



Chapter 8

Audits

If Government is committed to openness, transparency and accountability, then the House of Assembly establishment should be subject to audit i.e. a comprehensive legislative audit.

— Auditor General¹

The Audit Process of the House of Assembly

One of the themes permeating this report is the importance of transparency as a fundamental building block of accountability. With respect to financial transparency, the completion of an annual audit is one very important means of achieving that goal.

I have mentioned previously some of the difficulties surrounding the audit process in the House of Assembly in recent years, including:

- the limited scope of audits performed in the House over the years (i.e., the completion of audits only as part of a government-wide audit and the absence of any form of legislative or comprehensive audit process focused specifically on the House of Assembly);
- the exclusion of the Auditor General from the House audit process by the IEC from 2000 to 2004;
- the lack of any audits of the House for at least one year;
- the lack of timely completion of some audits; and

¹ *Report of Auditor General to House of Assembly on Review of Departments and Crown Agencies For Year Ended March 31, 2006, Part 2.1.*

- the failure of external audits for the years ended March 31, 2002 and 2003, to flag the troublesome issues that were subsequently identified in respect of the management of the financial affairs of the House.

The manner in which the accounts of the House were audited, especially since 2000, has been a matter of public discussion, with a variety of opinions being expressed on solutions for improving the audit process. It is appropriate, therefore, that the whole concept of an audit process within an institution like the House of Assembly be examined, in order to develop recommendations as to best practices for delivering audits of the accounts and activities of the House in a manner that is effective, suits the purposes of the House, is transparent, and provides accountability for the public funds that have been spent.

Government Audits - What Are They and Why Are They Carried Out?

The government is responsible for administering and managing public programs. Government officials who manage these programs and spend public funds must account for their activities to the public. Officials, legislators and taxpayers all wish to know if government funds are spent as intended and in accordance with appropriate laws, regulations and policies. These individuals need to be aware of situations where government or specific departments are not spending funds in accordance with their mission, or when services are performed in an inappropriate or inefficient manner. From this idea of entitlement to information on financial stewardship, the concept of public accountability has developed and the need for government audits was established.

Auditors assist legislatures and other governing bodies to fulfill their reporting responsibility to the public by providing assurance as to the credibility of management reports, assessments of various administrative practices and compliance processes. Thus auditors can assist in holding governments accountable to the public. However, it must be emphasized that there are *different types of audits*. This issue bears elaboration because I have sensed through the consultation process a belief or expectation in the minds of some that “an audit is an audit,” and that therefore *any* type of audit should identify and disclose any and all areas of potential concern to government and the public. I have learned that this may not be a reasonable expectation.

Governments and other public sector entities use their resources to achieve a variety of different social and economic goals. While audited financial statements provide accountability in the broadest sense of a government’s financial operations, these statements alone may not adequately report on and address the quality of financial stewardship and control, or report on performance generally. To address such issues, governing bodies and the public may be interested in information relating to such matters as:

- compliance with legislative authorities;
- the safeguarding of assets;
- appropriateness of management control systems;

- efficiency in the administration of resources; and
- overall effectiveness of various government programs.²

In this regard, it must be understood that the mandates assigned to auditors in different circumstances can vary significantly. Accordingly, the type of work performed by the auditors and the nature of the issues covered by the respective auditors' reports, will be dependent upon the auditors' mandate. Mandates for the auditors of the public sector are dependent upon the expressed requirements of the governing body. In addition to determining the types of procedures required to be performed by an auditor, the audit mandate also provides the auditor with the authority to carry out his or her work. These mandates may be embodied in legislation or established by contract by way of an engagement letter. The most common mandates for auditors of the public sector include (i) audits of the financial statements of the government, (ii) audits of compliance with legislative and related authorities, and (iii) value-for-money audits. Together, these three items constitute the concept of *comprehensive auditing*.

I note that generally, over the years, the mandate prescribed for House of Assembly audits was considered to be limited to that of a *financial statement audit* conducted as part of the general government-wide audit. As I explained in Chapter 3, when the Auditor General in 2000 signified her plan to conduct a more comprehensive legislative audit, which might have encompassed the other audit dimensions outlined above, the plan was blocked by legislative change. Clearly, the nature of the audit mandate is a crucially important determinant in establishing the level of objective scrutiny to be undertaken, and the extent to which it is reasonable to expect that control deficiencies and management weaknesses will be detected and reported. The following, therefore, is a review of the principles underlying each of the three elements of comprehensive auditing.

(i) Audit of Financial Statements

The element of comprehensive auditing known as a *financial statement audit* is the one most commonly associated with the role of an auditor and involves providing an auditor's opinion on the financial statements prepared by the government. Section 5100 of the *Canadian Institute of Chartered Accountants (CICA) Handbook*, sets out generally accepted auditing standards that comprise the professional standards with which an auditor must comply when expressing an opinion on financial statements.³ This section requires the expression of an opinion on whether the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows in accordance with

² See *Auditor General Act*, S.N.L. 1991, c. 22, ss. 12(2) for a more comprehensive list.

³ The Canadian Institute of Chartered Accountants Handbook, Toronto, Canada [which will sometimes hereafter be referred to as the *CICA Handbook*]. It should be noted that the CICA Handbook has sections specifically for Public Sector Organizations that are in addition to or in place of some sections that apply to for non public sector organizations. Throughout the course of this report, I refer to the *CICA Handbook* which encompasses the entire set of standards for all types of organizations.

Canadian “generally accepted accounting principles.”

Often, public sector auditors have a mandate that requires the expression of an opinion on whether the financial statements are presented fairly in accordance with disclosed accounting policies. In assessing the appropriateness of disclosed accounting policies, the auditor would refer to the standards in the *CICA Public Sector Accounting Handbook*, which is a part of the *CICA Handbook*.

When an auditor’s mandate is to express an opinion on the fair presentation of the government’s financial statements in accordance with a disclosed basis of accounting, the auditor should express, in his or her report on financial statements, a reservation of opinion on accounting policies believed to result in misleading financial statements, together with the reasons and a quantification of the effect on the statements.

As noted above, it is my understanding that this is the type of audit that was generally performed in relation to the House of Assembly, and no such reservations were expressed by the auditors over the years.

(ii) *Audits of Compliance with Legislative and Related Authorities*

The second element of a comprehensive audit involves assessing compliance with legislative and related authorities. This is often referred to as a “legislative” or “compliance” audit.

The examination standards as written in section 5100 of the *CICA Handbook* apply to all instances in which an opinion is provided on financial statements. Since readers of an audit opinion on compliance are entitled to the same degree of quality provided by an audit opinion on financial statements, the examination standards set out in section 5100 apply to both compliance and financial statement audits as well.⁴

In an engagement designed to express an opinion on compliance with authorities, reasonable assurance that the authorities specified in the audit report have been complied with is sought from appropriate officials of the institution being audited.⁵ Absolute assurance is not possible due to the requirement for judgement, the inherent limitations of internal control, and the use of various testing methodologies. In an opinion on compliance, the words "in all significant respects" are used, as insignificant items may be discovered but might be regarded as not worthy of inclusion in the report. If significant widespread non-compliance is encountered, further testing should be completed to confirm or dispel suspicions. If, in this instance, the auditor is also responsible for the audit of the financial statements, the impact of non-compliance should be considered and, in particular, whether

⁴ *CICA Handbook*, PS 5300.06.

⁵ *CICA Handbook*, PS 5300.07.

the non-compliance with legislative and related authorities results in misleading financial statements.

