Accountability, Performance Reporting, Comprehensive Audit -

An Integrated Perspective

CCAF FCVI

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Accountability, performance reporting, comprehensive audit - an integrated perspective

Published by
CCAF-FCVI Inc.
55 Murray St., Suite 210
Ottawa, CANADA
K1N 5M3
(613) 241-6713 Fax (613) 241-6900

ISBN 0-919557-47-3

Printed and bound in Canada.
Design and layout by Paul Edwards Design.
Print coordination by Poirier Litho.

This book is available in French under the title:
Reddition de comptes, rapports sur la performance et vérification intégrée - une vue d'ensemble.
Translation by Traduction Nicole Plamondon.

Canadian Cataloguing in Publication Data:

Main entry under title:
Accountability, performance reporting, comprehensive audit - an integrated perspective

Issued also in French under title:
Reddition de comptes, rapports sur la performance et vérification intégrée - une vue d'ensemble
Includes bibliographical references and index.
ISBN 0-919557-47-3

1. Auditing. 2. Organizational Effectiveness.
I. CCAF-FCVI Inc.

HF5667.A26 1996 657'.45 C96-900071-S

Table of Contents

This book is dedicated to:

the genius and memory of the late

James J. Macdonell

CCAF's founding chairman (1980-83),

whose intellect and energy created the vision and pointed the way,

and

Gordon H. Cowperthwaite

CCAF chairman (1983-93),

whose distinguished leadership sustained the vision and added to it new dimension and significance,

and

all those who have worked to create the body of knowledge and experience which this book reflects.

Harry Allen, George Anderson, Robert Anderson, Rodney Anderson, Alan Andrews, Douglas Archer, Jim Armstrong, Peter Armstrong, Marta Arnaldo, Roland Arpin, Phillip Aspinall, John Astle, John Atkinson, Joyce Bailey, Natalie Balko, Alan Barnard, David Barnes, Peter Barnes, Maria Barrados, Douglas Barrington, John Bart, William Barton, Gilles Bédard, Claude Bégin, Kenneth Belbeck, Carol Bellringer, Bruce Bennett, Jean Bernard, Liba Berry, Huguette Bertrand, David Bigney, Bob Black, Ralph Black, Andy Boehm, Jean-Pierre Boisclair, Shirley Boisclair, André Bolduc, Hugh Bolton, David Bonham, William Bradshaw, John Bradt, Francine Brazeau, Guy Breton, Robert Bromley, James Brophy, Donald Brown, Neil Brown, Judy Burns, Richard Buski, Brian Caine, James Cairncross, Doug Cameron, Frances Cameron, Heather Campbell, Denis Caro, Marcel Caron, Charles Carriere, John Carson, Claude Carter, Edward Case, Marlene Catterall, Howard Chan, Mike Charlton, Rhéal Chatelain, Warren Chippindale, Gail Christie, Ian Clark, Tom Closson, Jim Cluff, Carol Codori, John Cole, Barry Coopersmith, Penina Coopersmith, Brian Corbishley, Paul Cormier, Karen Cornelius, Catherine Cornell, Jean Cowperthwaite, Robert Cummings, James Currie, John Currie, James Cutt, Keith Dalglish, Francine Dalphond, Thomas Dalton, Alexander Davidson, Cathie Davis, Colin Deacon, Denis Desautels, Peter Dey, Gary Dickinson, Elwyn Dickson, Alan Dilworth, Marilyn Dolenko, Endre Dolhai, Elizabeth Dombroskie, Bill Drover, Raymond Dubois, Alistair Duff, Viviane Dunn, Gordon Dunnet, Kenneth Dye, Wally Eamer, Paul Edwards, Roberta Ellis, Robert Elton, Brenda Eprile, William Farlinger, Robin Farquhar, Tom Farrell, Lynn Faucher, Judy Ferguson, Mary Ferguson-Paré, Penelope Filiatrault-MacDonald, Elizabeth Fleet, Cecil Fleming, Jean-Pierre Fortin, Paul Fortugno, C.E.S. Franks, Alistair Fraser, Ronald Gage, Richard Gagné, Ida Garrett, Donald Gass, Yvan Gaudette, Yves Gauthier, Helen Gay, Frank Gelin, Murray Gill, Alan Gillmore, Fred Gingell, Robert Giroux, Jean-Paul Gobeil, Robert Gobeil, Bernie Gorman, Louis Gosselin, Marcel Goulet, Trent Gow, Donald Gracey, Katherine Graham, Alan Gratias, Christopher Green, Joan Green, Peter Gregory, Ronald Grey, Rodger Guinn, Roy Gunn, Kenneth Gunning, Ernest Hall, Lyle Handfield, Jack Hanna, John Hanna, Hugh Hanson, William Harker, Mary-Jane Harris, Richard Harris, Jim Hawkes, John Hayes, Robert Hayward, Bryan Held, Peter Held, Jacques Henrichon, Stephen Herbert, Ray Hession, John Hickman, Janet Hofstetter, John Holdstock, Gordon Hudson, Joe Hudson, Frank Hughes, Ron Huntington, Caroline Hupé, Jean Hurst, Ole Ingstrup, Fred Jaakson, John Jackson, Craig James, Jock Jardine, Katherine Jast, Warren Johnson, Diane Joly, François Joly, Malcolm Jordan, Guylaine Juteau, Tim Kaptein, John Kelly, Ronald Kiggins, Joseph Kirchner, Anne Kirkaldy, Paul Labbé, Huguette Labelle, François Lacasse, Roger Lachance, Patrick Lafferty, Jean-Guy Laliberté, Robert Lalonde, Jacques Lamonde, Claude Lamoureux, Marvin Lamoureux, Jean-Marie Lampron, Eric Lande, William Langdon, Spencer Lanthier, Gérard Larose, Gaston Latulippe, Victoin Laurin, Luc Lavoie, Guy Leclerc, Guy Lefebvre, Ken Leishman, Julian Lemieux, David Levine, Douglas Lewis, James Libbey, Fulvio Limongelli, Alwyn Lloyd, Robert Lord, Carol Ashfield Loughrey, John Lynch, Nancy Lynch, Howard Lyons, Andrew Macdonald, Dunbar Macdonald, Lyman MacInnis, Michael MacKenzie, David MacKinnon, Janice MacKinnon, R.D. MacLean, Harvey MacLeod, Elizabeth MacRae, Paul-André Malo, Clayton Manness, Lorna Marsden, Elizabeth Marshall, Brian Marson, Alan Martin, Guy Martin, Rita Mathers, Sunny Mathieson, Les McAdams, Mary McBride, Henry McCandless, Tom McCann, James McCrindell, Nevin McDiarmid, Leonard McGimpsey, Joseph McGrath, Michael McLaughlin, Doris McMullan, Edward McNamara, Hugh McRoberts, Giles Meikle, Larry Meyers, Jim Miles, Richard Mineau, Nick Mishchenko, Marcel Miville-Dechêne, Rollande Montsion, Donald Moors, Elaine Morash, Raymond Morcel, George Morfitt, Erma Morrison, David Moynagh, David Muir, Teresa Murphy, Wayne Murphy, Bev Ann Murray, Melissa Napier-Andrews, Nigel Napier-Andrews, Karen Nelson, Eugene Nesmith, Edward Netten, David Neumann, Peter Newdick, Clifford Nordal, Paul Northover, Elaine Orr, James Otterman, John Palmer, Richard Palmer, Pierre-André Paré, Gary Peall, Lewis Perinbam, Erik Peters, Jean Picard, Laurent Picard, Lise Pistono, Nicole Plamondon, Bernie Poirier, Joyce Potter, Colin Potts, Ed Powell, Errol Price, Dorothy Pringle, Robert Prosser, Ross Quane, Michel Racine, William Radburn, Paul Ramsey, Anne Randell, David Rattray, Michael Rayner, Angus Ree, Patrick Reid, Paul Reinhart, Brian Reinke, Stanley Remple, Robert Rennie, Arthur Roberge, Paul Robinson, Ronald Robinson, Lucie Rochette, Douglas Rogers, Harry Rogers, Lawrence Rosen, Edward Rowe, Terry Russell, Leonard Rutman, Vinod Saghal, Aline Saint-Amand, Donald Salmon, Roy Salmon, Karn Sandy, Donald Scott, Norman Scott, Rona Shaffran, John Sharpe, Peter Simeoni, Sonja Sinclair, Har Singh, Jon Singleton, Alistair Skinner, William Sloan, Jack Smith, Stuart Smith, Kimberley Speek, George Stephenson, Esther Stern, Kenneth Stevenson, Margaret Stockton, Wayne Streiloff, Claude Taylor, Gail Taylor, Robert Taylor, John Thompson, Hugh Tidby, Martha Tory, Seymour Trachimovsky, Alec Trafford, Guy Trudel, Peter Trueman, Robert Turnbull, Natalie Umiastowski, Peter Valentine, Peter Vaughan, Charles Vincent, Diana Vosseler, Edward Waitzer, Ross Walker, Josie Walsh, Ronald Warme, John Watson, Susan Watson, James Waugh, Barrie Webb, Linda Weeks, Michael Weir, Suzanne Werhar-Seebach, David White , Stan Whiteley, Nicole Wieczorek, Peter Wiley, Alan Willis, Geoffrey Wilson, John Wilson, Peter Wilson, Alan Winberg, Andrew Wingate, Douglas Wood, Brent Wortman, James Wright, Georgina Wyman, Donald Yeomans, Carman Young, Don Young, Donald M. Young, David Zussman, and the 119 CCAF International Graduate Fellows.

