it identifies certain implementation issues that need attention and makes two recommendations aimed at addressing them.

The report also contains observations on the design and operation of the QMS, as well as suggestions for the OAG to consider as it continues to improve its audit and assurance practices. The Report recognizes that the OAG is undertaking a number of improvement initiatives and describes good practices adopted by the OAG that will be of interest to other audit offices.

This document provides the OAG's response to the recommendations, observations and suggestions that have been made for each audit practice line and our Action Plan related to them. The Action Plan also identifies responsibility for implementing the planned actions and timelines for completion.

The following key overarching elements apply to all parts of our Action Plan.

- 1. Renewal of Audit Methodology (RAM) project.** This project includes revising and updating our audit methodology, related audit tools, checklists, and training and developing a change management component to ensure that our methodology is put into practice.
- 2. Involvement of senior management.** It is crucial that senior managers are involved, in a timely and appropriate manner, in all phases of the audit, key judgements, and key conclusions resulting from the audit work.

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

The OAG thanks the Peer Review Team for its professional work and quality report.

Response and Action Plan

Annual Audit Practice

Risk Assessment

Recommendation 1

We recommend that greater emphasis be given to implementing the risk assessment phase of the annual audit planning process that informs the nature and extent of further audit procedures. (paragraph 59)

Specific areas the Peer Review Team noted for improvement:

- Information Technology considerations were not well integrated in the audit team planning. (paragraph 55)
- The audit approach to assessing fraud risk was variable in the audit files and, in some cases, not demonstrably in accordance with requirements of the relevant auditing standard. (paragraph 56)
- Issues around the completeness and consistency of conclusions related to the components of internal control were noted. (paragraph 57)
- Linkages from the risk assessment process to the planned approach, relevant assertions, execution, and testing were difficult to follow. (paragraph 57)
- The practice review also found cases of incomplete risk assessment procedures, including over outsourced payroll functions. (paragraph 57)

Auditor General's response to Recommendation 1. Agreed.

This is an ongoing challenge for the Office. Our own internal practice reviews have also identified the need for improvements in this area. The Office's Executive Committee will take the necessary steps to ensure our audit methodology is fully complied with in practice. Our plan is to address this challenge in two ways. Firstly, as an interim step, we have provided guidance to assist auditors in improving the linkages of our risk assessments with both the planned and actual audit approach. The guidance also included increased senior audit management involvement in the planning (including risk assessment) phase of our audits. Secondly, we will ensure greater emphasis in this area as part of our Renewal of Audit Methodology (RAM Project) which includes revising and updating our audit methodology, related audit tools, checklists and training, and a change management component to ensure our methodology is put into practice. The target date for completion of the RAM Project is December 2011. Our progress in addressing this issue will be monitored by the Office's Executive Committee and by our ongoing practice review program.

| Specific actions related to Recommendation 1 | Responsibility |
|--|---|
| We have commenced a project to better integrate IT audit work with audit team planning, examination and reporting. The project will be completed by September 2010, with action commencing in Fall 2010 to be applied for audits for fiscal years ending on or after December 31, 2010. | AAG ¹ IT Audit / Product Leader ² |
| In Fall 2009, we provided our auditors with additional audit guidance to assist them in documenting risk assessment procedures. | Completed |
| More specifically, for assessing risks for fraud and internal control, we provided our auditors in Fall 2009 with additional audit guidance to assess and document those risks in our audits. | Completed |
| The Office also issued Senior Management Involvement and Documentation checklists in May 2010. | Completed |
| We will remind practitioners to use this guidance, and we will remind audit file reviewers to ensure that practitioners have properly and completely documented their compliance with Canadian auditing and assurance standards through, as appropriate, audit training, the September 2010 staff update sessions, and other fora. | AAG, Professional Practices Group / Product Leader / All AAGs |
| Finally, we will ensure greater emphasis in this area as part of our Renewal of Audit Methodology project, which is underway and will be completed by December 2011. | AAG, Professional Practices Group / Product Leader / All AAGs |

1. Assistant Auditor General

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

Documentation

Recommendation 2

To meet the requirement for sufficient and appropriate audit documentation in annual audits, we recommend that the OAG reinforce to staff the need for documentation on the electronic working papers to demonstrate compliance with relevant standards and OAG policy. (paragraph 67)

Specific areas the Peer Review Team noted for improvement:

- In a number of the audits examined, there were examples where the electronic working papers did not contain sufficient documentation to allow an experienced auditor to confirm that the extent of audit procedures was sufficient to support the judgements and conclusions in the audit file. (paragraphs 63/76)
- Documentation gaps suggest issues with both the preparation and timely review of working papers. (paragraphs 63/76)
- On occasion, the Report Clearance Summary was subject to revision after the initial presentation to the signatory of the audit report and review was not evidenced prior to the issue of the audit report. (paragraph 64)
- The unadjusted errors found were not adequately collated, documented, or reported in the Report Clearance Summary for one of the OAG's significant annual audits. (paragraph 66)

Auditor General's response to Recommendation 2. Agreed.

Our own internal practice reviews have also identified the need for improvements in our audit documentation. The Office's Executive Committee will take the necessary steps to ensure our audit methodology is fully complied with in practice. Our plan is to address this challenge in two ways. Firstly, as an interim step, we have provided guidance to assist auditors in ensuring the sufficiency and appropriateness of our audit documentation within our electronic working papers. The guidance also included increased senior audit management involvement in ensuring appropriate audit file review. Secondly, we will ensure greater emphasis in ensuring sufficient and appropriate audit documentation as part of our Renewal of Audit Methodology (RAM) Project, which includes revising and updating our audit methodology, related audit tools, checklists and training, and a change management component to ensure our methodology is put into practice. The target date for completion of the RAM Project is December 2011. Our progress in addressing this issue will be monitored by the Office's Executive Committee and by our ongoing practice review program.

| Specific actions related to Recommendation 2 | Responsibility |
|---|---|
| In May 2010, we provided our auditors with additional audit guidance to help ensure that sufficient and appropriate audit documentation exists within our electronic working paper files. In addition, the Office issued Senior Management Involvement and Documentation checklists. | Completed |
| To better assist our auditors in the collection, documentation, and reporting of unadjusted errors found in our audits, we will reinforce these requirements in our training by Fall 2010. | AAG, Professional Practices Group / Product Leader |
| We will remind practitioners to use this guidance and remind audit file reviewers to ensure that practitioners have properly and completely documented their compliance with Canadian auditing and assurance standards through, as appropriate, audit training, the September 2010 staff update sessions, and other fora. | AAG, Professional Practices Group / Product Leader / All AAGs |
| By Summer 2010, we will introduce a standardized disposition table for questions raised by the signatory during the signing meeting, which will be required to be completed for all audits. | AAG, Professional Practices Group / Product Leader |
| Finally, we will ensure greater emphasis in this area as part of our Renewal of Audit Methodology project, which is underway and will be completed by December 2011. | AAG, Professional Practices Group / Product Leader / All AAGs |

Reporting to Management

| Peer Observations/Suggestions | OAG Planned Actions | Responsibility |
|--|---|-----------------------|
| Consider developing a classification system that ranks annual audit findings according to the risk they represent to the audit entity and use this as a basis for determining which issues need to be formally reported to stakeholders. This would support consistency of reporting to audit committees and management, and also draw management's attention to issues considered to be of higher importance by the OAG. (paragraph 75) | A project has commenced that will consider developing a classification system that ranks annual audit findings according to the risk they present to the audit entity and to use this as a basis for determining which issues need to be formally reported to stakeholders. A decision will be made by Fall 2010. | Product Leader |