Mandates within this type of compliance engagement include:

- expressing an opinion on whether an entity complied with specified authorities or whether its transactions were carried out in compliance with specified authorities;
- expressing an opinion on whether the transactions that have come to the auditors' notice in the course of discharging their other audit responsibilities were carried out in compliance with specified authorities; and
- reporting instances of non-compliance with authorities observed in the course of discharging their audit responsibilities.

Auditors of public sector entities may have mandates to report instances of non-compliance with authorities that they have observed in the course of discharging their audit responsibilities. Such mandates require the auditor to report only those matters that, in his or her opinion, do not comply with relevant authorities. Some auditors may consider it appropriate to examine for compliance all of the matters that come to their attention in the course of discharging their other audit responsibilities, while others may examine only suspicious or high-risk transactions.⁶

Auditors with such a reporting mandate usually report the observed instances of non-compliance in their annual reports to the government or the legislature, as the case may be. These reports vary between jurisdictions, depending on variations in audit mandate and differences in the style and format of each individual auditor's report. Notwithstanding the format of the report, the context in which the observed instances of non-compliance were found would be described.

With respect to the audits of the House of Assembly, it now appears that there were ongoing compliance issues that were not detected in the financial statement audit process over the years. The Auditor General's recent special reports identify a number of alleged instances, spanning nine years, where there was an apparent failure to comply with stipulated maximum constituency allowances prescribed for certain Members. In addition, there are indications that certain expenditures, charged to a given account, did not comply with the purpose for which the funds were voted in that account. There are also questions as to whether there was compliance with the federal *Income Tax Act* in relation to the discretionary or non-receipted expenditure components of the constituency allowances. None of these discrepancies or compliance issues was highlighted in the financial statement audits conducted over the years as part of the Auditor General's government-wide audits, or

⁶ *CICA Handbook*, 5300.19.

as a result of the specific audits of the House conducted by external auditors for the years 2001-02 to 2003-04.

(iii) Value-for-Money Audits

The third main element of comprehensive auditing is value-for-money auditing. Value-for-money audits are conducted for the purpose of examining and reporting on matters related to any or all of the following:

- the adequacy of management systems controls and practices, including those intended to control and safeguard assets, to ensure due regard to economy, efficiency and effectiveness;
- the extent to which resources have been managed with due regard to economy and efficiency; and
- the extent to which programs, operations or activities of an entity have been effective.⁷

The auditor may be asked to audit all or only a portion of the matters set out above, as specified in his or her mandate. To illustrate, some mandates could require the auditor to audit and report on the adequacy of procedures to measure and report on program effectiveness, but do not require the auditor to report on the extent to which the programs are themselves effective.

The reporting requirements of value-for-money auditing mandates also vary. Many value-for-money auditing mandates, such as those relating to federal and provincial government departments and agencies, require the auditor to report deficiencies observed. However, other auditing mandates require the auditor to express an opinion, such as whether there is reasonable assurance, based on specified criteria, that there are no significant deficiencies in the systems and practices examined.

The auditor is expected to identify the criteria in his or her report and describe the findings sufficiently to allow readers to understand the basis upon which the auditor formed his or her conclusions.⁸ Value-for-money audit reports may include the auditor's recommendations and management's responses with respect to the matters reported.

The value-for-money dimension of auditing has generally not been followed in respect of audits of the House. While the notion of “value for money” presents challenging

⁷ *CICA Handbook*, PS 5400.04.

⁸ *CICA Handbook*, PS 5400.15.

public policy and measurement considerations in the broadest context of the legislature, questions related to “the adequacy of management systems controls and practices” in the administration and ongoing activities of the House are clearly relevant concepts. In fact, through Chapters 3 and 4, I have reviewed multiple indications of inadequacies in this regard - inadequacies which, prior to 2006, with a few exceptions, had gone essentially unaddressed in the audit process.

It is obvious from the foregoing that there are various dimensions of comprehensive auditing that have not been characteristically applied to assess compliance, management practices and controls in the House in the past. Accordingly, the need for a more prescriptive, encompassing audit mandate in this regard is compelling.

There is an additional auditing approach that also merits consideration in view of the nature of the issues before this commission - *forensic accounting investigations*.

Forensic Accounting Investigations

For many years, forensic accounting investigations were not commonly performed within any organization, government or private enterprise. However, with recent events such as the “Enron affair” and the “sponsorship scandal,” forensic accounting investigations are becoming much more prevalent.⁹ Since the release of the provincial Auditor General’s reports in 2006, there has been considerable interest in forensic accounting investigations in the hope or expectation that they may help resolve some of the questions about the transactions identified in those reports.

Forensic accounting investigations are conducted in a fashion that is as thorough and complete as possible. The findings of such investigations may be used in adversarial legal proceedings with the forensic accounting practitioner acting as an expert witness.¹⁰ These findings are the result of scientific detection and interpretation of the evidence of phenomena introduced into the books and records of an accounting system. Forensic accountants mainly utilize cause-and-effect analyses of these phenomena to discover any deceptions within the system and the effects these deceptions have.¹¹ Forensic accounting is utilized to obtain evidence to support criminal charges such as those related to bribery, fraud, theft, breach of trust, extortion or forgery. Forensic accountants utilize both accounting expertise and an understanding of the legal system to lay out factual conclusions in a clear and logical manner, including a description of the actions and events which have happened, the parties

⁹ The Enron Corporation collapsed in 2000 after a severe drop in its share price amid allegations of impropriety in its accounting for certain transactions and the occurrence of fraudulent activities within the ranks of senior management. The “sponsorship scandal” in Canada has now been described and dealt with by recommendations as a result of the *Gomery Inquiry*.

¹⁰ *The Canadian Law Dictionary* (Toronto: Law and Business Publications (Canada) Inc, 1980) defines “forensic” as “pertaining to court of justice; relating to or used in legal proceedings.”

¹¹ *What is Forensic Accounting?*, Journal of Forensic Accounting, R.T. Edwards Inc., 2003.

involved, the amount of misappropriation and any damages resulting from the actions.¹²

In situations where internal control systems fail or have been compromised, forensic accounting can often be valuable in analyzing the violation. Forensic accountants will attempt to determine the parties involved in the violation, and the approximate damage caused by the transaction. After the completion of the analysis, a forensic accountant may provide recommendations respecting the control system to eliminate or minimize such violations from occurring in the future. Experiences from forensic accounting investigations can also help pre-emptively to eliminate control risks from the system.

Application of Forensic Accounting Investigations to the House of Assembly

Due to their nature, forensic accounting engagements can be time-consuming and require the use of a significant number of highly trained individuals. They involve, in effect, an examination on a document-by-document basis. With respect to its application to the House of Assembly, it is necessary to balance the benefits of forensic accounting against its considerable costs.

While a forensic accounting investigation is a valuable tool for getting to the bottom of questionable transactions and for assessing what may have gone wrong with a system, it is not intended to be the basis of normal on going audit processes in an organization or institution. The cost associated with effectively double-checking every transaction as part of a general audit process on a “go forward” basis, once suitable policies, practices and systems of control are in place, would be disproportionate to the potential benefit. In fact, it has been suggested to me that no reputable accountant would promote the use of forensic accounting specialists for such purpose. There are, however, two *past* matters which *would* benefit from further investigation.