Introduction

Students of comprehensive auditing and practitioners or clients newly engaged in this area of audit practice are faced with a formidable challenge.

Existing literature on comprehensive auditing is both diverse and fragmented, often approaching the subject in terms of a specific aspect of practice—or in relation to a specific time period—or through the perspective, policies and procedures of a specific audit organization. Rarely has the literature ventured into an examination of the accountability context within which comprehensive auditors operate and the perspectives and roles of other key stakeholders to the accountability process—that is, those who govern and manage our institutions. Indeed, many general texts on auditing start from the assumption that the practitioner already has a knowledge of this accountability environment.

Thus, those who are new to comprehensive auditing face the difficult task of having to search far, wide and long for basic information and discussion on such matters. The onus has been on them to identify and envelop all these sources of knowledge and practice, sort out the contemporary from the *passé*, fill in the blanks, and somehow pull it all together and make the right connections.

This book seeks to remedy this problem. It makes no assumption that readers already possess a thorough grasp of the subject of accountability and related reporting principles. Instead, it deals with these matters extensively. It provides readers with the basic concepts, frameworks, tools and practice guidelines they need to begin their learning or careers in the area of comprehensive auditing. It is, however, more than a collection of pieces of knowledge and experience. The structure and content of this book reflect an important underlying philosophy and perspective. Simply stated, the philosophy is this: the defining role of audit is to serve an accountability relationship, and thus, to truly understand comprehensive auditing one must look beyond the borders of technical practice. It is essential to be knowledgeable about the broader accountability context and the roles and perspectives of those who operate within it. Having such knowledge permits practitioners to identify the audit approaches that will add the greatest value in the circumstances, assess the implications of such approaches for the actions of other key stakeholders in the accountability process and explain the consequences.

In this respect, this book is an extension of CCAF itself. The foundation's perspective is that if accountability is going to work properly, both parties to the accountability relationship—governing bodies and management—and the auditor who serves this accountability relationship, play important and interdependent roles. The research and education work of CCAF—supported by the efforts of its members—is designed to help all three parties achieve their mutual interest in improving performance and accountability.

The book is divided into three parts. Part I deals with the subject of accountability. It takes the reader through a wide-ranging and thoughtful examination of underlying theory, concepts and principles, and it connects these matters to contemporary thinking and practice in the areas of governance and management. We felt compelled to develop this material since, to be well-positioned to practise comprehensive auditing, the practitioner must first acquire a thorough knowledge of the business, an essential aspect of which is the accountability environment. The discussion that Part I gives to these issues is, we believe, unique in scope and character.

Part II focuses on performance reporting. It provides an overview of existing reporting practices in the public and private sectors, noting a number of recent initiatives in Canada and globally. It makes the case that concepts like performance and effectiveness should be viewed as multidimensional, arguing that this is necessary in order to respond to the reality of today's accountability and decision-making environment. Ideally, it is management, not the auditor, that is in the best position to report (make representations) on the performance or effectiveness of the organization. And if management does take on this responsibility, then the auditor plays a key role in providing assurance to the governing body (those to whom management reports) about the fairness and completeness of the information management has provided. Part II describes a framework of twelve attributes that is useful as a basis for such performance reporting. Drawing on actual practice in applying this framework, key considerations are discussed and a strategy for implementation is suggested. Audit practitioners need to have a thorough appreciation of such performance reporting concepts and strategies if they are to conduct their assurance role or, possibly, if they are called upon to provide such information to the governing body directly, in the absence of management taking on this reporting responsibility.

Part III provides an extensive review of comprehensive audit theory and practice. It examines several basic factors that influence the nature of the audit process and product. Three approaches or models of comprehensive auditing, and related considerations and implications, are also discussed. Most important for readers to know is that comprehensive audit is not a one-size-fits-all proposition. Moreover, what these different approaches entail, and how they are explained and implemented, is very much linked to matters discussed in earlier parts of the book. Part III also provides an overview of the issues and factors practitioners need to keep in mind, and the methods they employ, in conducting a comprehensive audit. Several key professional practice issues are given in-depth treatment, among them, reporting, audit criteria and evidence, existing standards of practice and quality assurance. The links between comprehensive audit and internal audit are also examined.

All three parts of the book emphasize that there is no universal template or panacea. There are choices. What the book seeks to do is provide readers with a basic understanding of what these choices are and how they are interconnected. It gives the reader a starting point and set of considerations from which to assess the relative merits of these choices in the circumstances concerned. And it suggests frameworks and strategies that can be helpful to the practitioner in engaging those who govern and manage the enterprise and, ultimately, in implementing the decisions that result from this process.

Educators in the areas of management, public administration and audit will find this book helpful as a basic reference text around which to develop a program of study for their students. More experienced comprehensive auditors will also find aspects of it useful—in reinforcing existing approaches, and perhaps in other ways, by adding new ideas and perspectives to their work.

This textbook is based on almost two decades of practice in the field of comprehensive auditing. It flows from the thinking and experience of several dozens of leading practitioners and researchers. It is the product of four individuals. First to mention is Guy Leclerc, former Deputy Comptroller General of Canada and for two years a research associate with CCAF. His efforts were joined by those of W. David Moynagh, CCAF's director of research and Jean-Pierre Boisclair, the foundation's president. Hugh R. Hanson played a key role as writer and as editor-in-chief ensuring that all the

pieces fit together. Liba Berry copyedited the book, Nicole Plamondon translated it into French, and Suzanne Seebach, Director, Operations & Communications, coordinated production and publication arrangements. All the members of CCAF's secretariat played an important supporting role in the development of this textbook. Without the efforts of all these people, this project would not have been possible.

A senior advisory panel was also established to provide strategic advice on a number of important policy issues relating to the focus of the book and the development of key positions taken within it. Comprising this panel were: Guy Breton, Auditor General of Quebec; Carol Bellringer, Provincial Auditor of Manitoba; Alexander M. Davidson, managing partner of Accounting and Auditing, Coopers & Lybrand; Denis Desautels, Auditor General of Canada; J. Colin Potts, partner, Deloitte & Touche; and Carman L. Young, Auditor of the Bank of Canada and former chairman of the board of the Institute of Internal Auditors. The perspective and wisdom that these distinguished individuals brought to their role made a major contribution to this initiative.

The foundation's board of governors and executive relied on CCAF's Research Committee to provide a rigourous professional challenge of content. In exercising this role, all members of the committee played a critical part in the development of this volume. It has benefitted greatly from their insights and suggestions.

Part I

Accountability

Part 1

Accountability

> **To serve… and present My true account…**
>
> John Milton, *Sonnet XVI, On His Blindness*

Introduction

Effective audit practice starts with a thorough understanding of the context within which the client and other key stakeholders operate. This context involves both the *governance* and *management* process, and the *accountability* arrangements that bind them together.

There has been much discussion about accountability. Accountability implies responsibility and public trust. The contemporary emphasis is on everybody's assuming responsibility and being accountable. Saying it, however, does not necessarily make it so. So many situations and circumstances demand that public officials and people in general be inspired by a sense of demonstrable responsibility, and yet it is the lack of accountability or its inadequacy that drives the current discourse on the subject. What characterizes the discussion is that beyond the utterance of the word, there is so often little explanation as to what is meant by it.

