Comprehensive Auditing

# *An* Introduction

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## TABLE OF CONTENTS

# INTRODUCTION

This publication provides an overview of comprehensive auditing and related public sector reporting principles. It is intended to give a general orientation to members of public sector governing bodies, the managements of these organizations, and auditors and consultants who provide advice to such clients and who serve accountability relationships.

Although the term comprehensive audit has been around since 1978, it is still not widely understood. This is probably because it describes an evolving concept, one that has changed considerably over the years. What has not changed is the commitment of its practitioners to improving value-for money in the Canadian public sector.

This booklet explains what we mean by that term now, the conditions that make it important to adopt this form of auditing in the public sector, allied notions of accountability reporting, and the different forms that comprehensive audit can take. It also describes the overall approaches that are used in practice and some of the benefits that are associated with comprehensive auditing.

## BACKGROUND—WHY HAVE COMPREHENSIVE AUDITING?

### THE GOVERNANCE CONTEXT[1]

The fundamental need for the broader approach that comprehensive auditing brings to the way it serves relationships between management and governing bodies is rooted in the current context of governance in the public sector.

Public sector, and corporate, governance is under stress. A perceived ineffectiveness has induced a lack of confidence in our major institutions. Quickly evolving technologies introduce new risks and uncertainties that concern society. Continuous improvement of governance structures and processes is needed to capture and sustain the support of stakeholders and to help us agree on the strategic directions, investments and accountabilities that will optimize our opportunities for economic and social progress.

There is a general expectation that our public sector institutions should create a climate for prosperity and employment, a healthy and educated population, a firm information and physical infrastructure, and a reasonable social safety net. These are all components of an ability to maintain and increase our competitive position both at home and abroad.

Competing with these imperatives is the need to reduce and manage costs and deficits and to constrain taxation. As a result, the nature of decisions being made by government has changed profoundly. Not too many years ago, most decisions focussed on where and how to invest the next dollar. This is no longer the case. Today, decisions much more frequently concern where and how to divest the next dollar, how to alter programs and levels of service, and how government can serve as a facilitator rather than a service provider.

Inherently, these decisions carry with them a greater degree of risk and controversy, not to mention financial and human consequences. All of these factors combine to place a premium on effective governance.

The hallmarks of effective governing bodies (as identified in CCAF research) include the achievement in practice of certain fundamental characteristics. These include:

***Some Principles Associated With Effective Governing Bodies***

- Being composed of people with the necessary knowledge, ability and commitment to fulfill their responsibilities
- Understanding their purposes and whose interests they represent
- Understanding the objectives and strategies of the organizations they govern
- Knowing and obtaining the information they require to exercise their responsibilities
- Once informed, being prepared to act to ensure that the organization's objectives are met and that performance is satisfactory

1 We use the term "governance" in this publication to refer to the responsibilities and actions of all members of governing bodies including the federal and provincial legislatures, boards of directors, trustees of hospitals, municipal councils, school board members, directors of Crown corporations, boards of directors and similar bodies throughout the public and private sectors.

- Fulfilling their accountability obligations to those whose interests they represent by reporting on their organization's performance

As can be seen from the above, an important part of governance is the capacity of governing bodies to be well informed about the performance of the organizations for which they are responsible. For two reasons it is equally important that they have a high degree of confidence in the information that they receive about performance:

First, because they will use that information to make the important strategic and policy decisions that are intended to make their organizations as effective, efficient and economical as possible in meeting their mission

Second, because they ought to be able to demonstrate to stakeholders, service users, funders, employees, creditors, suppliers, and labor that they are basing their decisions on sound, reasonably complete and meaningful information.

This is a test of due diligence. Simply stated, governing bodies must themselves be adequately informed if they are to demonstrate convincingly that they have made the right choices or, as a minimum, to explain the choices that were available.

Being able to meet the test of due diligence and explaining choices are at the heart of maintaining public confidence in public institutions.

Comprehensive audit can add credibility to members of governing bodies and management (and hence confidence in the institution) by providing independent and objective opinions on:

- the information that members of the governing body receive and that they use to assess economy, efficiency and effectiveness
- the managerial practices and systems that are in use in the organization
- the information that governing bodies report to stakeholders about performance.

## The Evolution of Comprehensive Auditing

Comprehensive auditing was developed primarily as a response to a client demand for better accountability information. Simply put, in the 1970s members of the federal and several provincial legislatures realized that they were not getting the performance information they needed. They sensed an accountability vacuum. They had choices to make: either they could ask management to report on performance (the financial accountability model), or they could have a third party (the auditor being a prime candidate) attempt to fill the gap.

Possibly frustrated by the apparent unwillingness or inability of management to exercise its responsibility to report on performance, many legislatures formally asked their auditors to supply broader accountability information. Thus was comprehensive auditing born. Larger municipal governments and other public sector institutions started to follow suit. The Canadian Comprehensive Auditing Foundation (CCAF) was established as a medium to help the profession carry out the added responsibilities that were being assigned. Professional bodies such as the Québec Ordre of Chartered Accountants responded and for example, in the case of Québec, founded a Committee to advance knowledge about the concept among public sector institutions and practitioners in Québec.

In assigning to auditors the responsibility of helping to fill the perceived accountability vacuum, governing bodies have nevertheless been cautious in how much of this role they have given to auditors. They have implicitly recognized that the first duty to report lies with management, not auditors. For example, legislated and voluntary regimes of comprehensive auditing seldom explicitly mandate auditors to report effectiveness information where management does not do so. They also often restrict auditors from commenting on the merits of policy.