Matters Requiring Further Investigation or Audit

The work of this inquiry and that of the Auditor General have left unanswered questions with respect to a number of particular transactions that have, or may have, occurred. Some of the most troublesome questions relate to the transactions anticipated in the minutes of the Commission of Internal Economy on March 6, 2002, and February 26, 2003, with respect to potential year-end payments to MHAs related to their constituency allowances. As was discussed in some detail in Chapter 4,¹³ the IEC minutes indicate that adjustments to the constituency allowances were approved, but the amounts were not

¹² Forensic Accounting and the Expert Witness, American Management Association, URL: <<http://www.flexstudy.com/catalog/index.cfm?location=sch&courseum=95063>>

¹³ Chapter 4 (Failures) under the heading “Lack of Commitment to Governance, Transparency and Accountability”.

indicated; yet the nature of the payments appears to have been verified to the satisfaction of the external auditors. Nevertheless, I have been unable to confirm, from the records made available to me and my research staff, whether or not any such payments were in fact made or to whom they might have been made. To ensure that full confidence can be restored in the House of Assembly and its operations, this unresolved discrepancy must be addressed to ensure that appropriate action can be taken and the potential for a recurrence is blocked. Accordingly, I recommend:

Recommendation No. 49

A forensic accounting investigation should be conducted to determine if the transactions contemplated by the decisions of the Commission of Internal Economy on March 6, 2002, and February 26, 2003, with respect to potential payments to MHAs of sums related to their constituency allowances occurred, and if so, if they reflected the intent of the decision so made.

A second area that requires an audit assessment is the financial operations of the House for the fiscal year 2000-01. Section 9 of the *Internal Economy Commission Act* requires that the accounts of the House, “under the direction and control of the commission, be audited annually by an auditor appointed by the commission.” This is a mandatory requirement. There *must* be an audit. The fact that the audit is to be conducted under the “direction and control” of the commission does not mean that it can “control” the situation by not having one at all.

I have already noted that the Commission of Internal Economy never did cause an audit to be conducted of fiscal year 2000-01. That audit gap continues to this day. This is all the more troublesome because it relates to the year (2000) when the amendments were made to the *Internal Economy Commission Act* giving the IEC authority to bar access to the Auditor General to the accounts of the House, following a stated intention by the Auditor General to conduct a compliance audit. That is a year that certainly deserves audit scrutiny. As I indicated in Chapter 3, it was suggested to me that the failure to initiate the 2000-01 audit was due to a clerical error at the administrative level in the House. However, in light of the decision to amend the legislation in 2000; the decision to oust the Auditor General; the excessive and inappropriate delays in initiating the audits; the confusing array of IEC minutes on the matter; and the IEC-directed revisions to the external auditor’s mandate period as indicated in the IEC minutes, I am reluctant to accept the notion of clerical error as an explanation for the audit void. In all the circumstances, I believe it is prudent to ask the question: “Was there a reason the 2000-01 fiscal year was not audited?”

I acknowledge that the Auditor General is in the course of a very substantial audit process, and he is reviewing MHA constituency allowance accounts dating back to 1989. It has been suggested to me that the work that the Auditor General is presently undertaking is sufficient to meet the audit requirement in section 9 of the *Internal Economy Commission Act* in respect of the year 2000-2001 and that no separate financial statement audit need

therefore be performed. It is not at all clear, however, as to whether the Auditor General, with his renewed mandate in 2006, will necessarily be performing a discrete and complete audit covering all of the accounts of the House, producing financial statements and compliance comments for the year 2000-01, *as a separate part of his larger multi-year review*. If not, his current work will *not* in fact be a substitute for the audit requirement in section 9.

I believe it is important that a full audit of 2000-01 be completed and that careful consideration be given to the levels of materiality that should be applied, given the fact that in the two subsequent years the level of materiality applied (which was appropriate according to generally accepted auditing standards) appears to have been a contributing factor to the failure to discover discrepancies that subsequent investigations have shown were in fact present. If indeed an audit of this nature has been, or is being, conducted by the Auditor General, and *separate financial statements and opinions thereon relating to the House of Assembly* have been or are to be prepared, then they should be produced and submitted to the IEC and the Public Accounts Committee for consideration. If they are not, or will not be, prepared as a result of the Auditor General's current work, then they should be, so as to comply with the law and the expectations that existed when the IEC took it upon itself, following the legislative amendments in 2000, to control and direct the audit process.

There is one other matter that should be addressed in this context. In Chapter 3, reference was made to concerns expressed by the Auditor General in his annual report for the fiscal year ended March 31, 2003, that "the expenditures of the House of Assembly have not been audited for the past four years."¹⁴ That would include fiscal year 1999-2000. It is obviously inappropriate for the accounts of the House to escape audit scrutiny for *any* year. Inasmuch as it appears that the fiscal year 1999-2000 may not have figured even in the audit of the overall governments accounts generally, I believe that it is now appropriate for a separate audit of this fiscal year to be conducted, as well as for 2000-01.

¹⁴ See Chapter 3 (Background) under the heading "Audits of the House of Assembly".

Accordingly, I recommend:

- Recommendation No. 50***
- (1) A complete financial statement and legislative compliance audit should be conducted forthwith of the accounts of the House of Assembly, as a separate entity, for the fiscal years 1999-00 and 2000-01, with appropriate levels of materiality, taking into account the size of the organization and the experience of subsequent years; and***
 - (2) Upon issuance of financial statements, auditor's report and management letter, if any, in relation to the fiscal years in question, they should be referred to the Public Accounts Committee for review.***

Moving from an assessment of opportunities to reinforce the scope of the audit process, and areas requiring specific attention, it is important to explore the reasonable expectations for the nature and form of results of the audit process - the *audit deliverables*.

Audit Deliverables

The audit deliverables¹⁵ vary from engagement to engagement and are directly dependent upon the auditors' mandate.

In relation to a financial statement audit, the auditors' report is required to express an opinion on whether the financial statements are in accordance with generally accepted accounting standards, or a disclosed basis of accounting. Additionally, it is normal practice for a management letter to be issued at the completion of a financial statement audit. This letter communicates the various matters that would have come to the auditors' attention during the audit, which, in their judgement, should be brought to the attention of senior management of the organization with respect to the systems of internal control. As the management letter might well contain information that discusses potential control deficiencies within a client's organization, it is important for this letter to be issued on a timely basis.

As a best practice, most auditors attempt to release the management letter at the same time as, or shortly after, the issuance of the auditors' report. It is common practice for auditors to query senior management about the issues contained in a previous management

¹⁵ The term "audit deliverables" means the information given to the client to fulfil the mandate of the particular type of audit, and includes such things as the audit report, management letters and independence letters.

letter to determine if the issues were subsequently addressed or whether these issues still persist for the current year's engagement.

The *CICA Handbook*, section 5751, sets out additional requirements for disclosure to management. These items include:

- results of the auditors' procedures in relation to management judgments and estimates;
- concerns identified in relation to significant accounting policies, such as revenue recognition and cut-off of expenses;
- instances of fraud or any illegal acts identified during the audit;
- a listing of significant errors corrected by management during the audit;
- unadjusted audit differences considered by management to be immaterial;
- significant weaknesses in internal control;
- concerns about fraudulent financial reporting;
- disagreements or difficulties encountered with management during the audit engagement; and
- confirmation of auditor independence.

I would emphasize that, prior to the audit reports issued by the Auditor General in 2006, there had not been a concern raised in management letters in respect of the House since 1997.