Performance Audit / Special Examination Practices

Improved Reporting

| Peer Observations/Suggestions | OAG Planned Actions | Responsibility |
|---|--|---|
| <p>While we recognize that the OAG has adopted a policy of publishing concise reports, these reports may be improved by including more context about the issue, project or program subject to audit/examination, and an explanation of the potential impact of the findings. In most instances, we believe that providing additional context will not substantially increase the length of reports. (paragraph 38)</p> | <p>Performance Audit:</p> <p>By Fall 2010, we will review and update, as appropriate, our guidance on report writing to ensure that the subject of the audit is described within the broader context of the organization being audited. In order to better explain the impact of findings (the “so what”) we began implementing an Action Plan in February 2010 for completion during 2010.</p> | <p>AAG, Professional Practices Group / Product Leader</p> |
| <p>In addition, the 2004 peer review suggested that the presentation of reports could be improved through the use of graphics and tables to present complex numerical data and footnotes showing sources of evidence. We consider that this suggestion is still valid. (paragraph 73)</p> | <p>Considering that the use of graphic elements to improve the clarity of our reports is an ongoing priority for the Office, we will look for ways to encourage the use of graphic elements through information sessions with audit teams and training for editors by Fall 2010.</p> <p>The suggestion to use footnotes showing sources of evidence has been considered and judged not to be useful.</p> | <p>Product Leader / Communications Principal</p> |
| <p>The special examination reports did not always explain why certain systems and practices (or components within the systems and practices) were selected for detailed examination, although this information was communicated to the corporation’s board of directors in the examination plan. Also, in some reports there was not a clear explanation of the alignment between findings and the reported conclusions for each system and practice examined, and the corporation’s system and practices as a whole. It would assist readers to better understand the report if an explanation of the term “significant deficiency” was included. (paragraph 39)</p> | <p>Special Examination:</p> <p>In April 2010, we issued guidance on report writing for special examinations that addressed:</p> <ul style="list-style-type: none"> a) the importance of context in the special examination report; b) why the selected systems and practices were chosen; and c) why findings should be aligned with reported conclusions. <p>Effective immediately, we will include an explanation of the term “significant deficiency” in all special examination reports.</p> | <p>Completed</p> <p>AAG, Professional Practices Group / Product Leader / Communications Principal</p> |

Electronic Audit File Management

| Peer Observations/Suggestions | OAG Planned Actions | Responsibility |
|---|--|------------------------------|
| With respect to performance audit, the electronic audit management software program was not always used. In addition, we found that when the software was used, its application was inconsistent, with considerable variation in the structure and organisation of electronic files. (paragraph 43) | In March 2010, the electronic audit management software structure was revised, guidance issued, and training provided to performance auditors that addressed the issues concerning consistent application, structure, and organization of electronic audit files. Office policy that the use of our electronic audit management software is mandatory for performance audit was also reaffirmed. | Completed |
| With respect to special examinations, it was difficult to follow the audit trail (the evidence) in the electronic working papers without the assistance of the audit team, although appropriate supporting evidence was available. (paragraph 43) | By Fall 2010, the importance of properly organized audit files and working papers will be discussed with individual audit teams, through audit training, staff updates and other fora. | Product Leader / All AAGs |

All Audit Practices

Design of Quality Management System (QMS)

| Peer Observations/Suggestions | OAG Planned Actions | Responsibility |
|---|--|---|
| We consider that there is scope to improve the design of the QMS. For example, the performance audit QMS could eliminate some overlapping sub-elements. Additionally, the consistency of the scope of the criteria and the way they are expressed could be improved in the three subsidiary QMSs. We observed that some of the key instruments supporting the QMS, such as policies relating to the Audit Management element of the annual audit QMS could be revised to more closely align with the auditing standards. (paragraph 26) | <p>These matters will be addressed as we develop one Quality Management System for all audit practices. The new QMS will be finalized by December 2011.</p> <p>As part of our RAM project to update our audit methodology, referred to in the introduction, by Fall 2011 we will review and revise, as appropriate, all audit policies, including those which address Audit Management. We will also ensure that they conform in all material respects with Canadian auditing and assurance standards.</p> | <p>AAG, Professional Practices Group/ Product Leaders</p> <p>AAG, Professional Practices Group/ Product Leaders</p> |

Continuous Improvement

| Peer Observations/Suggestions | OAG Planned Actions | Responsibility |
|--|--|--|
| We suggest that the OAG develop and implement a more robust and systematic process for ensuring that the lessons learned from audits, stakeholder surveys and practice reviews are identified, captured and disseminated. These lessons should desirably be incorporated into learning and development programs and audit/examination methodology and guidance. (paragraph 71) | A more systematic approach to capture continuous improvement and take appropriate action will be established. The first components will be operational by Winter 2011, and the full capability will be implemented by Fall 2011. | Chief Information Office / AAG Professional Practices Group / AAG Corporate Services |

Practice Review

Referencing Audit Work

| Peer Observations/Suggestions | OAG Planned Actions | Responsibility |
|---|--|------------------------|
| We consider that a more detailed referencing of the practice review programs to the audit/examination working papers would facilitate more efficient assessment of the practice review work. (paragraph 47) | The next cycle of practice reviews, which will start in Summer 2010, will include more detailed referencing to detailed working papers and observations. | Deputy Auditor General |