Comprehensive auditing is now practiced in virtually all provincial governments and in the federal government. It is practised by both external auditors (legislative auditors) and internal auditors.

Many medium-to-large sized municipalities have adopted the concept, as have a number of health care, educational and social service institutions. Federal Crown corporations are by law required to conduct periodic "special examinations" which, in turn, invoke all of the principal elements of comprehensive auditing.

The maturity of practice is further demonstrated by the promulgation of *Value-for-Money Auditing Standards* by the Canadian Institute of Chartered Accountants. Practice is further supported by CCAF, which conducts research to encourage the further development, evolution and acceptance of the concept, and which provides professional development, training and networking opportunities for practitioners as well as executives and members of governing bodies.

Internationally, audits that go beyond traditional financial statement auditing have become accepted in most western countries and, increasingly, in developing nations. United Nations organizations have also mandated both their internal and external auditors to report on observations dealing with value for money issues. These audits, while not always referred to by that name, usually cover the same types of matters having to do with economy, efficiency and effectiveness as do comprehensive audits.

## Benefits of comprehensive auditing

> *Auditing for the sake of auditing, comprehensive or otherwise, is unjustifiable at the best of times and is especially so today when limited resources and high service demands are taxing most public sector institutions.*

Comprehensive auditing is intended to add credibility to the the quality of public sector administration, promote confidence in public sector institutions, contribute to effective management, and—most importantly—help members of governing bodies discharge their due diligence and good governance responsibilities.

Comprehensive auditing is not a universal panacea for effective governance, strong management or meaningful accountability. But it can be an important contributor to all of these.

It allows members of governing bodies to be confident that they can demonstrate the quality of their governance and build confidence in their organization.

It gives governing body members a disciplined way to demonstrate that they have been duly diligent over a broad range of issues and information pertaining to the effectiveness and well-being of their organization and the interests of their stakeholders.

For management it offers the benefit of adding credibility to their assertions to the governing body, funders and others about the quality of their stewardship and management. The confidence that is born from their ability to do this should be considered as an important and valuable asset of the organization.

The insights and observations arising from such audits often suggest actions that allow the organization to be more economical and efficient and to achieve better results with the resources available. The process is value-added to the organization's stakeholders.



## AN INTRODUCTION TO COMPREHENSIVE AUDITING

All audits serve accountability relationships between those people who delegate responsibilities and those who undertake to carry them out. Comprehensive auditing is no exception to this rule.

Many assignments have been undertaken in the last few years that have been labelled as comprehensive audits. Unfortunately, some of these do not have the characteristics of true audits. That does not mean that the assignments have not been useful or that their conclusions are invalid. But they have been misnamed: they are not audits. This is troublesome, as it may create unjustified expectations for clients and other users of these reports. A clear definition of terms should help prevent misinterpretation.

### THE TERM "COMPREHENSIVE"

The first word, *comprehensive*, was chosen to convey the idea that the examination includes more than the traditional audit of financial statements and an examination of how closely the organization has complied with pertinent statutory authorities and regulations. A comprehensive audit looks at how the organization has given attention to value-for money—that is, to economy, efficiency and effectiveness.

There have been many attempts to define the elusive concepts of economy, efficiency and effectiveness. Over time, the following definitions have come to be generally accepted.

*Economy is the obtaining of the appropriate quality and quantity of goods and services at the appropriate times and at the best prices.*

*Efficiency is achieving the best possible productive use of goods, people and money.*

*Effectiveness is the extent to which programs are actually accomplishing what they were intended to do.*

In this booklet we use the terms *comprehensive auditing* and *comprehensive audit reports*. The literature defines comprehensive auditing as a concept rather than a technique—one that embraces three related but individually distinguishable aspects of public sector accountability:

- financial reporting
- compliance with authorities
- the economical, efficient and effective management of public funds and resources (often referred to as the value-for-money component of comprehensive auditing).

*Because financial and compliance auditing processes have been well established for some time, the term* comprehensive auditing *is often taken to connote the newer element, value-for-money auditing. We have adopted that usage in this booklet. We want to make it clear to readers that our use of the terms* comprehensive audit *and* comprehensive audit reports *and our comments about them should not be interpreted as extending to the financial and compliance elements of the broader comprehensive audit concept.*



## Audit

CCAF has adopted the following working definition of audit:

**Audit serves an accountability relationship. It is the independent, objective assessment of the fairness of management's representations on performance or the assessment of management systems and practices, against criteria, reported to a governing body or others with similar responsibilities.**

An audit must serve an accountability relationship. It must be a report to someone who has delegated authority on the performance of those to whom that authority has been given.

Because it is the *raison d'etre* of audit, we should have a clear understanding of what we have in mind when we use the term *accountability*. The Wilson Committee[2] provided a useful explanation:

### *Accountability Defined*

*...the obligation to answer for a responsibility that has been conferred. It presumes the existence of at least two parties: one who allocates responsibility and one who accepts it with the undertaking to report upon the manner in which it has been discharged.*

*Wilson then explained the relationship of audit to accountability by saying that:*

2 *Report of the Independent Review Committee on the Office of the Auditor General of Canada*, 1975, page 9. This Committee studied the responsibilities, reporting procedures and relationships of the Office of the Aditor General of Canada. Its recommendations significantly influenced the provisions of the *Auditor General Act* of 1977.