The word *accountability* evokes, to some, a set of lofty ideals intuitively and eminently sensible. To others, it is a normal expectation from anyone entrusted with a responsibility. Still others see in the word an element of confrontation.

The concept of accountability draws its meaning from a diverse body of literature in the areas of political science, religion, philosophy, sociology, management science, and public administration. Each of these disciplines has something important to say on the subject. What is said, however, often has a one-dimensional quality and is couched in the language of that discipline. Added together, an almost surrealistic picture of the subject of accountability emerges.

Trying to apply simple logic to bring the pieces into focus often leads to oversimplification. In much of the management literature, accountability is assumed, relegated to the status of a technical, bureaucratic process, and then quickly dispatched in favour of other topics. Indeed, accountability does include process elements, but it also involves a wide range of values, beliefs, attitudes, and behaviours, which are important determinants of the nature and endurance of accountability arrangements.

Part I of this book focuses on the subject of accountability and related issues of governance and control. While it identifies the key elements of the literature, it also attempts to go deeper, explaining the varied interpretations those concepts are given and how they can be connected. For the practitioner to provide professional advice and products in the service of improving accountability, it is important to understand the subtleties, and sometimes the contradictions, associated with the subject and with the perspectives and strategies that governors, management and other stakeholders bring to bear in their respective accountability relationships.

The context of accountability is *governance,* another term that has recently gained currency. Public sector—and corporate—governance is under stress. Ineffective governance processes are barriers to an organization's effective performance. An efficient and accountable management cannot ensure good performance if those responsible for the direction of the organization cannot or will not perform their duties appropriately.

In dealing with the subject of governance in this first section of the book the purpose is not to provide a definitive and exhaustive explanation of the concept; rather, it is to impart a sense of the culture and characteristics of governance. It attempts to discover basic principles that will help the reader understand the concept in various situations.

Chapter 1 provides a general context, exploring conceptual issues, offering examples of philosophical approaches to the subject of governance. The second chapter deals with governance in both the public and private sectors. It describes the government structures in Canada to provide governance and some of the constraints under which government operates. Reference is also made to the form of government in other countries. Chapter 2 also explains the responsibilities of directors of corporations whose securities are issued to the public.

Chapter 3 examines some of the concepts surrounding both governance and accountability, and explains various terms that are used in that context.

Chapter 4 discusses the concept of accountability. This general discussion tries to give the reader an understanding of the theory and some of the issues involved in establishing an effective accountability regime.

Chapter 5 addresses the concept of ministerial responsibility and its diverse interpretations. These differing views introduce the reader to the subtleties involved in issues of this nature.

Chapter 6 describes accountability in such contexts as the private sector, monopolies, and the nonprofit sector. The differences among the various accountability regimes highlight the complexity of the application of the concept of accountability.

Control and controls are the subject of Chapter 7. Two polar approaches to control in an organization are discussed, as well as the operation of controls in certain circumstances.

The conclusion of Part I stresses the importance of knowledge of governance and accountability issues to audit practitioners and those involved in performance reporting. It contains a checklist of questions that the leader of a comprehensive ought to be able to answer in respect of the client's governance and accountability arrangements.

The Appendix uses the government of Canada to illustrate the complex issues surrounding control and controls, and the major attempts to improve its systems. This emphasis on the Canadian government is not meant to exalt it over other institutions; it is used as an illustration of control and controls because it is big, complex, well-documented, and is observed and commented upon considerably more than others. And it contains all the dilemmas in accountability facing other institutions.

Section 1

Accountability's Context–Governance

Chapter 1

Governance—Definitions and Issues

The word *governance* comes from the Greek word *kybernan,* to direct the course of a ship, or to steer the ship. The Romans borrowed the word as *gubernare* and it eventually crossed the English Channel as *governor,* a steerman or a pilot. In French, the rudder of a ship is called a *gouvernail*. In the familiar language of politics in the United States, one hears occasional reference to "steering the ship of state," a metaphor for governance.[1]

Governance is an elegant word summarizing the all-embracing concept of authority and control, of governing. Recently, the term has appeared with increasing frequency in the literature of management and public administration. Recognition of its crucial importance to effective public administration and prosperous private enterprises has given governance its current prominence as an issue. Its recognition has even spawned research institutes[2] and caused existing organizations to gain a better understanding of the concept and to review their governance practices.

Depending on the context, the word *governance* may be used to describe a variety of notions:

- *the art of governing:* the concepts and methods involved in governance, (for example, parliamentary or presidential, unitary or federated, military or civilian, authoritarian versus democratic, in the case of governments);
- *the exercise of authority:* the use of power, the process of governance;
- *the structure of authority:* the arrangement—hierarchical, bureaucratic—for governance to take place; and
- *the jurisdiction:* the area in which the governing body has authority.

The highly generic and detailed definition of governance developed by Dr. Duncan Sinclair to guide an academic medical centre is applicable to any governing body:

Governance is the exercise of authority, direction and control. It can be thought of as the right and responsibility to determine the purposes and principles by which an organization will function and then to arrange for its management accordingly. The purposes are what the organization seeks to accomplish; the principles are the context, the value system, within which it operates. Governance deals with *what* an organization is to do and is, therefore, highly focused on planning, setting goals and objectives, and on the development of policies to guide the organization and monitor its progress toward implementation of its plans. Provided that the governing body has confidently arranged for effective management of the organization, the primary focus of governance should be on the long-term—the organization's mission, values, policies, goals, objectives and, for public sector institutions… its accountability under the terms of its implicit social contract.[3]

A Definition of Governance (in the nonprofit context)

Governance is the fulfillment of responsible ownership on behalf of the community.[4]

Definition of Governance (used in the World Bank)

From a general definition of governance as "the exercise of authority, control, management, power of government," the World Bank has formulated a more relevant definition for its purposes: "The manner in which power is exercised in the management of a country's economic and social resources for development."[5]

Governance versus management

Elaborating on his definition, Duncan Sinclair contrasted governance with management:

> *Governance* is where the buck stops. But governance is something quite different from management. Governors cannot and should not attempt to manage organizations whose policies they control.
>
> *Management* is the act, art or manner of controlling or conducting affairs, the skillful use of means to accomplish a defined purpose. If governance has to do with *what* an organization is to do, management deals with *how it does it.* Management, in our complicated world with all its rules and regulations, requires expertise, experience and highly developed sophisticated skills. It is (or should be) a very professional activity that governors have to ensure is firmly in place to serve the needs and execute the plans of their organization. Just as governors should not try to manage their organizations, so should managers not try to provide them with governance. Managers are accountable to governors.[6]

In Canada, the exercise of authority over public hospitals has given rise to public debate. Clarification of this issue came from Ontario where a ministerial committee suggested that new legislation define governance and specify the distinction between governance and management. The committee suggested that governance, in the Public Hospitals Act, be defined as :

> The exercise, by the hospital's board of directors, of authority, direction and control over the hospital.
>
> The fundamental responsibilities of the hospital board are to ensure that the hospital fulfills its purposes and principles, its social

contract and its objectives for patient care management, quality of programs and services, fiscal integrity and long-term viability.

Management's responsibility is to develop and implement the strategies and programs to achieve the principles, purposes, goals and objectives set by the board.

There are shades of gray separating governance from management. The difference between them, however, is that the board's authority derives from both the hospital corporation and the community, whereas management's authority derives from the board to which it is accountable. Procedures should be developed to enable the hospital corporation and the community to assess the effectiveness of the hospital's governance, and to provide a basis for public scrutiny of the hospital's fulfillment of its social contract.[7]

GOVERNANCE STRUCTURES

Institutionalized governance is exercised through a governing body that has the power of scrutiny or direction, such as a board of directors or governors, a regulatory body, a cabinet in its executive role, a city council, or a legislative assembly. The form that a governance structure takes depends on a number of factors. It may, for example, be established by legislation or honoured tradition. Different structures suit different organizations. In any event, how things happen within a formal governance structure will be influenced by the human factor—the personalities, talents, and desires of the people involved.

Michael Atkinson defines governance structures as:

> The informal and patterned ways in which different institutions and actors interact within particular political and administrative settings to develop policy goals, select among means, cope with uncertainty and controversy, and foster legitimacy and support for policies.[8]

SOME RELATED CONCEPTS

To better understand the general nature of governance and the structures through which it is practised, it is useful to touch on some key philosophical underpinnings.