In relation to compliance audits, the main deliverable is an auditor's opinion that states whether the entity is in compliance with the required authorities. Additionally, a management letter often accompanies this type of report. It discusses the exceptions found during the examination, and includes as any other comments or recommendations the auditor wishes to communicate to the oversight board. A compliance audit in relation to the House of Assembly would, of course, be expected to examine MHA expenditures on constituency allowances in relation to the prescribed maximums, and to either confirm compliance, or through the management letter, highlight any exceptions identified. Since, prior to 2006, it appears this type of audit was not specifically mandated for the House of Assembly, no such issues were identified, or no related communication conveyed, until June of 2006.

The main deliverable in relation to a value-for-money audit is the "findings report." Due to the nature of this type of audit and the level of scrutiny from the public and media that often results, this type of report must be clearly written and concise so that the user of

the report understands the motive and findings of the audit. A value-for-money report would clearly communicate the following items:¹⁶

- the objectives, scope, and time period covered for the audit;
- the professional standards used;
- a description of the program or activity that was audited;
- the criteria used and any disagreement with management on their suitability;
- the observations made;
- the recommendations made to assist in correcting deficiencies;
- management comments in relation to findings; and
- conclusions reached by the engagement team.

As with all types of audits, the timing of this communication is essential and it should be released as close to the audit completion date as possible. Auditor follow-up of recommendations made in its report is crucial to ensuring that corrective actions are taken and the issues identified are resolved. As noted previously, the value-for-money audit approach has not to this point been applied in respect of the operations of the House.

Audit Legislation of the Province of Newfoundland and Labrador

Against the foregoing review of the basic concepts in the auditing discipline generally, and some of the specific issues identified in the course of our review of the House of Assembly, it is pertinent to consider the nature of the legislative framework applicable to the audit of the public accounts of the Government of Newfoundland and Labrador. In this regard, sections 10, 11, and 12 of the *Auditor General Act* are most relevant.¹⁷

Sections 10 and 11 provide:

10. The auditor general is the auditor of the financial statements and accounts of the province and shall make those examinations and inquiries that the auditor general considers necessary to enable him or her to report as required by this *Act*.
11. The auditor general shall examine the several financial statements required by the *Financial Administration Act* to be included in the public accounts of the province, and any other statement that is required to be audited by the auditor general under that *Act* or another statement that the Minister of Finance may present for audit and shall express his or her opinion as to whether the financial statements present fairly the financial position, results of operations and changes

¹⁶ *CICA Handbook*, PS 5400.12.

¹⁷ S.N.L. 1991, c. 22.

in the financial position of the province in accordance with the disclosed accounting policies of the provincial government and on a basis consistent with that of the preceding year, together with reservations the auditor general may have.

To date, these provisions have been interpreted to mean that the Auditor General can perform the financial audit of the province and report thereon. In accordance with these responsibilities, he and his predecessors have been carrying out financial statement audits, and have delivered their reports on the accounts of the province to the House annually as required.¹⁸

The more specific requirements of the audit process conducted by the Auditor General are dealt with in section 12 of the *Act*:

- 12(1) The auditor general shall as he or she considers necessary but at least annually report to the House of Assembly on:
 - (a) the work of the office;
 - (b) whether, in carrying out the work of the office, the auditor general received all of the information including reports and explanations the auditor general required;
 - (c) the results of the auditor general's examination of the financial statements referred to in section 11; and
 - (d) audits, examinations and inquiries performed under this *Act*.
- (2) A report of the auditor general under subsection (1) shall include the results of the auditor general's examination of the accounts of the province, and shall call attention to anything the auditor general considers significant, including instances where:
 - (a) collections of public money
 - (i) have not been effected as required under various *Acts* and regulations, directives or orders under those *Acts*,
 - (ii) have not been fully accounted for, or
 - (iii) have not been properly reflected in the accounts;

¹⁸ See ss. 12(1).

- (b) disbursements of public money
 - (i) have not been made in accordance with the authority of a supply vote, or relevant *Act*,
 - (ii) have not complied with regulations, directives or orders applicable to those disbursements,
 - (iii) have not been properly reflected in the accounts, or
 - (iv) have not been made for the purposes for which it was appropriated;
 - (c) accounts have not been faithfully and properly kept;
 - (d) assets acquired, administered or otherwise held are not adequately safeguarded or accounted for;
 - (e) accounting systems and management control systems that relate to revenue, disbursements, the safeguarding or use of assets or the determination of liabilities were not in existence, were inadequate or had not been complied with; or
 - (f) factors or circumstances relating to an expenditure of public money which in the opinion of the auditor general should be brought to the attention of the House of Assembly.
- (3) Paragraph (2) (f) shall not be construed as entitling the auditor general to question the merits of policy objectives of the government.

As noted earlier in my report, for the last several years the Auditor General has been performing “legislative” or “program” audits on a rotating, department-by-department or program-by-program basis. I understand that this process was commenced during the 1990s and the Auditor General had hoped to cover all programs within the government within at least a 12-year period. The program audits the Auditor General’s office currently completes are a combination of compliance and value-for-money audits, as I have described above. His office has indicated that they believe that the authority to undertake this type of audit is derived from the *Auditor General Act*, most notably, section 12. I understand, however, that there have been occasional challenges to this position.¹⁹ Whatever the scope of audit permitted by section 12, it is certainly clear that legislative or compliance audits (as opposed to value-for-money audits) are included. This is as it should be. It is fundamentally important that an audit of the public accounts address the compliance of public officials with legislative and other regulatory requirements governing the spending of public money.

I would emphasize, therefore, that when the Auditor General is engaged to audit the public accounts, his authority to audit extends beyond the standard financial statement audit

¹⁹ As a result, the Auditor General has proposed certain amendments to his constituent legislation to remove any ambiguity surrounding the legality of performing value for money audits for the province.

and may include compliance considerations. I note as well, however, that from a practical point of view, compliance audits are not completed on every part of government on an annual basis. By contrast, whether a private auditing firm would have the authority to engage in auditing inquiries beyond a standard financial statement audit would depend on the specific terms of engagement, which are established through agreement between the auditor and the entity being audited at the outset of the process.

The Audit Process of the House of Assembly

For the fiscal years from 1989 to 1999, the Auditor General performed financial statement audits of the province's accounts. The accounts of the House of Assembly - a very small part of the overall provincial accounts - were consolidated into these financial statements and would have been contemplated during the Auditor General's audit planning process. The degree of examination that the legislature's accounts would have received during the Auditor General's audit of the provincial accounts was likely dependent upon a number of factors, most important of which would normally be materiality and risk.

The concept of materiality recognizes that some matters, either individually or in the aggregate, are important if financial statements are to be presented fairly in accordance with generally accepted accounting principles. A misstatement, or the aggregate of all misstatements, in financial statements is considered to be material if, in the light of surrounding circumstances, it is probable that the decision of a person who is relying on the financial statements, and who has a reasonable knowledge of business and economic activities will be changed or influenced by such misstatement or the aggregate of all misstatements.²⁰

The materiality level calculated by the Auditor General to plan and execute his or her audits during these periods was calculated based upon the balances of the province's consolidated accounts, where total revenues and expenditures now exceed \$5 billion. This materiality level for the consolidated accounts would be significantly different than the level that would have been calculated for a separate audit based on the legislature's accounts alone, where annual expenditures are more in the order of \$15 million. As a result of the variance in materiality levels, the audit performed on the provincial financial statements would not have focused on the accounts of the legislature in sufficient detail to extend to issuing a separate audit opinion for the legislature.