*...audit is a process that is superimposed on an accountability relationship. It is carried out to establish that a report on the responsibility assumed is a correct or fair one and is usually performed by a third party, primarily serving the interests of the party who delegated the responsibility.*

A number of characteristics essential to financial statement auditing are also associated in full measure with comprehensive auditing. These characteristics flow from the basic requirement that auditors be independent, in fact and appearance, and that they be objective and competent. They include:

- sufficient appropriate evidence be gathered in an orderly and systematic way
- auditors have responsibility and freedom to determine the scope and depth of work necessary to support their opinions
- the auditors have an obligation to carry through an audit engagement to the point of reporting their conclusions. This obligation to report is not contingent on the nature of the findings or of discussions that may take place with management in the course of an audit.

Another important characteristic is the existence of appropriate, relevant and agreed criteria on which to base the auditor's examination and resulting opinion. Without such criteria, auditors could not arrive at conclusions that a third party would judge to be objective, and the resultant reports could be considered to be biased or highly subjective.

These characteristics have been essentially reflected in the CICA *Value-for Money Auditing Standards*. While *value-for-money* criteria may not be universally agreed across all parts of the public sector, they can be agreed with clients in specific organizations; it has been happening for years.

*In short, comprehensive auditing is a form of audit that goes beyond the traditional purview of financial statement auditing and extends to matters having to do with economy, efficiency and effectiveness.*

*It is rigorous. It adheres to traditional auditing concepts, but it is also intended to respond to the information and assurance needs of members of public sector governing bodies, their stakeholders and funders, and their managements.*

## An evolving concept

Comprehensive auditing has evolved considerably in the last 15 years. It is not a rigid or static concept. In fact, there are three very different models for comprehensive auditing, all of which approach the question of value-for money in quite different ways.

One model for comprehensive auditing focuses on the quality of management systems and practices as an indicator of the extent to which the organization pays due regard to economy, efficiency and effectiveness. Another approach is for the audit to concentrate on providing audit assurance on the reports by management to a governing body or stakeholders on the performance of the organization. A third approach is for the audit itself to attempt to provide a performance report where the organization's management has not provided one to the governing body.

Which approach is right for a particular organization will will depend on a number of factors. These factors include, but are by no means restricted to: the state of the organization's systems and managerial practices, the culture and value systems of the organization, the quality of trust between the governing body and management, the interests of the organization's governing body members and management, the extent to which the organization is committed to demonstrating its accountability to its stakeholders, and its past history of work in this area.

The main determinant of which approach is most appropriate, however, lies in the quality of the accountability relationship between executive management and the governing body: the extent to which the governing body currently is informed about key aspects of the performance of the organization, the methods by which it is informed, and the way in which it uses the information it has been given.

Before looking more closely at each of the three possible approaches to comprehensive auditing, it will be worthwhile to consider the nature of the information a governing body needs to discharge its responsibilities appropriately.



## INFORMATION FOR EFFECTIVE GOVERNANCE AND MEANINGFUL ACCOUNTABILITY

### A RECOGNIZED NEED

During a major research project, CCAF learned that public sector executives had, for many years, indicated a willingness to provide better information to members of governing bodies about the performance of their organizations beyond the financial results.

They indicated, however, that they lacked an agreed framework, or set of principles, on which to base any such reports. They were frustrated by many aspects of existing reporting approaches. This included a proliferation of technologies and concepts, improper positioning of auditors, analysts and managers in the process, and the resulting fragmentation of financial and non-financial performance information.

Somehow it seemed the overall picture of their organizations' performance never emerged in a way, and at a level, that was meaningful to them and to their governing bodies. As a result, it was difficult to link decision making to performance information. It was very difficult, if not impossible, to achieve common ground among executives, members of governing bodies, analysts, stakeholders, auditors and others.

Moreover, public sector executives almost universally were uncertain and therefore concerned about how more robust information on performance might be received and used by governing bodies. In short, their concerns extended beyond technical issues and included important questions on how governing bodies would behave once provided with more meaningful information.

It was in the above context that senior executives committed themselves to work with CCAF to find a suitable set of principles to guide management reporting of performance to governing bodies, and to establish the role of audit in relation to such reports.

As readers will no doubt appreciate, in the public sector the financial bottom-line is usually not seen as the defining, and certainly not complete, indicator of an organization's success in meeting its objectives or in providing value to its stakeholders and supporters.

What has emerged from this effort is a set of principles around which meaningful information, rigorously prepared and supported, can be reported to governing bodies. Meaningful information includes, but goes well beyond, financial results and traditional efficiency measures. It seeks to portray a picture of an organization's real effectiveness, recognizing that effectiveness is a multi-faceted concept.

## Understanding effectiveness/performance.

How effectiveness or performance is understood seems to depend largely on who is looking for it. Different views may be held by voters or investors than by public servants or executives, by customers than by suppliers, and by employees than by boards of directors. Each view undoubtedly has validity for the people holding it.

A common perception is that the central effectiveness question is "Are we achieving our objectives?" The literature and our consultations, however, revealed that this is only one among a number of critical factors that are essential to a meaningful understanding of performance.

Effectiveness is not a single, indivisible concept. It contains subjective, value-laden components that will change with time and with viewpoint. Forming judgements about effectiveness often involves weighing multiple, competing and sometimes contradictory objectives and measures.

In view of this, we decided that it would not be productive to suggest yet another definition of effectiveness to add to the many already found in the literature. What we did instead was to distill effectiveness into a number of attributes that capture the range of thinking in the literature and provide a reasonable basis for meaningful reporting on performance.

The list of attributes is not biased towards any single view of effectiveness, but is intended to accommodate the broad range of interests of governing bodies. It is the list below that has been proposed as the framework, or set of principles, to guide effectiveness/performance reporting to governing bodies.