CIVIL GOVERNANCE AND LIBERTY

Much of the concept of civil governance derives from the theory of the manner in which the state relates to its population. Civil governance is related to civil liberty.[9] The contrast is natural liberty, which implies absolute freedom to do what one wants to do. Civil liberty also means freedom of action, but only as long as it does not harm the "common good" and does not infringe on someone else's liberty. Political liberty is the freedom to participate in civil governance by voting, holding public office, and expressing one's political opinions in public.

The translation of the concept of civil governance into social and political arrangements provides the basis of a constitution from which the laws of the land can be promulgated. It has also engendered social contracts, compacts, covenants, and citizen's charters. Let's explore these notions, starting with the social contract.

SOCIAL CONTRACT

The concept of a social contract has been articulated by philosophers like Thomas Hobbes, John Locke, and others. The term is most often associated with the eighteenth-century French thinker Jean-Jacques Rousseau. He imagined a state in which free citizens, acting freely, would relinquish part of their freedom to the state.

Participatory democracy would characterize the process. In our present context, however, the term does not apply to a document binding two parties in a set of mutual obligations, but rather to a political arrangement describing the relations between a government or a major public institution and the community it serves. The social contract becomes a promise, an undertaking, a declaration, in effect an "unwritten agreement between society and those who seek to serve it."[10]

Social compact

People in the labour movement may relate to the expression "social compact" as a variant of a social contract. A *compact* is an agreement between individuals or groups; *contract* essentially means the same thing, except the term is used to describe the formal document reflecting the compact.

In the word *compact* was the connotation of an agreement between factions that choose to look at each other as equals. The term has somewhat modified its meaning through time. The domination of the government of Upper Canada by a clique of like-minded people at the turn of the nineteenth century was called the Family Compact; so was the expression describing the alliance in the early 1700s between the Bourbon rulers of France and those of Spain. More recently, in 1974, the British Labour government promised price subsidies, and price and dividend controls to trade unions, in exchange for restrained wage demands. Social compact was the name given to the proposal.

The Mayflower Compact, contrary to what is so often thought today, does not really suggest a social contract of independent and equal people constituting by consent their own sovereign and representative government for the purpose of the protection of their own liberties and property. On the contrary: the compact is one formed among people who characterize their status as that of "loyall subjects", of "our dread soveraigne Lord, King James." Their guiding purpose, they declared, was twofold: "the glorie of God," i.e. the "advencemente of the Christian faith," and "the honor of our king & countrie."[11]

Covenant

In the United States, the Constitution is often regarded as a covenant, a term borrowed from the Bible and sometimes deemed to be just another word for social contract. However, not only is the Constitution viewed as having intellectual origins (in the sense of getting agreement on the most appropriate political system), but it is also seen as spiritually inspired and grounded in religious ethics. In this sense, the framers of the Constitution are said to have brought forward a covenant, not merely a social contract.[12]

Citizen's charter

In the United Kingdom, a citizen's charter was tabled in Parliament in 1991. It focused on the promise of raising the quality of public services and making them responsive to the needs of citizens. In introducing the charter, Prime Minister John Major was specific about the intent:

> How we will, for example, be introducing guaranteed minimum waiting times for

> hospital operations. How we will require all schools to provide parents with reports. How British Rail will be introducing new compensation schemes for poor service. How those who regulate electricity, water, gas and telecommunications will be given the same strong powers to insist on good service standards for the customer. How we will toughen up inspection and audit, relate pay more closely to performance, and provide the citizen with more and better information.[13]

In the mind of the prime minister, the charter is not limited to improving the quality of service: "The citizen's charter is about giving more power to the Citizen," insisting, however, that citizens have responsibilities—as parents, as taxpayers—as well as entitlements. There are four themes in the charter: quality, choice, standards, and value. The spirit of the citizen's charter, which covers the whole of the public service, is present in the charter drawn by a large number of government agencies. Those public declarations usually state the promise, the commitments, the rights of the citizens, but some of them include the role and obligations of citizens. For instance, the Job Seekers Charter insists that people applying for a job keep appointments on time.

Closing the loop in the accountability under a social contract, or an arrangement under any other name, is not an easy step, as it generally consists of an agreement between the government and the governed, which is the population at large. The latter cannot effectively organize to represent themselves and negotiate with equal cohesion and consistency. It may well be, however, that the terms of the U.K. Citizen's Charter are such that redress is available for mal- and nonfeasance by the government authority concerned.

The promises made by a political party that is successful in an election is an informal charter—a commitment to do certain things while in office. If citizens think that the government has not lived up to its implied commitment, they have to wait for the next election to show their displeasure.

Democracy

Democracy is a form of government that recognizes the right of all members of society to influence political decisions, either directly or indirectly.

In a *direct democracy*, power is exercised directly by the people: clearly, this is possible only where the population is small. In *representative democracies*—which is what modern democracies are—political decisions are taken by citizens elected by the people to be their representatives.

The central institution of a modern democracy is a representative legislature in which decisions

The Language of Democracy

What, Sir, is the genius of democracy? Let me read that clause of the Bill of Rights of Virginia, which relates to this: 3d cl. "That Government is or ought to be instituted for the common benefit, protection, and security of the people, nation, or community: Of all the various modes and forms of Government, that is best which is capable of producing the greatest degree of happiness and safety, and is most effectually secured against the danger of maladministration, *and that whenever any Government shall be found inadequate, or contrary to these purposes, a majority of the community hath an undubitable, unalienable and indefeasible right to reform, alter, abolish it, in such manner as shall be judged most conducive to the public weal.*" This, Sir, is the language of democracy: that a majority of the community have a right to alter their Government when found to be oppressive.[14]

Patrick Henry, 1788

are taken by majority vote. The characteristics of such a democracy are regular elections, free choice of candidates, universal suffrage, freedom to organize rival political parties, independence of the judiciary, freedom of speech, freedom of the press, and respect for civil liberties and minority rights.

The nature of a constitution

A constitution defines the fundamental values and rules of a society.

The Essence of a Constitution

[A CONSTITUTION] IS CONCERNED WITH WHAT IS DONE TO MAKE SOCIETY INTO A PROPERLY STRUCTURED, CONTINUOUS LIVING BODY, SO THAT THE POLITICAL ACTION OF WHICH THAT SOCIETY IS CAPABLE CAN BE EFFICIENTLY AND EFFECTIVELY CONDUCTED. MACHINERY, YES. BUT ALSO THOUGHT, THE DOCTRINE, THE TEACHING, THE CONVENTIONAL NOTIONS. WHAT DOES THE SOCIETY THINK ITS GOVERNMENT IS, HOW DOES IT TREAT IT, WHAT DOES IT DO TO AMEND IT? WHAT FORMS OF CHANGE ARE POSSIBLE, WHAT REFORMS...?[15]

[T]HE CONSTITUTION OF AN ORGANIZATION IS ITS FUNDAMENTAL NORMATIVE STRUCTURE… A SET OF AGREEMENTS AND UNDERSTANDINGS WHICH DEFINE THE LIMITS AND GOALS OF THE GROUP (COLLECTIVITY) AS WELL AS THE RESPONSIBILITIES AND RIGHTS OF THE PARTICIPANTS STANDING IN DIFFERENT RELATIONS TO IT.[16]

A constitution is often conceived of as a charter, a declaration or text outlining the nature of a government or other organization. A country's constitution specifies how power will be shared among the people, the legislative and executive bodies, and the judiciary. It has legal precedence over all other laws of the land. It is the basic law used to interpret all other laws.

Not all countries have written constitutions. Great Britain is the leading example of a country with an unwritten constitution. But it is unwritten only in the sense that there is no single document referred to as the constitution:

> There are in fact various laws of constitutional significance, and there is a great corpus of authoritative constitutional writing in which scholars and lawyers discuss the constitution as it is, and as they think it ought to be. It remains true, however, that a number of important constitutional practices are followed with rigidity although they are nothing more than conventions. The fact that Britain does not have a formally written constitution is thus not of a great significance for the practice of government and politics. A binding authoritative constitution does exist and politicians and public administrators are no less constitutional in their behavior than their counterparts in those countries which do have a formally designated document.[17]

On the Nature of a Constitution

THE CONSTITUTION APPEARS TO BE A RESTRAINT WHEN IN FACT IT IS NONE AT ALL… SIR, I WILL NOT DECLAIM, AND SAY ALL MEN ARE DISHONEST; BUT I THINK THAT, IN FORMING A CONSTITUTION, IF WE PRESUME THIS, WE SHALL BE ON THE SAFEST SIDE… MANY MILLIONS OF MONEY HAVE BEEN PUT INTO THE HANDS OF GOVERNMENT, WHICH HAVE NEVER BEEN ACCOUNTED FOR, THE ACCOUNTS ARE NOT SETTLED YET, AND HEAVEN ONLY KNOWS WHEN THEY WILL BE.[18]

Melancton Smith
Anti-federalist, 1788

Concepts such as rights and responsibilities, power sharing, representation, participation and influence, which, as noted above, are rooted in such notions as social contract, democracy, and constitution, are very much a part of the governance equation in relation to our public- and private-sector institutions. Earlier, key definitional and structural aspects were highlighted. Let us now examine a set of characteristics that, taken together, provide a framework for looking at the quality of governance. The discussion will return to these issues as it delves further into the subjects of governance and accountability and the arrangements that bind them.