Through the financial audit on the accounts of the province, several management letter points were raised and communicated to the Clerk of the House. The management letters were dated February 16, 1995, October 25, 1995, January 30, 1997, and December 15, 1999, and related to the audits of the Consolidated Revenue Fund financial statements for the years ended March 31, 1994, 1995, 1996, and 1999. The Auditor General has issued no

²⁰ *CICA Handbook*, PS. 5142.04.

management letters to the House since December 15, 1999.

The letters for the years ended March 31, 1994 and 1995, included a reference to a lack of segregation of duties. The letter for the year ended March 31, 1999, stated “No significant matters came to my attention during the audit.” When the Auditor General was questioned about the comments, and why the reference to the lack of segregation of duties was no longer mentioned in the letter of December 15, 1999, the Auditor General replied that, when the matter was previously raised, suggestions for improving the controls surrounding the lack of segregation of duties were made. I understand that, in such circumstances, it is not uncommon for auditors to revisit their prior recommendations and specifically assess progress, if any, on rectifying the deficiencies; and, if necessary, to reiterate their concerns if the matter had not been rectified. It appears that this process was not followed in this case.

Up to year 2000, no *stand-alone* financial statement *or* program audits had ever been performed on the accounts of the legislature. In 2000, the Auditor General attempted to initiate a program audit in the House of Assembly, as noted in Chapter 3. While the Auditor General performed compliance or legislative audits on a rotating basis throughout many government departments prior to 2000, she had not previously selected the House for this treatment. Unlike financial statement audits, these types of audits do not have a materiality threshold and are performed to determine if government funds are spent for their intended purpose. As explained in Chapters 3 and 4, this attempt to perform such an audit was firmly resisted by the IEC and resulted in changes in the legislation. The effect of the change was to consign to the Commission of Internal Economy the authority to choose who would audit the accounts of the House and, just as importantly, *to determine the scope of the audit*. Thus, the IEC could - and did - thereafter bar the Auditor General from the House. Under the amended legislation, the audit process was “under the direction and control of the commission.”²¹ In choosing an alternative “external” auditor, the IEC could limit the scope of the auditor’s engagement to exclude a compliance audit.

It is critical to realize that choosing an external auditor whose terms of engagement did not include a full compliance audit was not a substitute for the type of audit work that the Auditor General was proposing to do in the House before being asked to leave. To achieve equivalency, the mandate of the external auditor would have to have been defined to parallel the scope of authority and responsibility given to the Auditor General in section 12 of the Auditor General Act.

²¹ *Internal Economy Commission Act*, R.S.N.L. 1990, c. I-14, s. 9, as amended by S.N.L. 2000, c. 17.

The External Audits

Tenders for external audits were called in February 2003. The tender originally requested proposals for audit services for the fiscal periods ending March 31, 2001 to March 31, 2005, and an external public auditing firm was selected through the process. The term of appointment, however, was subjected to a change from the original proposal term. Instead, of the requirement to perform audits for five fiscal years, the engagement period was reduced to three fiscal years, from March 31, 2002, to March 31, 2004. I have already noted above, that as a result of this change, an audit void was created whereby neither an external auditor nor the Auditor General reviewed the financial records of the legislature for the fiscal year ended March 31, 2001.

The mandate for the audit, as shown in the final request for proposals,²² was as follows:

- to support the Auditor General’s attest opinion on the financial statements and public accounts of the province;
- to provide attest audit assurance related to the annual statements of expenditure and related revenue and the schedules of assets and liabilities of the House of Assembly; and
- to provide a report to the House of Assembly for each year, including any significant comments the auditor wished to bring to the attention of the House of Assembly.

In the technical sense, it appears that the mandate relates to only the first element of a comprehensive audit- that of the *financial audit* - and did not require any compliance or value-for-money auditing to be performed. Again, I note that the engagement letter, which would have prescribed the final mandate, was not available to me.²³

The external audits for the fiscal years ended March 31, 2002 and 2003 commenced in the fall of 2003. At the time, the auditors met with the Clerk of the House of Assembly, and the Director of Financial Operations, amongst others to discuss planning for the audit,

²² “Request for Proposals: Audit of the Accounts of the House of Assembly,” Requirement 3 (a)-(c) (undated – obtained from Clerk of House of Assembly).

²³ As noted in Chapter 3 (Background), the external auditors, in their response to the government’s request for audit proposals, had offered to perform some compliance testing during the course of their audits. No engagement letter could be located, and the auditors have indicated that their engagement was ultimately to perform a financial statement audit only. In the end, it has been difficult to determine just what the scope of the audit was, as no final documented engagement letter was ever located either from the external auditors’ or the House’s files.

and to arrange a time to commence the fieldwork.

Although the audit engagements began in the fall of 2003, there were significant delays encountered throughout the audit process, and the audit reports related to the 2002 and 2003 fiscal years were not released until October 5, 2005. While the audit of the March 31, 2004 fiscal year had commenced prior to the release of the 2002 and 2003 reports, the audit had not been completed by the summer of 2006 and was subsequently cancelled.²⁴

I was told that the delay in the issuance of the audit reports for 2002 and 2003 was a result of multiple factors. Firstly, it appeared that the auditors encountered difficulty in obtaining all of the documentation necessary to complete the engagement. This slowed the progress of the audit team and resulted in the redeployment of the members of the engagement team to other audits. Secondly, we have been told by the external auditors that no pressure was placed on them by the management of the legislature or the IEC to complete the audit. Whatever the reason, in my judgement prolonged delays in the completion of the audit exercise undermined the usefulness of the audit process and detracted from adherence to the principles of transparency and accountability.

Apart from issues related to the timing of the audits, the results of the audits bear further examination.

Results of the External Audits

The standards of the Canadian Institute of Chartered Accountants require that an auditor must not issue an unqualified opinion in the following instances:

- the financial statements contain material departures from generally accepted accounting principles with respect to one or more matters; and
- there is a limitation in the scope of the auditor's examination that prevents him or her from obtaining sufficient appropriate audit evidence.

As the external auditor has released unqualified opinions on the financial statements of the legislature for the years ended March 31, 2002 and 2003 it is apparent that they determined neither of these conditions applied for the relevant fiscal periods.

Research staff of the Commission conducted a thorough review of the audit processes followed by the external auditors. We were provided with unlimited access to the audit files

²⁴ At a meeting of the Commission of Internal Economy on October 5, 2006, the IEC agreed that they would not require the external auditors to complete the audit of the House of Assembly for the year ended March 31, 2004. (Information contained in the draft Minutes of Commission of Internal Economy, 2006-2007, October 5, 2006 at Minute No. 6.)

related to those audits. Our review started with the planning sections of the 2002 and 2003 audit files. The engagement and control risk for the audits was considered normal by the auditors and, due to the existence of a simple computer environment, computer risk was assessed as minor. Materiality was calculated based upon expenditures as recommended by the *CICA Handbook* and was established at approximately \$125,000.

It is important to note that, during an audit, testing is performed of the controls over systems and of a sample of transactions that have taken place. The types and extents of tests are determined by the risks assessed and the materiality of the transactions. The results of these procedures assist the auditor in determining if the financial statements of the entity are free of material misstatements and dictate whether an unqualified opinion can be given on the financial statements.

The audit procedures listed in the work plan and the related details of these procedures were reviewed. Procedures that were included in the audit programs were signed as having been performed by staff members responsible for execution of fieldwork and by managers and partners as reviewers of the work performed.