## Framework for performance reporting

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***Framework for Performance Reporting to Governing Bodies***

*A meaningful and credible report to a governing body on performance or effectiveness should disclose substantive information on the following matters:*

***Management direction:*** *the extent to which the objectives of an organization, its component programs or lines of business, and its employees, are clear, well-integrated and understood, and appropriately reflected in the organization's plans, structure, delegations of authority and decision-making processes*

***Relevance:*** *the extent to which a program or line of business continues to make sense in regard to the problems or conditions to which it is intended to respond*

***Appropriateness:*** *the extent to which the design of a program or its major components, and the level of effort being made, are logical given the specific objectives to be achieved*

***Achievement of intended results:*** *the extent to which goals and objectives have been realized*

***Acceptance:*** *the extent to which the constituencies or customers for whom a program or line of business is designed judge it to be satisfactory*

***Secondary impacts:*** *the extent to which other significant consequences, either intended or unintended and either positive or negative, have occurred*

***Costs and productivity:*** *the relationships among costs, inputs and outputs*

***Responsiveness:*** *an organization's ability to adapt to changes in such factors as markets, competition, available funding or technology*

***Financial results:*** *the matching of, and the accounting for, revenues and costs and the accounting for and valuation of assets, liabilities and equity*

***Working environment:*** *the extent to which the organization provides an appropriate work atmosphere for its employees, provides appropriate opportunities for development and achievement, and promotes commitment, initiative and safety*

***Protection of assets:*** *the extent to which important assets—such as sources of supply, valuable property, key personnel, agreements, and important records or information—are safeguarded so that the organization is protected from the danger of losses that could threaten its success, credibility, continuity and, perhaps, its very existence*

***Monitoring and reporting:*** *the extent to which key matters pertaining to performance and organizational strength are identified, reported, and carefully monitored.*

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Information about only one or a few of these attributes is insufficient to allow governing bodies to form balanced judgements about the effectiveness of an organization. But with information on all these attributes, or on all that are relevant in the circumstances, recipients of the information may start making such judgements with greater confidence. The framework is intended to open up, not restrict, dialoge and understanding about effectiveness.

Although none of the attributes is new, what is novel is the powerful synergy that occurs when they are all considered at the same time. When that is done, important choices and trade-offs become apparent that may otherwise have been imperceptible to management and governing bodies.

A further interesting feature of this framework is that, in addition to affording a structured view of past performance and current status, it incorporates notions, such as responsiveness, that provide a basis for assessing possible future performance.

It is important to note that the adoption of the framework does not presuppose that reports will be structured using the attributes as labels (although they can be), but rather that reports will address the issues they raise.

## A PRACTICAL PROPOSITION?

Informing governing bodies through reports that are based on the above reporting principles is a significant and challenging task for management. However difficult it might be, reporting on the 12 attributes is both a feasible and a practical proposition. Over the last several years the framework has been used by a wide variety of significant public sector organizations to report formally on performance to their governing bodies.

As can be easily appreciated, without some circumspection the task of reporting information to governing bodies along the lines contemplated in our framework could easily become overwhelming or unmanageable. Nevertheless, practical approaches to successful implementation have been developed. Guidance is available to organizations interested in adopting the reporting framework.

## REPORTING BEYOND THE GOVERNING BODY

Confidence in an organization's performance will likely require that governance become more transparent to important stakeholders such as funders, service users, the public at large, employees, regulatory bodies, consumers, creditors, and so on. Ultimately, this means that external reporting by organizations will have to include a wider range of information than at present. The principles described above could form the basis for such broader reporting.

The many dynamics at play in the public sector will affect how governing bodies use the information they receive from management, including how much of it they are willing to include in their accountability reports to stakeholders.

As a minimum, stakeholders might benefit from having assurance that the governing bodies have, in the course of exercising their duties with due diligence, received the kind of performance information suggested by the 12 attributes which comprise the reporting framework described above.

Over time, we think that public organizations, as they build experience with reporting that is guided by these principles, should also consider public reports based on these same principles.

The first issue at stake, however, is the extent to which a governing body itself wants to be informed.

## Three choices for comprehensive auditing

As mentioned above, there are three approaches that can be taken to comprehensive auditing. They are:

***Reporting on management systems and practices***

*In this approach the focus of the comprehensive audit is the quality of management systems and practices. These are examined with a view to using them as an indicator of the extent to which the organization pays due regard to matters having to do with economy, efficiency and effectiveness.*

***Attestation to management reports on performance***

*Using this approach, audit concentrates on delivering an opinion of the completeness and integrity of management's reporting to the organization's governing body or stakeholders on the performance (effectiveness) of the organization. The reporting framework or principles described previously, or similar frameworks, would guide management's reporting and, of course, the audit.*

***Audit reporting on performance***

*A third approach is for the audit itself to provide a performance report where management has not provided one to the organization's governing body. Here again the principles described previously, or similar frameworks, would guide the auditor in developing the performance (effectiveness) report for the organization.*



Following are highly summarized overviews of some of the key features associated with each of the three approaches.

### Reporting on management systems and practices

This approach is currently the most prevalent form of comprehensive audit practice. It is generally typified by long-form reports prepared by auditors that comment on the adequacy of management systems and practices relative to the economical, efficient and effective administration of funds and other resources.

The genesis of this form of comprehensive auditing began long before any comprehensive audit legislation was enacted in Canada. For many decades, federal and—in some cases provincial—auditors general reported *instances* where they thought that there had been a lack of due regard to value-for money in the administration of public funds.