Essential characteristics of good governance

Governance can be either good or bad, assiduous or negligent. Good governance displays a desire to move away from exercise of authority through controls which may be effective but ephemeral, towards exercise of leadership which is at once effective, inspiring, continuous, and lasting.

To govern well implies the application of foresight, knowledge, understanding, and judgment, as well as considerable trust. Affirmation of power and imposition of rigorous controls are least likely to be used in enlightened governance. As a corollary, good governance is very demanding of accountability.

But what is good governance and how will we know we have it? The following are key characteristics of good governance.[19] We know we have good governance when governing bodies:

- comprise people with necessary knowledge, ability, and commitment to fulfill their responsibilities;
- understand their purposes and whose interests they represent;
- understand the objectives and strategies of the organizations they govern;
- understand what constitutes reasonable information for good governance and obtain it;
- once informed, are prepared to ensure that the organization's objectives are met and that performance is satisfactory; and
- fulfill their accountability obligations to those whose interests they represent by reporting on their organization's performance.

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1 See Richard Lederer, "Language-Hats in the Ring, (The Parlance of Politics)," *Delta Airlines Sky Magazine*, November 1992, 128.
2 The Institute On Governance in Ottawa and the Institute of Corporate Directors in Toronto, for instance.
3 Duncan Sinclair, Dean of Medicine, Queen's University, "Governance of the Academic Medical Centre," in *ACMC Forum*, vol. XX, no. 4, 12.
4 R. J. Umbdenstock, W. M. Hageman and B. Amndson, "The Five Critical Areas for Effective Governance of Not-For-Profit Hospitals," *Hospitals and Health Services Administration*, no. 35, 1990, 481-92.
5 The World Bank, *Governance and Development* (Washington, D.C.: The World Bank, 1992), 3.
6 Sinclair, "Governance of the Academic Medical Centre," 12.
7 Ontario Ministry of Health, *Into the 21st Century, Ontario Public Hospitals, Report of the Steering Committee, Public Hospitals Act Review* (Toronto: Ontario Ministry of Health, February 1992), ES-3.
8 Michael M. Atkinson, *Governing Canada, Institutions and Public Policy* (Toronto: Harcourt Brace Jovanovich Canada Inc., 1993), glossary.
9 See Michael G. Kammen, *The Origins of the American Constitution* (Toronto: Penguin Books, 1986), ix.
10 This characterization of the social contract is from White, Kerr and J. E. Connelly, "The Medical School's Mission and the Population's Health," *Annals of Internal Medicine*, December 1991, vol. 115, no. 12, as cited in University of Ottawa Health Sciences Complex Strategic Planning Process discussion paper, *Healthy Directions* (Ottawa: University of Ottawa Health Sciences Complex, 1992), 53.
11 Thomas L. Pangle, "The Constitution's human vision," *The Public Interest*, no. 86, Winter 1987, 79.
12 Irving Kristol, "The Spirit of '87," *The Public Interest*, ibid., 5.
13 Treasury, *The Citizen's Charter: Raising the Standard* (London: HMSO, Cm 1599, July 1991), 1.
14 Speech of Patrick Henry in the Virginia Ratifying Convention, June 5, 1788, as cited in *The American Constitution, For and Against, The Federalist and Anti-Federalist Papers*, J. R. Pole, ed. (New York: Hill and Wang, 1987), 119.
15 G. R. Elton, *The Future of the Past* (Cambridge: Cambridge University Press, 1968), 24-25, as cited in Peter Hennessy, *Whitehall* (New York: The Free Press, 1989), 11-12.
16 M. N. Zald, *Power in Organizations* (Nashville: Vanderbilt University Press, 1970), 225.
17 J. E. Kingdom, ed., *The Civil Service in Liberal Democracies, An Introductory Survey*, (London: Routledge, 1990), 11.
18 *The American Constitution*, back page.
19 CCAF, *In Search of Effective Governance*, video script, 1994, 15.

Chapter 2

Governance in Canada

Federation versus Confederation

The semantics of constitutional arrangements can be tricky. Many authorities make a distinction between a *federation* and a *confederation.* In a federation, in their view, the common government has ascendency over the governments of the states comprising it; it is supreme. In a confederation, the emphasis is on the sovereignty and autonomy of each constituent state and is usually formed to achieve efficiency in external purposes—defense, international trade, external affairs. The federal system in Canada has enough of both to satisfy large elements of the two definitions. The Fathers of Confederation have given us a federal government, and the provinces, over 125 years, have displayed different points of view about their understanding of what exactly Canada is.

National versus Federal

We might add a Father of the U.S. Constitution and the fourth president of the United States, James Madison's distinction [20] between national and federal which, in a way, explains why the Meech Lake agreement had to be ratified by every province regardless of its population instead of by the majority of the population in the country. If the constitution is national in character, the supreme and ultimate authority would reside in the majority of the people of Canada; if it is federal, the concurrence of each province would be essential to every alteration of the constitution that would be binding on all. This implies a different understanding of *federal* than is given above.

Canada's constitution contains both written and unwritten elements. We inherited from Great Britain an accumulation of constitutional decisions, precedents, and practices defining government authority. The British North America Act of 1867 (BNA Act) granted Canada its independence and is the basis for the written part of the constitution. It has been formally renamed the Constitution Act, 1867, and has been amended several times, most recently by the Constitution Act, 1982, which contains the Canadian Charter of Rights and Freedoms. An important part of the Canadian constitution divides the totality of governmental powers between the provinces and the federal government, a point of controversy over the decades. It also contains provisions for such matters as periodic elections (at least every five years) that are essential to ensure a continuing democracy.

The Canadian constitution sets out broadly the nature of our government. It draws heavily on the Westminster (British) model, and the principles of parliamentary government apply equally to the federal government and the provinces. The positions of prime minister and premier do not appear in the written constitution, nor does the term *cabinet.* They are elements of the unwritten part of the constitution, but no less important to the essential working of Canadian governments.

The Form of Government in Canada

The Crown is the sovereign authority—that is, head of state—in Canada's system of government. The Crown is represented at the federal level by a governor-general, who as a public figure is very active, but within the system of government plays a largely ceremonial role. The governor-general takes advice from the Privy Council of Canada, more precisely from its operational part, the cabinet headed by the prime minister. At the provincial level, a lieutenant-governor represents the Crown and takes advice from the provincial executive council.

CANADA HAS ADOPTED FROM GREAT BRITAIN THE WESTMINSTER MODEL OF PARLIAMENTARY GOVERNMENT. IT HAS A PARLIAMENT IN THE FORM OF A BICAMERAL ASSEMBLY, CONSISTING OF AN APPOINTED SENATE,[21] AND AN ELECTED HOUSE OF COMMONS. THE FORMAL ROLE OF PARLIAMENT IS THAT OF LEGISLATION, BUT MOST LEGISLATION IS FRAMED BY THE CABINET, WHICH IS ABLE TO RELY ON THE SUPPORT OF ITS PARTY MAJORITY IN THE HOUSE OF COMMONS, SO THAT THE EFFECTIVE ROLE OF THE HOUSE IS ONE OF SCRUTINIZING THE EXECUTIVE, AND PROVIDING A FORUM FOR POLITICAL DEBATE.[22]

THE MOST IMPORTANT DETERMINANTS OF CONTROL AND USE OF POWER IN THE CANADIAN PARLIAMENTARY SYSTEM ARE THE POLITICAL PARTIES. ELECTIONS ARE MORE A MATTER OF VOTERS CHOOSING BETWEEN PARTIES AND PARTY LEADERS THAN BETWEEN INDIVIDUAL CANDIDATES. THE WINNING PARTY BECOMES THE GOVERNMENT, WITH A MONOPOLY OVER EXECUTIVE POWER AND DOMINATION OF PARLIAMENT. WITHIN THE HOUSE OF COMMONS, THE BASIC STRUCTURE OF PROCEEDINGS IS THE ADVERSARIAL FORMAT OF CONTEST AND DEBATE BETWEEN THE GOVERNMENT AND OPPOSITION PARTIES.[23]