Further review of the audit files, however, identified instances where audit procedures were not completed as outlined in the audit plan. For example, 32 MHA expense reports were initially selected for testing during the 2002 audit. One of the expense reports selected for testing was not completed, as it could not be located, and two additional expense reports were selected. In the 2003 audit file, five of the 34 expense reports selected were not tested. In this instance, no explanation was provided in the file to indicate why these five expense reports were omitted from testing. No errors were found in the samples that were tested.

No management letter was issued for either of the 2002 or 2003 audits, and no management letter points were documented in either of the files. As discussed previously, management letters contain information about a client's business to help him or her improve controls and are regularly issued at the completion of most financial audits. When the external auditor executives were asked about this issue, they advised us that no such letters were issued for these years; and that, if a letter was necessary, it would be issued after the completion of the 2004 audit (which audit, as noted above, was subsequently cancelled).

It was surprising to learn that signed engagement and management representation letters were not located in either of the audit files. These are standard forms for all financial statement audits. The engagement letter details the scope of the audit to be performed and is usually obtained prior to, or at the commencement of, the audit. The representation letter is normally dated the same as the audit report and is obtained at the conclusion of the audit. It confirms management's representations regarding the information provided to the auditor during the audit.

While we did review the audit files and the processes documented, a detailed assessment of the audit performed by the external auditor has not been undertaken to determine if the audit was performed in accordance with *CICA Handbook* requirements, as

this is beyond the scope of the Terms of Reference of this Commission.

Our review of audit practices generally, and the audit experiences of the House of Assembly in particular, give rise to a number of concerns:

- the lack of effort undertaken to ensure that audits were commenced and completed on a timely basis in the past;
- the confusion as to the scope of the audit for which the external auditors were engaged;
- the failure of the audit process, as undertaken and completed to detect and report any weaknesses or deficiencies (when it was subsequently discovered that serious inadequacies did exist);
- the need to ensure that the nature of the audits of the House was appropriate to address the needs of the House and the public in terms of enhancing accountability; and
- the need to ensure that matters identified through the audit process (as noted in respect of the audits in the 1990s) are addressed on a timely basis.

Accordingly, I recommend:

Recommendation No. 51

- (1) The Speaker and the House of Assembly Management Commission should be required by legislation to ensure that appropriate audits of the House of Assembly and its statutory offices are commenced and completed on a timely basis;***
- (2) Careful attention should be given by the Commission and its audit committee to the detailed terms of engagement of each auditor to ensure that the scope of the audit is appropriate to the purpose of the proposed audit;***
- (3) To remove doubt as to what is required, the types and broad scope of any audits that are required to be conducted of the House and its statutory offices should be stated in legislation; and***
- (4) For each type of audit to be performed for the House of Assembly, the appropriate communications and reports should be issued within 60 days of the completion of the audits and management should respond with any comments within a further 60 days.***

Common Practices in Canada

In order to assess the past audit practices of the Newfoundland and Labrador legislature, and to make recommendations on a mandate for the future, it is important to understand the audit practices in place at the provincial and territorial legislatures across Canada. To determine this, questions were asked of various finance officials employed by the provincial and territorial legislatures across the country. Some of these questions and a brief summary of the responses will be described here. A complete listing of responses by province and territory is included in Appendix 8.1 of this report.

Some of the more prominent questions and a brief summary of the responses are outlined below:

1. *Does the Auditor General audit the accounts of the House of Assembly (Legislature) or is this role conducted by an external auditing firm?*

The majority of the provincial respondents to this question stated that their Auditor General performs the audit of the legislature. For two respondents, Nunavut and the Yukon, the Auditor General of Canada provides this service. The federal House of Commons uses an external auditor to perform a separate financial statement audit of the House of Commons.

Based upon the responses received, I felt that further clarification on this question was required. I mentioned earlier that the accounts of the legislature in Newfoundland and Labrador have been included in the consolidated accounts of the province every year. Thus, I wanted to ensure that I was able to determine if the responses were indicating a situation similar to that in Newfoundland and Labrador, or if, indeed, there were different arrangements in the remainder of the country. As a result, all provinces and territories were contacted and asked whether a *separate* financial statement audit is completed on the legislature. Only two provinces, Ontario and Alberta, stated that their legislature receives a separate financial audit. The remaining respondents indicated that audits are performed from the perspective of the government as a whole, and, similar to the Newfoundland and Labrador situation, materiality for the audit is at the level for the government as a whole. The province of British Columbia stated that the Auditor General has never, as yet, attempted to audit the accounts of the legislature.

Other than the House of Commons, no respondents stated that an external auditing firm was used to perform a financial statement audit of the legislature. Two provinces, Nunavut and the Northwest Territories, indicated that an external accounting firm is used to audit their pension plans.

2. *Does the audit mandate (Terms of Engagement) of the Auditor for the accounts for the Legislature differ in any way from that of the Auditor General in respect of government departments? Does the process contemplate regular “comprehensive audits” - or are they more “high-level” reviews?*

All respondents to this question stated that the audit mandate of the auditor for the accounts of the legislature does not differ from the mandate that applies to various government departments. Most provinces stated that the audit of the legislature is mainly a

high-level review and does not take on the characteristics of a comprehensive audit. Alberta, the Yukon, and Nova Scotia all stated that their audits could contemplate comprehensive audits. All respondents stated that a value-for-money audit has never been performed on their respective legislatures; however, the option is available, as with any government department.

3. *Is there a management letter process whereby an auditor's comments and concerns are tabled in writing, or is this function accomplished through the Auditor General's report?*

The answers to this question varied, with five respondents stating that there was a management letter process in place. Four respondents stated that this function was accomplished through the Auditor General's report.

4. *Are there stipulated timeframes in which an audit must be completed? What happens if an audit is missed?*

The majority of respondents stated that there is a requirement for the audit of the legislature to be performed annually. In relation to deadlines for the completion of audits, few provinces responded to this question. The Northwest Territories stated that they attempt to have their audit completed by the end of August, while the Yukon stated October 31. Both of these entities have fiscal year-ends of March 31. Most respondents did not answer the second part of this question, as the audits have always been completed in a general timely fashion.

5. *Is there a policy for Commission follow-up on audit findings? What is it and who oversees the process?*

Most respondents stated that there is no formal policy in place in relation to follow-up on audit findings. Most did state, however, that there is an informal policy in place whereby management of the legislatures would review the auditor's findings and provide a formal response to the auditor's queries. Additionally, it would be common practice for the auditors to follow up on these points in subsequent audits to determine if they have been addressed.

The Future of Audits of the House of Assembly

It is apparent that the audit processes that were implemented in the past were not sufficient to provide the transparency and accountability that is needed to maintain public confidence, in the financial affairs of the House, let alone restore it from its current position.

While audits are only one of the mechanisms for public disclosure of the information surrounding the legislature, they are, nevertheless, an important one.

As I have discussed previously, there are three types of audits potentially applicable to government generally and to the legislative branch in particular: (i) financial audits, (ii)

compliance audits, and (iii) value-for-money audits.

The survey indicated that most provinces and territories currently receive a financial statement audit only as a part of the overall audit of the accounts of the provinces or territory, and only two of the respondent provinces and territories allow compliance or value-for-money audits on their legislatures. Nonetheless, I am firmly of the view that an annual financial statement audit of the Newfoundland and Labrador House of Assembly *as a separate entity* is required.²⁵ Without it, there will not be the improved transparency and accountability that is needed at this time. The goal of a financial audit is to express an opinion on whether the accounts of the legislature are fairly presented in accordance with the accounting policies noted. As the concept of public accountability is critical to restoring trust in the administration of government funds expended by the legislature, I believe that the House of Assembly must continue to receive an annual financial audit of its accounts.