The prime characteristics of direct reporting of these types of instances by auditors were the following:

- the observed instance was exactly that—usually an instance of a specific transaction or a specific decision
- the instance was observed as part of other audit activities: the observation did not result from a systematic, planned approach to address value-for money
- there were no pre-determined criteria to help assess what would or would not merit audit reporting.

Reports that comprise primarily instances are today rarely held to be the product of comprehensive auditing. Where such instances do appear in audit reports, they are usually provided as specific examples to support broader comprehensive audit opinions.

In the mid-1970s, the enactment of value-for-money legislation called for more systematic approaches. The new mandates focussed the auditors' attention on finding value-for-money deficiencies and on the systems that were, or should have been, in place to ensure that there was due regard for value-for money. As a result, systematic approaches were developed to set the scope of the audits, to develop criteria against which to assess management practices and systems relative to value-for money, and to prepare reports.

Over time, the approach has become further sophisticated. The approach most widely used today by both legislative auditors and private firms who do comprehensive auditing can best be characterized as direct reporting of assessments based on reasonable criteria (usually agreed upon with the client's management) of whether due regard to economy, efficiency and effectiveness has been demonstrated in the administration of resources. This approach recognizes that auditors are not simply searching for deficiencies to report.

The key to this approach is the availability of sufficient, appropriate value-for-money criteria. These criteria make it possible for auditors to determine whether or not reasonable standards were being met. Today, these criteria are considered such an integral part of the comprehensive audit process that *Value-for-Money Auditing Standards*[3] , issued by the Canadian Institute of Chartered Accountants, recommend that the criteria be identified in value-for-money audit reports.

One of the important results of using this approach is that the audit reports emphasize findings and conclusions on whether or not due regard for value-for money was evident. To the extent that specific instances or deficiencies are reported, they are reported in support of, or as exceptions to, the conclusions expressed in the report.

Practitioners recognize that if they were to focus their reports solely on negative observations and conclusions, they would not likely be contributing as much as they could to the future quality of public administration. Accordingly, the auditors' recommendations and management's responses are usually included in the reports to increase their value and to provide an opportunity for management to express its views on the desirability of these recommendations. Positive or favorable comments are also included to recognize the good as well as the bad.

The above approach recognizes that governing bodies want more than lists of problems—it is a step towards the expression of broad opinions on the state of management in audited organizations. It also provides recommendations that will help the organization to be more efficient and to manage its resources more effectively.

This approach does not in all cases overcome the possibility of negativity in the resulting reports. If an organization does not in large

3 *Public Auditing Statement 4, Value for Money Auditing Standards*, The Canadian Institute of Chartered Accountants, March 1988.

measure meet the value-for-money criteria, the report will say so. But when an organization does some or most key things well, the auditor will report a generally favorable opinion that creates a positive context for mentioning any specific deficiencies found and audit recommendations for improvement.

This results in a fair report that more accurately reflects the organization's true performance. This, in turn, is more useful to the governing body in its decision-making.

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### *Federal Crown corporations have gone a step further*

*One of the most interesting steps in the evolution of comprehensive auditing took place with the introduction in 1984 of legislation calling for special examinations of federal Crown corporations. The mandate for this work can be found in Part X of the* Financial Administration Act. *It requires that an examiner carry out a special examination of the financial and management control systems, information systems, and management practices that are to be maintained by the Crown corporation to provide reasonable assurance that:*

- *the assets of the corporation and each subsidiary are safeguarded and controlled*
- *the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently, and*
- *the operations of the corporation and each subsidiary are carried out effectively.*

*Upon completion of special examinations, the examiners are required to submit a report to the board of directors on their findings:*

*"(2) The report of an examiner under subsection (1) shall include*

*(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and*

*(b) a statement of the extent to which the examiner relied on internal audits."*[4]

*What is particularly significant about this legislation is that it requires the auditor to provide an opinion on value-for-money matters, that the opinion must say whether the auditor is confident that there are "no significant deficiencies", and that the opinion must cover the entire entity. In passing this legislation, Parliament was apparently convinced that a widely scoped report would best serve the needs of the directors of these corporations and of the ministers who have responsibility for the corporations' overall direction.*

*The auditing community has reacted positively to this legislation, and examiners have issued these broad-scoped opinions. The first such opinions were provided to boards of directors in 1989, in keeping with the implementation requirements of the* Financial Administration Act.

*In a sense, this legislation represents the culmination of the evolution of direct reporting, given the scope of the audits and the nature of the opinion required.*

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[4] *Financial Administration Act*, s.139(1)

## Attestation to management reports on performance

While most comprehensive audit practice has followed the approach described above, there is another approach that comprehensive auditing can take if management fulfills its role in reporting on its performance. That is the provision of audit opinions on reports that contain representations by management on matters of economy, efficiency and effectiveness. Historically, the lack of such management reports has meant that this approach could not be much used.

More recently, however, the client, management and audit communities have been working together to develop acceptable frameworks to underlie such reports, and experimentation has begun in preparing management representations on effectiveness. The framework of 12 attributes of effectiveness, described in this booklet, is the product of that effort.

The notion of management reporting to a governing body on the performance of the organization is not new. The individual attributes of effectiveness are not new. What is new is reporting that brings together all of these attributes and that is based on sufficient discipline and rigor that the information is reliable and credible.

When management makes such reports they are making representations, just as they do when they prepare a set of financial statements. An important observation is that the act of preparing management representations on performance or effectiveness is a management job. It should not be confused with comprehensive audit. The audit takes place after management has prepared its representations.