THE PRIME MINISTER AND THE CABINET

The prime minister and the cabinet of ministers are not directly elected to those positions by the people, though they are usually popularly elected as members of the House of Commons. The prime minister is usually the leader of the political party that won the majority of seats in the last election. In turn, the cabinet is chosen by the prime minister from among his or her supporters in the House of Commons and the Senate.[24]

Executive power is really in the hands of cabinet led by the prime minister. Interestingly, "neither of these are actually mentioned in the BNA Act. The origins of the Canadian cabinet lie in the Privy Council, a body formally charged with the function of advising the Governor-General. Once chosen, cabinet members formally gain their authority by being sworn in as members of this Council. Though remaining privy councillors for life, but they lose their executive authority once they cease to be members of the cabinet."[25]

THE WORD *EXECUTIVE*

THE WORD *EXECUTIVE* IS DERIVED FROM THE LATIN VERB *EXSEQUI*, TO FOLLOW THROUGH OR TO CARRY OUT. IN THE PRIVATE SECTOR, CORPORATE EXECUTIVES HEADED BY A CHIEF EXECUTIVE OFFICER (CEO) CARRY OUT THE WILL OF THE BOARD OF DIRECTORS. IN PRIVATE FAMILY MATTERS, EXECUTORS OF ESTATES FOLLOW THE WISHES OF DECEASED TESTATORS. IN OUR GOVERNMENT, THE WORD *EXECUTIVE* REFERS TO THE CABINET AND BUREAUCRACY: THE EXECUTIVE ARM OF GOVERNMENT. THE MOST SENIOR NONELECTED OFFICIAL IN THE PRIVY COUNCIL OFFICE IS THE CLERK OF THE PRIVY COUNCIL AND HOLDS THE SIMULTANEOUS TITLE SECRETARY TO THE CABINET. FARTHER DOWN THE HIERARCHY ARE OFFICIALS WITH THE TITLE EXECUTIVE DIRECTOR.

By convention, the great majority of cabinet members are chosen from the House of Commons. The reason is that the ministers can then be accountable to the elected chamber; the Senate is considered an inferior forum in which to hold ministers to account.

Collective Responsibility

In Canada's system of government, cabinet ministers are not only accountable for their own portfolios, they also have a collective responsibility as members of the government. The cabinet assumes responsibility for the policies and performance of its government. Individual ministers have the task of meshing their individual accountability with respect to their own departmental policies and programs with their collective responsibilities as ministers of the Crown in support of their own government.

The executive head, the prime minister, has considerable power within the system. The formal constraints inherent in the principle of the *separation of powers* that can limit the actions of the president of the United States are absent, since the prime minister remains a member of the House of Commons, wherein his party remains in control of the majority. On all important issues, party discipline is strict; members vote as their leaders tell them to.

The prime minister is given the honorific "Right Honourable"; other federal cabinet ministers are "Honourable." They keep these titles for life. Members of provincial cabinets are members of the executive council and keep the title "Honourable" only while they hold office. On occasion, provincial politicians are inducted into the Privy Council of Canada and are "Honourable" for as long as they live thereafter.

Although tradition has it that the premier is *primes inter pares*—first among equals—within the cabinet, the prime minister's authority is absolute. Moreover, the authority to make top public service appointments (deputy ministers and other order-in-council appointments) represents a power akin

Ministerial Responsibility: the Doctrine

Ministerial responsibility, along with the fusion of the executive and legislative branches, are distinguishing features of responsible government. The rules relating to these features are not set down in the Constitution. They are governed by convention, precedent and common sense. There is no single definition of ministerial responsibility; there are, in fact, three parts to the doctrine.

First, there is the responsibility of a minister to the Queen or the Governor General; this is often overlooked, but it is basic to our constitutional order. Governments are not elected but appointed, and ministers serve not for a term, but until they die, resign, or are dismissed.

Second, there is the individual responsibility of a minister to the House. This revolves around the question of when a minister should offer his or her resignation, and when it should be accepted or asked for. The answer seems to turn on the personal relationship between the minister and the prime minister. The principle is accepted, however, that where there is a personal culpability on the part of a minister, in the form of private or public conduct regarded as unbecoming and unworthy of a minister of the Crown, the minister should resign.

The third responsibility is that of the ministry collectively to the House. If the confidence of the House is lost, it spells the end for the ministry unless the government is granted a dissolution and is sustained by the electorate.[26]

to that of the president of the United States, but free of the need to obtain legislative approval of appointments. "The main constraints are probably political rather than constitutional, deriving from the balance of support within his party, from public opinion and from the activities of interest groups."[27]

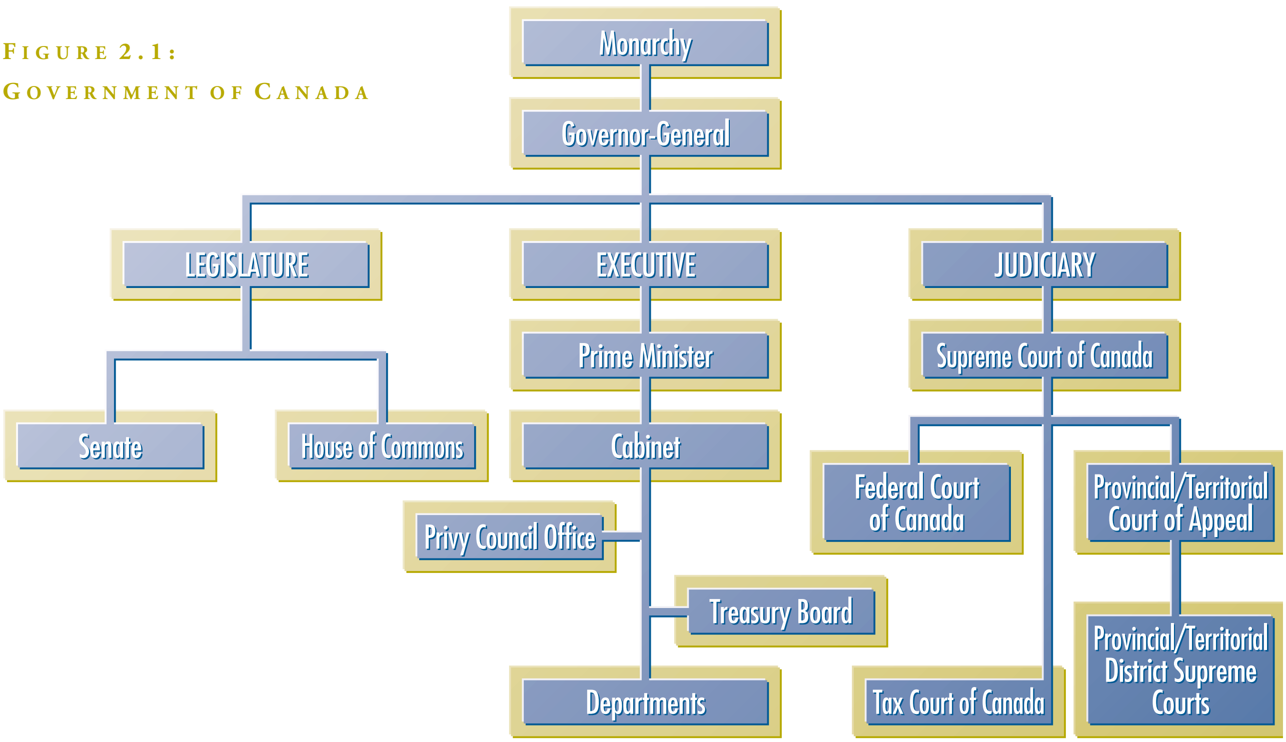
Much of the working of the cabinet is through a number of committees. As of 1994, there were four such committees: Economic Development Policy, Social Development Policy, Special Committee of Council, and Treasury Board.[28] Previously, there had been a much larger number of committees, coordinated by other, overarching committees.

Ministers, their staffs, and many senior public servants are constrained by conflict-of-interest guidelines designed to ensure probity in the conduct of public business. A formal structure exists to monitor compliance with these standards.