I was particularly interested to learn that the Auditor General of Canada adds an additional requirement to her financial audits of Crown corporations.²⁶ The federal Auditor General has instituted a policy of providing an opinion on whether the transactions that have come to her notice in the course of discharging her audit responsibilities were carried out in compliance with “specified authorities.” While this is not a full compliance audit, it adds additional assurance that matters related to compliance have been examined for such Crown corporations. Appendix 8.2 provides an example of such an audit report. I believe that adding such a requirement to the financial audit of the House on an annual basis would be an important measure to reinforce accountability of the legislature.

As important as subjecting the House to a separate annual financial statement audit (supplemented by a limited compliance report) may be, something more is also required. A full compliance audit would determine whether government spending is properly authorized and is in accordance with government policy. Regardless of the fact that none of the other provinces or territories that responded to the survey is currently subjected to a compliance audit, I believe that auditors of the House should be periodically mandated to perform a compliance audit and to express an opinion on whether the expenses incurred in the operations of the House of Assembly are in accordance with the policies of the legislature and, where applicable, the policies of the government. The scope of a compliance audit is greater than the expanded financial audit I have just mentioned, and would result in a stand-alone report. It would cover the full scope contemplated by a compliance audit described previously, and not simply express an opinion on transactions that have come to the auditors’ attention while performing other audit functions. It would involve the preparation of an audit plan that would articulate the scope of the engagement, the criteria to be used to conduct the audit, and the resources necessary to complete the engagement.

²⁵ I note that the Supreme Court of Newfoundland and Labrador which is part of the other branch of government - the judicial branch - has a separate financial statement audit of its financial operations conducted on an annual basis, pursuant to s. 67 of the *Judicature Act*, R.S.N.L. 1990, c. J-4.

²⁶ See e.g. *Auditor’s Report on the Canadian Air Transport Security Authority* (March 31, 2006) at Appendix 8.2.

There are currently two issues to be addressed with respect to the intensity of the compliance audits. One is with respect to ensuring that internal controls recommended in this report have been implemented, or existing controls are being appropriately modified to ensure the right controls are in place for the present. The other is with respect to ensuring that the controls are effectively maintained and are not slowly changed or eroded over time so as to render them useless.

Due to the amount of preparation required to complete a full compliance audit, I do not believe that it would be practical to have a compliance audit of the House performed every year. Instead, I am satisfied that the required outcomes from a compliance audit can be obtained if one is completed every three to four years, or once during each General Assembly. Fiscal periods in which a full compliance audit is not completed would be supplemented by the opinion on the transactions examined during the financial statement audit as noted previously.

In the short term, to address the issue of improving public confidence, I believe that a compliance audit should be initiated within six months of the implementation of the changes to the controls that are being recommended in this report. This will allow time to have the controls implemented. Then, to ensure that they continue to operate, another one should be performed within a year. If there are no significant issues that arise from these first two compliance audits, then the schedule can revert to once every General Assembly. To those who feel that a compliance audit should be done every year, it must be remembered that right now the Auditor General only does compliance audits on a rotating basis throughout government on a twelve-year cycle. The regime that I am recommending (once every four-year General Assembly and twice in the next general Assembly) is a substantial improvement on that.

A value-for-money audit determines if government programs are being run efficiently and effectively. Due to the nature of such an audit, I am of the view that a value-for-money audit is not required for the legislature. The concept of an Auditor General, rather than the voting public, determining the effectiveness of government programs has further reduced the popularity of this type of engagement for the legislature in multiple jurisdictions across the country. None of the other provinces or territories currently is subjected to a value-for-money audit. I would stress, however, that there is one component of the concept highlighted in the review of the value-for-money audit outlined earlier in this chapter that should be considered generally applicable to the audit process in the House - the need to examine and report on “the adequacy of management system controls and practices, including those intended to control and safeguard assets”²⁷ (not from the perspective of the efficiency or effectiveness of legislative programs, but from the perspective of effective financial control). I would envisage that this examination could be incorporated in the

²⁷ See under the heading “Government Audits – What are They and Why are They Carried Out?”; (iii) Value for Money Audits”.

regular financial statement audit mandate by way of explicit inclusion in future engagement letters.

Performance of the Audit Engagements

It is necessary to consider the most appropriate organization to be engaged to perform the audits of the House of Assembly: the Auditor General or an external accounting firm.

One advantage to having the Auditor General perform the audit of the legislature is the fact that he or she has a “whole of government” mandate. Such mandates are all-encompassing, matching the responsibilities and interests of legislatures and covering organizations as diverse as government departments, agencies, commissions, boards and Crown corporations.²⁸ In this way, legislatures can rest assured that they will receive all their officers’ conclusions and recommendations for the whole government entity. As well, the Auditor General is fully familiar with public sector processes and would be more accustomed to the government’s reporting systems than a private firm engaged from outside.

This is not to say that external auditors would be unqualified or unprepared to perform this type of work. Many private firms are regularly engaged on projects that involve government-related work and so would also have public sector experience

Another advantage of having the Auditor General perform these types of engagements is that the Auditor General’s office has the option of reporting directly to the House. Private sector auditors must report directly to their appointees, usually the executives of the government departments, or in the case of the House, the Clerk or the Speaker. The Auditor General will often have access to the Public Accounts Committee of the legislature, and this gives the Auditor General a formal and very direct way to apprise legislators of significant audit findings.²⁹

One advantage of using an external auditor is that external auditors have developed specialized skills in the area of internal controls in response to changes in the field of auditing with the adoption of Multilateral Instrument 52-109 and Sarbanes Oxley legislation.³⁰ These regulatory requirements in Canada and the United States require management to certify with respect to the design and effectiveness of their organization’s disclosure and reporting controls. External auditors are engaged to audit controls implemented within the organization, or to assist organizations with reviewing and implementing any necessary controls to assist the management team to gain confidence over the effectiveness of internal controls and thereby to enable them to feel comfortable in

²⁸ See Canadian Council of Legislative Auditors, “Legislative Audit: Serving the Public Interest,” (Draft Discussion Paper as part of the CCOLA Project), (February 2000), online: Canadian Council of Legislative Auditors < [http://www.ccola.ca/web/english/serving %20public %20interest.pdf](http://www.ccola.ca/web/english/serving%20public%20interest.pdf)>.

²⁹ Ibid.

³⁰ Canadian Securities Administrators, *Multilateral Instrument 52-109: Certification of Disclosures in Issuers’ Annual and Interim Filings*, March 2004; and *Sarbanes-Oxley Act 2002*, P.L. 107-204.

signing the required certifications. A similar engagement related to the accounts of the House could be efficiently and effectively performed by external auditors.

It has been argued that one of the most significant advantages of using an external auditor to perform the audit of the legislature is that it ensures the autonomy of the legislature is not unduly impacted. Accordingly, it is also argued that having the option of selecting an auditor provides flexibility to the Commission of Internal Economy and ensures the independence surrounding the audit can be maintained.