### The Concept of a Management Representation

**What is a management representation?**

*A management representation is an explicit statement made by senior management to their governing body (e.g., a Board of Directors) in relation to an aspect of the organization's performance.*

**What is the aim of a management representation?**

*It is a means by which management discharges an important aspect of its accountability responsibilities, i.e., to report to those who have approved the organization's mandate and delegated or provided the requisite authority and resources.*

*A management representation provides input to decision making by the governing body and provides a basis for them to exercise their oversight responsibilities, i.e., holding management to account for the performance of the organization.*

*The information included in a management representation also provides the governing body with an important basis for explaining the performance of the organization—and, indeed, their own decisions—to the public whose interests they are elected or appointed to represent, and to other stakeholders in the affairs of the organization.*

**On what scope of activity do management representations focus?**

*Depending on the complexity of the organization, specific requirements that may be imposed on the situation, or the aspect of per-*

*formance being examined, management representations could focus on the organization as a whole or on a major line of business or program.*

### *What are the major components and characteristics of a management representation?*

*The core of a management representation is information. A management representation is not just a summary interpretation or conclusion by management, although management and the governing body may wish to provide/receive such summary judgements as a context for further discussion between them.*

*The management representation should reflect the full range of key information needed to provide a complete explanation of performance. The implications of significant gaps or caveats in this regard should be discussed.*

*Commonly agreed principles and conventions (between the governing body and management) do not exist at this stage in the evolution of management representations on effectiveness. As a result, it would be reasonable for a management representation to include some discussion of how the information is important to senior management and the governing body, and the criteria that have been applied in assessing performance. This provides an explicit basis for establishing mutually agreed expectations between management and the governing body.*

*It also provides a key point of reference for the work of various practitioners who perform tasks on behalf of these two parties. This includes, for instance, the evaluator or analyst who works for management and who may be asked to perform information-gathering and analysis tasks to support management in making their representations. It also includes the auditor who works for the governing body and who may be asked to examine management's representations and report to the governing body as to the fairness and reasonableness of these representations.*

### *What is it reasonable to expect at first?*

*At first, it would be reasonable to expect that neither the Board nor management will have a perfect sense of the interests and requirements of the other* vis-à-vis *management representations. Nor is it likely that all the required information will be available given the newness of some concepts.*

*Realistically, initial application is aimed at exploiting existing and readily available information and analysis to maximum advantage, and at identifying and assessing any gaps. The initial product, albeit imperfect, can then be used as a basis for establishing a consensus between management and the governing body as to what more is needed, what can be cost-effectively provided, and what strategy will be pursued in this regard.*

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Where management makes representations, the comprehensive audit largely parallels traditional financial statement attest audits. It adds credibility to what management is saying so that members of the governing body and stakeholders can have a sufficient level of confidence in the information that they are using to make key strategic and policy decisions.

Comprehensive audit reports that attest to management representations on effectiveness may be provided in either highly summarized fashion (similar to the audit opinions that auditors usually give on financial statements), or they may be longer in form and narrative. In either case, the focus of the audit opinion is on the information reported by management and not on the details of systems and managerial practices.

The underlying approach to the audit of management representations on effectiveness has traditional roots: it is systems based. In other words, the auditor must be satisfied that the control systems that produced the information used by management in their representations are reliable. Moreover, the audit will extend to ensuring that the representations are not only sound insofar as the information they contain, but that they also contain all the information that they should in order to result in meaningful disclosure.

Interestingly, it was a federal Crown corporation that was first to adopt this approach. An audit opinion was issued on a management report on the Corporation's effectiveness. That opinion is reproduced, in part, below.

"...in my opinion, based on the agreed upon framework, the Corporate Representation as at June 30, 1989 reports on, in a reasonable and complete way, the most important aspects of the effectiveness of the Corporation and the Corporation has the information, systems and practices in place to support the statements contained therein."[5]

Since the above opinion was issued, similar opinions have been issued in a number of other organizations.

5 *Reporting and Auditing Effectiveness, The Experience of Canada Morgage & Housing Corporation*, CCAF, 1990, page 23.



This approach to comprehensive auditing is much closer to the model used for financial statement auditing in which management prepares statements that auditors audit. In effect, the role of auditors, although not all the work they have to do, is the traditional one.

## Audit Reporting on Performance

Governing body members often find themselves in a situation where they might want the type of performance information anticipated in the framework discussed above but, for one reason or another, management is not providing this information or is not supplying it in a sufficiently rigorous or comprehensive fashion. In these cases audits focussing on systems and practices, such as those described in the first approach above, may be insufficient to meet the due diligence needs of the governing body.

In such as situation, boards may consider a third model of comprehensive auditing, one that goes further than looking at systems. In this model, in the absence of management information on effectiveness, the auditor obtains and reports results-oriented information to the governing body. This information might be based on the effectiveness reporting framework that has been outlined in this booklet.

This model that has not, as yet, been very much used in Canada, although there is provision for it in legislation, both in Canada and in other countries.

## WHO CHOOSES THE APPROACH?

No one of the three approaches outlined above can be said to be superior to the other in all circumstances. Each can bring considerable value and benefit to governing bodies, to executive management and ultimately to stakeholders. The selection of the approach to some large extent needs to be based on the individual circumstances and needs of particular organizations. What is important is that the decision not be made in a vacuum.

The decision about what approach to use should not be simply made by either management or the governing body and then imposed. It ought to be the product of informed discussion between the two partners in the accountability relationship. Moreover, it is important that the auditor be involved in the decision-making process—not with a view to dictating the outcome, but rather to help ensure that all parties have sufficient background and knowledge about each of the potential choices. They must have this knowledge if their decision ultimately is to produce the best value for the organization and meet its needs and interests.