Central agencies

Both the provincial and federal governments use *central agencies* to oversee and bring cohesion to their bureaucracies. These agencies exercise the will of the government as a whole, rather than the interests of particular departments. They go by various names. Probably the most central of these bodies is the one that serves the cabinet. Others, such as treasury or management boards are concerned, among other things, with financial allocations and procedures. A civil or public service commission deals with personnel matters and is typically charged with ensuring the integrity of the merit system of hiring and promotion within the bureaucracy. The degree to which authority in the fields of interest of these central agencies is delegated to the operating departments and agencies varies greatly from jurisdiction to jurisdiction.

Figure 2.1: Government of Canada



Source: The 1996 Canadian Global Almanac (Toronto: Macmillan Canada, 1996).

> THE CABINET IS SERVICED BY A SECRETARIAT KNOWN AS THE PRIVY COUNCIL OFFICE. THIS SERVES TO LINK THE EXECUTIVE HEAD WITH THE BUREAUCRACY THROUGH A TWO-WAY TRANSMISSION OF INFORMATION, AND THE COMMUNICATION TO THE APPROPRIATE DEPARTMENT OF CABINET DECISIONS REQUIRING BUREAUCRATIC ACTION.[29]
>
> TO SOME EXTENT, THE PRIVY COUNCIL OFFICE CAN BE SEEN AS THE INSTRUMENT OF THE PRIME MINISTER, IN THAT IT SHARES HIS OVERARCHING, COORDINATING FUNCTION. THROUGH THE OFFICE HE IS ALSO ABLE TO MANAGE THE CABINET'S BUSINESS AND DECIDE THE ORDER AND THE CONTENT OF THE AGENDA.[30]

All jurisdictions also have a number of specialized offices that enjoy government-wide jurisdiction, but are not themselves arms of the government. These include the auditors, privacy commissioners, and ombudsmen. These officeholders typically report to the legislature rather than to a minister and represent means through which the legislators hold the government accountable for its administration.

GOVERNMENT DEPARTMENTS

The federal and provincial public services comprise departments and agencies that together share the totality of the bureaucratic responsibility. The allocation of responsibilities among departments is largely functional (for example, transport, communications, municipal affairs).

The essential feature of government departments is that they are answerable to the legislature through the minister. The organization chart of the department is hierarchical, with each level of responsibility reporting to the one above in a chain of command and responsibility rising through to the deputy minister and culminating in the minister's relationship with the House.[31]

Entry and promotion within the bureaucracy (except at the highest levels) is governed by the merit system, featuring competition for positions with provision for appeal. A large percentage of public servants belong to unions, through which they bargain with the government on salary issues and other conditions of service.

Senior public servants have substantial influence. They are responsible for overseeing the delivery of government services and controlling the bureaucracy. As senior advisers, they are responsible for developing policy for recommendation to their ministers. Since most of these people are career civil servants, they often have more expertise concerning the issues facing their departments, and the constituencies they serve, than do the ministers, who typically serve only a few years in any one portfolio. Some observers argue that the influence of top bureaucrats increases when cabinets are reduced in size, as has been the trend. This is

> POLICY-MAKING IN CANADA CONSISTS OF NOT ONE BUT MANY PROCESSES, EACH WITH ITS PARTICULAR TRAITS. BUT THE MOST IMPORTANT PROCESSES, INCLUDING RATIONAL POLICY-MAKING, BUREAUCRATIC PLURALISM, AND EXECUTIVE FEDERALISM, ARE EXECUTIVE-CENTERED. EXECUTIVE-CENTREDNESS LEADS TO DIFFICULTIES IN BUILDING CONSENT. POLICY-MAKING IS PRIVATE, BELOW THE LEVEL OF PUBLIC VISIBILITY AND OFTEN POLICIES, WHEN THEY EMERGE, ARE SPRUNG FULL-BLOWN ON A SURPRISED, UNSUSPECTING AND SOMETIMES NON-TOO-PLEASED PUBLIC. IT IS HARD TO LINK THE INSIDE, PRIVATE SPHERE OF GOVERNMENT WITH THE OUTSIDE PUBLIC WORLD OF POLITICS. EXECUTIVE-CENTRED POLICY-MAKING DOES NOT LEAD TO THE MOBILIZATION OF CONSENT WHILE POLICIES ARE BEING DEVELOPED. PARLIAMENT IS UNIMPORTANT. IT RATIFIES AND AUTHORIZES DECISIONS WORKED OUT ELSEWHERE.[32]

because ministers have wider responsibilities than before and must rely more heavily on the advice of their senior officials. The issue of how the public service should be held accountable is one arousing controversy, as is discussed in the next section.

Government agencies

Outside the departmental structure, in both the provinces and federal government, there is a substantial group of agencies referred to as Crown corporations serving at once a commercial and public policy purpose (for example, Export Development Corporation; Ontario Hydro). They ultimately report to a minister, but they enjoy varying degrees of freedom from ministerial and legislative control. Typically, Crown corporations have a governing body in the form of a board of directors drawn from the public and, where appropriate, includes a senior official from the department which has a key policy interest in the business of the agency.

> Thus it can be seen that the Canadian political culture permits a high degree of autonomy to the agencies of public administration, resulting in a complex and varied structure. However, the civil service, with its tight level of control and accountability, remains central to the whole system, playing a dominant role in key policy areas and remaining close to the processes of central resource allocation and policy-making. Clearly the high degree of political control afforded by the government department remains valued, though the presence of a large quasi-autonomous sector helps to create an environment in which such control is constantly questioned.[33]

Moreover, numerous regulatory or quasi-judicial agencies are given substantial autonomy to administer the law. These bodies regulate transportation and communications, settle disputes concerning municipal bylaws, determine the status of refugee claimants, decide on compensation for victims of violent crime, and perform a number of other functions. They enjoy freedom from direct political oversight because of the nature of their responsibilities. They are specialized in a way that courts could not be and rely on the expertise of their members and staffs to carry out the broad intent of the legislation that gave them life. Usually, appeals can be made to the courts from decisions of these bodies.

The judiciary

Disputes involving the interpretation of Parliament's laws are handled by the Federal Court of Canada, which has both a trial and appeals division. Criminal law and laws under provincial jurisdiction are dealt with by the provincial courts. Each province determines the structure of its judiciary, although many provincial court judges are appointed by the federal cabinet. The final court of appeal for all Canadian legal disputes is the Supreme Court of Canada.

Although appointed by governments, judges become independent of political influence on appointment. Typically, recommendations for judicial appointments are made by independent committees that include members of both the bench and the bar; they often include lay membership. Judges may serve until retirement age. Although there are provisions for removing judges from office, the process is difficult and, if instituted, invariably attracts widespread public attention.

Local government

Under the Canadian constitution, each province has authority to determine the organization of local governments within its borders. Practice varies, and provinces have devised a wide range of local bodies to fulfill responsibilities that their legislatures have delegated to them. Regional governments, municipalities (usually distinguishing among cities, towns, villages, improvement districts, and so on), school boards, hydro and other utility commissions, and health-planning areas are some of the more common instruments that provinces have chosen to implement policy and deliver services. All these bodies are creatures of provincial legislatures, which have the legal power (though often not the political support) to change, abolish, amalgamate, or rename them.

Some of these local bodies, such as municipal councils and most school boards, are elected; others are appointed. Some have the power to levy taxes; others do not. A few positions on these governing bodies are considered to be full-time and are paid accordingly; others receive no remuneration. Whatever their nature, taken together, these local bodies comprise tens of thousands of Canadians who, in one way or another, feel called upon to serve their communities through local government.

Nongovernmental organizations

In addition to this, but at some remove from government, are the myriad agencies, funded in whole or part by public money, that provide services in such fields as recreation, health, social services, and the like. These organizations are guided by citizens who provide the governance essential to their effective and continuing existence.

Typically, these entities are the creations of private citizens interested in a particular policy or service. They often represent examples of power sharing within society, with organizations like the Red Cross blood service and children's aid societies carrying out mandates established in legislation and supervised by government departments. Governments sometimes use these organizations to deliver services in the belief that the involvement of local citizens will provide a more relevant service.

Recently, governments have assumed increasing control over organizations such as hospitals for which they are footing the major part of—or all of—the bill. Governments with differing political philosophies may take different approaches to these organizations, so that there may be variations between jurisdictions and transitions over time within jurisdictions.