This is not to say, as some have suggested, that it is *inappropriate* to have the Auditor General audit the accounts of the House. In fact, variants of this theme of Auditor General inappropriateness were put forward as the justification for removing the Auditor General from the House in 2000. Justifying comments included, for example, that inasmuch as the Auditor General is an “officer” of the House, it would be inappropriate to have an insider-employee act as the auditor. Also, since the Auditor General’s overall budget is established by the IEC, it has been argued by some that it is inappropriate to have him or her audit the affairs of the body that exercises fundamental decision-making powers in relation to his or her resources. Of course, this is spurious. Even in the private sector, an auditor is engaged and paid by the entity that will be audited. In that sense, the external auditor is “employed” by the entity. This relationship does not compromise the auditor’s independence. The auditor remains bound by detailed professional rules of conduct. In any event, the Auditor General is, in reality, not an employee of the House in the normal sense of the term. The office is regarded as independent and is equally bound by professional rules of conduct. The practices across Canada also belie a concern about an audit of the legislature by an Auditor General unduly affecting legislative autonomy: with the exception of the House of Commons no provincial or territorial jurisdiction has used an external auditor to promote legislative independence.

The Auditor General is by statute the “auditor of the financial statements and accounts of the province.”³¹ Inasmuch as the House spends public money, the accounts of the House are included in the accounts of the province. It is therefore certainly *not inappropriate* for the Auditor General to conduct an audit of the House’s spending of public money. Either the Auditor General or an external auditor, provided they are given the *proper mandate* could be expected to conduct an effective financial audit of the House.

Having considered this matter carefully, I believe that an annual financial statement audit of the House (supplemented by a limited compliance report, as previously described) must be performed, but the IEC, assisted by advice from its audit committee, should have the option of choosing either an external auditor or the Auditor General to perform it.³² To

³¹ *Auditor General Act*, S.N.L. 1991, c. 22, s. 10.

³² I note that Bill 11, “An Act to Amend the Internal Economy Commission Act” has recently been placed before the House of Assembly but has not yet been enacted. It purports to repeal s. 9 of the *Internal Economy Commission Act* and to provide that “The accounts of the House of Assembly shall be audited annually by the Auditor General.” In my view, this amendment is not adequate to address the full panoply of auditing concerns

prevent a situation from arising again in which the accounts are not subjected to a specific audit, as occurred for the fiscal year ended March 31, 2001, the Auditor General should automatically be considered the auditor if an external auditor is not selected by the IEC by the end of the fiscal year. The Auditor General should also have a residual authority to perform an audit of the House on his or her own motion if that is considered warranted.

An external auditor or the Auditor General could also, in principle, equally perform a compliance audit. However, due to the Auditor General's greater familiarity with government systems and policies, I believe that the most efficient and cost-effective process would be to have the Auditor General perform this type of audit, particularly for the audits during the next General Assembly.

Accordingly, I recommend:

- Recommendation No. 52***
- (1) The accounts of the House of Assembly and its statutory offices should be audited annually by either the Auditor General or an independent external auditor chosen by the House of Assembly Management Commission assisted by the advice of its audit committee;***
 - (2) Such an annual audit should consist of a financial audit of the House of Assembly and its statutory offices separate from that of the government as a whole and should include:***
 - (a) an analysis of and an expression of opinion on whether or not the expenses incurred by the House of Assembly administration are in accordance with the policies of the House of Assembly Management Commission and, where applicable, the policies of the executive branch of the government; and***

discussed in this chapter. Most significantly, it begs the question as to what the scope of the audit should be. The recommendations in this report, on the other hand, recognize the necessity for two types of audits: (i) a financial statement audit (with certain enhanced characteristics) to be conducted annually by either the Auditor General or an external auditor, and (ii) a compliance audit to be conducted once every General Assembly by the Auditor General. The recommendations I have made, if accepted, would subsume the provision of Bill 11 and make its enactment unnecessary.

- (b) an analysis of and an expression of opinion on whether the Clerk's assessment of the effectiveness of internal controls of the House and statutory offices is fairly stated and whether internal controls are operating effectively;*
- (3) Where the Commission fails to appoint an auditor for a particular fiscal year by the end of the previous fiscal year, the Auditor General should be deemed by legislation to be the auditor for that year;*
- (4) Subject to paragraph (5), a compliance audit should be conducted by the Auditor General on the House of Assembly and its statutory offices once every General Assembly;*
- (5) Until the controls in the House of Assembly administration have been assessed as having no significant weaknesses, a compliance audit should be performed by the Auditor General, initially within six months of the adoption of the revised controls as implemented in response to this report, and then within one year of the first assessment; and*
- (6) Any such audits shall not be considered to entitle the Auditor General or any other auditor to question the merits of policy objectives of the House of Assembly service, the House of Assembly Management Commission or the statutory offices.*

Constituency Allowance Review

In addition to the compliance audits recommended above, consideration needs to be given to providing the Speaker of the House with the ability, at any time, to commence a review of the spending of any Member of the House of Assembly. As with the compliance audit, the purpose of this examination would be to determine if a Member's spending is in accordance with the policies of the legislature and the government, where applicable. This option would allow the Speaker flexibility to assure himself or herself of the appropriateness of the expenditures and assure the Member that all is well.

In fairness to the Member, should the Speaker have concerns that the expenditures are not appropriate, the Member must be given the opportunity to have an independent person review the situation and offer his or her opinion, which I believe must be binding.

Accordingly, I recommend:

Recommendation No. 53

- (1) The Speaker should, at any time, have the authority to review a Member's allowances to ensure that the expenditures are for the intended purposes and are in accordance with the policies and rules so established; and***
- (2) If the Speaker determines that such expenditures, in his or her view, are not appropriate, the Member should have the option of requesting the matter to be reviewed by the Commissioner of Legislative Standards.***

Tabling of the Annual Report

Each year the IEC is required to table a report in the House of Assembly. As a result of several amendments over the years, this obligation assumed less and less significance because of the relaxation on the requirement for timely reporting. As well, in the past number of years, the minutes describing the discussions of the IEC were incomplete and financial components were incorrect. Elsewhere in this report, I have described these matters in further detail. It is important, however, that reports of the activities of the IEC be available to the public and that they reflect accurately what has occurred. This annual report should be prepared by the Speaker of the House and should comprise the deliverables of the auditor, as well as the other documents deemed necessary for the overall governance of the legislature. The annual report should contain the following documents:

- the audited financial statements of the accounts of the House of Assembly;
- the management letter containing audit findings and recommendations resulting from the audit of the House of Assembly;
- a discussion of past audit recommendations and how they are presently being addressed by the House of Assembly;
- a report that outlines a plan to address audit recommendations of the current year audit;
- the minutes of all meetings held by the Internal Economic Commission during the year;
- a statement of the total salary, allowances and expenses approved for each Member;

- a listing of all payments made to each Member of House of Assembly;
- a listing of any changes or adjustments made to the allowances previously approved for each Member of the House of Assembly; and
- a statement from the Comptroller General stating that the salary, allowance, and expense amounts in the listing agree with the amounts recorded in the accounts of the government.

In order to ensure the full benefit of this annual report and maximum accountability of public funds, the report should be tabled and published within three months of the legislature's fiscal year-end.

Accordingly, I recommend:

<p><i>Recommendation No. 54</i></p> <p>(1) <i>An annual report should be tabled in the House of Assembly;</i></p> <p>(2) <i>The annual report should contain the items noted in this report and be tabled in the House within 90 days of year-end and if the House is not then sitting, within five days of the next sitting of the House; and</i></p> <p>(3) <i>In addition, the Speaker should be required to deliver a copy of the report to every MHA, post it on the House's website and make it available on request by members of the public.</i></p>
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