## HOW DO GOVERNING BODY MEMBERS INFLUENCE A COMPREHENSIVE AUDIT?

While comprehensive audits share many of the characteristics of financial audits, there are several important differences. It's these differences that make it possible—and important—for clients to be involved in decisions more than they are in financial audits.

### SCOPE

Financial auditors know exactly what it is they are going to examine: the financial statements prepared by management and the documentation supporting them. In addition, financial audits typically cover the entire entity being audited.

Not so for comprehensive audits. Because they involve an examination of so many factors, these audits often include in their scope only a part of the organization under study. To do a complete comprehensive audit of an entire government, hospital, educational institution, or corporation at one time, for example, might well require a prohibitive expenditure of resources.

Comprehensive auditors are faced with choices about what they will examine. Will it be one function across a number of organizational units (perhaps the entire client organization), or all aspects of one or more parts of the overall organization? The scope of the audit is an important variable.

In making decisions about scope, auditors take into account a number of factors, such as the amount of resources involved, the time since the last audit, the results of the last audit, the potential risk of loss, and so on.

Here's the first place where the clients for the audit may have valuable input to their auditors. Clients are likely to know where their problems lie and on what parts of their operations they would most like assurance of performance. It is entirely appropriate for members of governing bodies, such as legislators, directors, or trustees, to discuss—and try to influence—what comprehensive audits should examine.

Auditors must, of course, fulfill the conditions of their mandates, be they mandates prescribed by governing bodies in law, such as would be the case for legislative auditors, or mandates that are determined by a client outside the context of formal legal requirements. While mandating instruments usually deal with scope, they often do so in a very general way. In practice, auditors have a responsibility to provide sound reasons for deciding to audit matters that are low on the clients' list of priorities in lieu of ones that are high. By holding frank discussions with the auditors before the audit begins, it is possible for clients to help ensure that the truly important things are examined.

## DEPTH

In audits of financial statements, there are guidelines to help auditors decide just how detailed an examination they are going to undertake. Again, there are no such general guidelines—at least not yet—for comprehensive audits.



Decisions about how detailed an examination will be are taken with the scope and the availability of audit resources in mind. Obviously, the more detailed an examination of a given subject, the more it will cost. Obviously, too, decisions about depth must be taken into account when deciding on scope.

Apart from cost, the most important factor to take into account in deciding on the detail into which the audit should go is the degree of certainty with which the auditor will be able to come to an opinion.

No audit can result in complete certainty: the cost would be exorbitant, and the judgments that are implicit in auditing preclude this even as a theoretical goal. Typically, auditors examine samples, going to whatever lengths they think necessary to be reasonably confident of the eventual opinion they express.

Here, too, it is appropriate for clients to express their views. There may be some areas in which they require only a relatively low level of audit assurance about performance. In other areas, however, they may want to have great confidence in what the auditor has to say. In such instances they would want the auditor to collect more evidence and carry out the examination in greater detail. They may even be prepared to trade some breadth of scope for more certainty about an audit opinion on a particular subject.

CCAF recommends that comprehensive auditors convey in their reports just how much assurance they would like readers to derive from their reports—how confident they are about their opinions—and that this topic be the subject of active consideration at the planning stage.

## Criteria

Auditors assess their findings against established criteria to determine whether things are as they should be. For financial auditors, these criteria are well established: the Generally Accepted Accounting Principles (GAAP) issued by the Canadian Institute of Chartered Accountants (CICA).

There is no equivalent to GAAP for comprehensive auditors to follow with respect to management systems and practices. To date, there has been substantial progress in developing useful criteria by which auditors can assess due regard for value-for money in particular circumstances. Nevertheless, in light of the enormous range of matters that can come under study in comprehensive audits, it is unlikely that any equivalent of GAAP will be established for these audits in the near future.

Lacking such established criteria, comprehensive auditors must determine, for each audit, what the yardsticks are against which they will assess performance. It is critically important that these criteria be understood and agreed to by the client before the information-gathering stage begins. Otherwise, the auditor may be assessing performance on a basis that is irrelevant to the people responsible for the organization.

According to CICA standards for comprehensive auditing, auditors should discuss these criteria with clients at the outset of an audit. It is in the interests of clients to take these discussions very seriously.



## Significance/materiality

In preparing their reports, auditors have to decide what is important enough to bring to their clients' attention. In financial auditing, these decisions are guided by the generally understood concept of materiality. No such broadly adopted concept is available to guide comprehensive auditors or the users of their reports.

In making decisions about what to report, comprehensive auditors take a number of factors into consideration. These factors include such matters as dollar value, risk of occurrence of an undesirable event, potential savings, and impact on the program or organization under study, among others.

If a comprehensive audit report is going to be truly useful to its readers, it should tell them about the things that are important to them. While an experienced auditor may have a shrewd idea of what clients are most interested in, this is no substitute for a full and frank exploration of the subject with them. Here, too, clients have an opportunity to influence the audit and its outcome.

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In summary, comprehensive audits involve a number of important variables, giving rise to a number of decisions that will be made differently from those usually required in financial audits. These decisions, involving the scope of the audit, the amount of detail into which it will delve, the degree of certainty its findings will have, the criteria by which performance will be judged, and the factors that will decide what is important enough to report, pertain to matters of real importance to the clients.

These are all decisions to which clients have a legitimate right to contribute. Members of audit committees, and all those on governing bodies, have a clear stake in the outcome of comprehensive audits. They also have an opportunity, and a duty, to participate with their auditors in making those decisions that so substantially influence that outcome.

By doing so, they will help ensure that the very best value will be gained from the money spent on comprehensive audits.



## WHAT ABOUT INTERNAL AUDIT?

Comprehensive auditing is by no means the exclusive preserve of external auditors. Internal auditors and others with internal review mandates have an important contribution to make to their organizations through comprehensive auditing. They are also often well positioned to assist management in implementing a regime of reporting representations on effectiveness to governing body members and to stakeholders.

The definition that CCAF has adopted for comprehensive auditing specifically provides for internal audit's important role.

In many organizations internal audit plays a broader role than that implied by our definition of audit. Where internal audit reports to management and not directly to the governing body, as is usually the case, the above definition recognizes that executive management will want assurance from their internal auditors about the information that they will have received from other levels of management and that they are relying on to form their representations to the governing body.

The same rules and standards concerning independence and objectivity that pertain to internal financial audit should also apply to any mandates that internal auditors undertake in the comprehensive audit area.

Just as with financial auditing, the potential involvement of internal audit with comprehensive auditing does not preclude the involvement of external auditors, and vice-versa. Simply put, it's not one or the other.

Each has a role to play, each has strengths that ought to be utilized, and each should be involved appropriately.

As with the determination of the scope of the audit and the fundamental approach to be used, the assignment of responsibilities for comprehensive auditing between internal and external auditors should be assessed in the light of the specific circumstances of an organization.



## SKILLS NEEDED

Comprehensive auditing, as we use the term, is not the unique preserve of accountants or auditors. The breadth of scope implicit in any audit that takes into account important notions of economy, efficiency and effectiveness means that no one professional discipline can, or should, lay claim to all the competencies needed to undertake an auditing engagement of this type.

People who lead comprehensive audits must have an understanding of a wide range of management practices and a sensitivity to their application in specific circumstances. Similarly, they must have an in-depth appreciation of the nature of the client's business, its mission and its strategies.

Such individuals also need the capacity to lead and manage multi-disciplinary audit teams because, in many cases, specialized expertise may be required to conduct specific facets of the audit. It is not hard to visualize, for example, that medical expertise might be required in comprehensive audits of health care institutions and, similarly, educators might be needed in similar audits of educational institutions.

The use of multi-disciplinary teams, bound together with a strong audit discipline, is normally a distinguishing feature of comprehensive auditing.

## THE LIMITS OF COMPREHENSIVE AUDITING

Comprehensive auditing as described in this booklet and in the literature generally has a broad scope. In looking at the wide range of matters having to do with an organization's performance, it attempts to penetrate value-for-money issues that are close to the heart of governing body members, management and stakeholders. Three approaches to comprehensive auditing are described above. But despite the fundamental breadth for comprehensive audits and the variety of choices in applying the concept comprehensive auditing is not an unlimited concept.

Some forms of practice are entitled to be designated audit, and others are not. Determining those that do or do not deserve to be labelled as audit is based on testing the engagement against well-understood and accepted conventions and characteristics of auditing.

The first test of the appropriateness of using the word audit to describe existing value-for-money practice, therefore, lies in examining the primary purpose of the engagement to see whether it is serving an accountability relationship. Applying this test means that only that portion of value-for-money practice that serves an accountability relationship should legitimately be called audit. Thus, a broad range of value-for-money services that are carried out for other purposes should not be called audits, even though they may employ audit methodologies, and even though there may be some strategic or tactical benefits to be gained from calling such services comprehensive audits.

*Our definition of audit stresses that audit serves an accountability relationship. The auditor is not part of that relationship. The relationship is one that is exclusive to two parties: management and the governing body.*

That portion of practice that serves an accountability relationship needs to be further tested against other important characteristics of independence, objectivity, competence, and criteria (discussed above) before it may be called audit. These characteristics are also associated with financial statement auditing and have to do with the very nature of auditing. Their impact is to ensure that people who delegate responsibility receive an authoritative and useful report on the discharge of that responsibility.

Unless all these elements are present, an assignment cannot properly be called an audit.

Many practitioners from accounting, auditing and consulting firms provide their clients with consulting services in the value-for-money area; indeed, members of the legislative audit community from time to time undertake research in addition to their audit duties that relate to value-for money. These services are valuable, and we encourage practitioners to provide them when they can be of assistance to their clients.

Such services, however, are sometimes either sought or rendered, or both, under an audit label. This can only create confusion. It is in the best interests of comprehensive auditing to use the term audit only when an audit, as described above, has been conducted.

Engagements that are not designed to serve an accountability relationship, and/or that do not meet all the criteria that we have identified should not be called audits. For example, while recognizing that comprehensive audits often lead to management improvements, work that is designed primarily to achieve cost reductions, or productivity increases, or improvements to other elements of effectiveness, would not likely be labelled as such.

Similarly, engagements that are ostensibly held out to serve an accountability relationship, but whose terms of reference are so circumscribed that the resulting report would not likely be meaningful to the party that conferred the responsibilities that are being audited, should not be called audits.

Another form of value-for-money work that is often characterized by rigorous process, but which we do not think fits our working definition, are investigations into alternate forms of management and their potential impact. These could include organizational studies or investigations into different ways of providing services or acquiring goods or services.



## WHERE IS COMPREHENSIVE AUDITING APPLICABLE?

Comprehensive auditing and its allied management reporting practices and principles have an important and valuable role to play in all types of public sector institutions.

These include, but are not limited to:

- federal, provincial and local governments
- health, education and social service institutions
- government-owned or controlled corporations
- other enterprises and charities or non-profit organizations who use public funding to sustain their activities.

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