The role of elected representatives

Acting as the elected representative of a constituency is not a simple task. The following issue has never been entirely resolved with respect to representatives and their electorates.

The Burke-Jefferson question

> There are on the one hand the "Burkeans" adhering to the views of the British Parliamentarian Edmund Burke who claimed not to be a mere delegate of his electors but a free-thinking member of Parliament who owed them the independent exercise of his judgment.
>
> On the other hand are the "Jeffersonians." The American Thomas Jefferson asserted, in his thorough-going advocacy of democracy, that elected representatives must remain directly accountable to those who elected them.[34]
>
> If Canadians have traditionally been Burkeans, inclined to invest power and responsibility in their elected representatives, they appear now to be becoming Jeffersonians, constitutionally distrustful of government and insistent that their representatives respond more sensitively and directly to the voice of the people.[35]

In recent years, Canadians have increasingly used informal meetings to discuss public issues. The public consultations that preceded the national referendum of 1992 and the Ontario treasurer's 1994 pre-budget public meetings are but two of many examples. These town-hall meetings, as they are often called, reflect citizens' desire to influence the public debate directly, instead of relying solely on their elected representatives. Some observers have dubbed this phenomenon *participatory democracy*.

The trend toward achieving a louder public voice has strengthened the position of those who argue for greater independence in the voting power of individual members of legislatures; they argue for a weakening of the party discipline that many have considered essential to the operation of parliamentary democracy. Proponents of this change want to see fewer votes being considered challenges to confidence in the government and to allow members to vote according to the views of their constituents or the dictates of their individual consciences.

JEFFERSONIANS

WESTERN CANADIANS WERE VERY MUCH JEFFERSONIANS IN THE EARLY PART OF THE CENTURY. MEMBERS ELECTED TO PROVINCIAL LEGISLATURES SIGNED PLEDGES TO VOTE A PARTICULAR WAY ON SPECIFIC ISSUES AS INSTRUCTED BY CONSTITUENTS. SIMILAR PLEDGES WERE EXTRACTED FROM PROGRESSIVE PARTY MEMBERS ELECTED FROM WESTERN CANADA TO THE HOUSE OF COMMONS IN 1921.[36]

Elected members occasionally face a dilemma when they want to vote according to their conscience or according to their constituents' wishes, against their party's position. Reelection depends heavily on staying in touch and favour with the voters back home; advancement, however, depends on good standing with the party leadership. To whom, then, is the elected member primarily accountable?

INFLUENCES ON POLICY IN A DEMOCRACY

As explained above, Canada is a federal, constitutional democracy. It is also a pluralistic society, encompassing many interests and forces that have an effect on the way our governments function.

SPECIAL INTEREST GROUPS

Not only do elected members—and governments—have to keep a finger on the pulse of their constituents, they must also deal with special interest groups. These groups—sometimes called single-issue or pressure groups—are organizations of citizens devoted to a specific area of public policy, promoting a specific view. The Church in medieval (and more recent) times, the antislavery movement of English abolitionist William Wilberforce and his associates, the suffragette and temperance movements in the early part of the twentieth century, and the environmental, prochoice, and antiabortion groups of today are all examples.

These groups share a common method of operation: they try to attract the greatest possible attention to their cause in an attempt to shape public opinion and influence government policy. Many of these groups are adept at manipulating the media, and that part of the media that thrives on controversy is often all too happy to give them the publicity they crave. Because of the single-mindedness of their advocates and the media attention they attract, issues promoted by these groups frequently acquire a visibility, and possibly have an impact, out of proportion with either the basic value represented or the number of people sympathetic to these causes.

Since some issues spawn diametrically opposed interest groups (for example, pro-choice and pro-life groups), elected representatives frequently find themselves on the horns of a dilemma.

Jeffersonians would do the political calculus and vote with the majority of their constituents regardless of the validity of their thinking; Burkeans would vote according to their conscience and risk offending their electorates. Others would abstain from voting in the belief that inaction would be the least disturbing course to follow.

Lobbyists

Lobbyists are people who influence legislators and governments to act in the interests of their clients. They do this by seeking interviews, writing letters, bringing external pressures to bear, and so on. In this respect, they act much like special interest groups (who also engage in lobbying), with the difference that lobbyists are not necessarily personally committed to the cause they are promoting.

Lobbying[37] is not limited to getting the ear of legislators on the government side; it is also directed to the opposition parties. Furthermore, recognizing the importance of the nonelected part of the executive arm, lobbying activities are frequently and intensely aimed at civil servants who enjoy influence in policy development and implementation.

Lobbying is sometimes viewed as good, sometimes as bad. Lobbyists can often help bring issues to a satisfactory expeditious resolution. They may contribute to the clarification of an issue or suggest compromises such that the legislation or intervention accommodates the general welfare even if it appears to have sided with a particular interest. Lobbyists often sponsor coalitions to promote public knowledge, debate, and support. They also relish an opportunity to get their client's point of view expressed in the media.

It has been reported that the number of lobbyists in Washington rose from approximately 400 in 1960 to 7,000 in 1990. Moreover, there were an estimated 27,000 lawyers who were ready to make representations or lobby on behalf of their clients. In Ottawa, activities resembling lobbying have been going on for as long as the government has existed. In 1992, some 300 firms acknowledging activities of the type regulated by the federal Lobbyists Registration Act.

Lobbying is often seen as undemocratic because so much of it occurs behind closed doors. Skeptics suspect, rightly or wrongly, that shady deals are made. Even the satisfactory resolution of an issue may not allay the suspicions of individuals devoted to transparency and accessibility in public affairs. No one has yet devised a way of making lobbyists publicly accountable; this does not mean, however, that they are unaccountable in the sense of being irresponsible.

Whatever one may think of them, lobbyists play a significant role in public policy development, and are here to stay.

Opinion polls

Public opinion polling is another source of influence brought to bear on elected representatives and governments. Often acting independently, pollsters pick the issues, formulate the questions, assemble the replies, analyze the answers, and release the results to the media. The issues selected are based on their topicality. Sometimes topical value is raised simply by taking a poll and publicizing the results.

Alternatively, pollsters undertake surveys on behalf of a sponsor, such as a political party, the premier's office, other parts of the executive branch of government, corporations, or pressure groups. In these cases, the issues are those of the sponsor, possibly the questions, as well. Basic data, for example, the actual responses, often remain confidential, in the hands of the polling organization or the sponsor, and thereby the pollsters themselves become part of the circle of private advice to the government or organization and are no doubt contributing to the agenda of the day in a manner largely beyond official access-to-information mechanisms.

The public and the media pay considerable attention to poll results as they are announced with the seeming regularity of weather reports. Responsible pollsters announce the sample size (usually a minuscule portion of the population) and the degree of statistical confidence in the results. The major pollsters in Canada are technically expert and should be viewed as objective. Subjectivity may arise in the formulation and the sequence of the questions asked. Pollsters will sometimes publish the questions along with the results to help readers, commentators, and analysts form their own opinions.

David Flaherty, a prominent Canadian academic remarked: "Although such companies claim that they are simply measuring opinion in an objective fashion and giving politicians a road map of voters' attitudes, one suspects that the published results of their polling shape reality as much as reflect it. Polls at least influence everyone's perception of the present."[38]

In favor of such polls is the notion of consulting the population directly, which allows citizens to have direct input into policy-making. Assuming the polls are accurate—and there is evidence to suggest that they often are—the benefit to the democracy is a punctual awareness of the mood of the population on many policy issues. Nevertheless, as an expression of participatory democracy, polls cannot replace a good public discussion. That the results of polls are often kept confidential by the government leads some people to think that polls contribute to an erosion of parliamentary control.

The media

A free press—print and broadcast—is essential for a democracy; it is impossible to imagine a truly functional democracy without one.

The press plays several roles. In one role it supplements the work of the political opposition by acting as a watchdog: probing, publicizing, commenting, sometimes exposing. It provides a vehicle for information sharing and a forum for public debate. It can inform and influence both the public and the policymakers.

Much of reporting, editorial and commentary, is unbiased, serving nothing but the truth. Some reporting, however, advocates a particular viewpoint or philosophy, reflecting the inclination of the reporters or owners of the media outlet. And nearly all media are subject to market forces of competition—they need readers, listeners, viewers, advertisers. Foreign competition must also be met. In such an environment, the temptation to indulge in sensationalism in order to foster sales is omnipresent. To prevent excesses and to promote responsible journalism in Canada, the laws of libel are buttressed by a press council to which appeal can be made.

Understandably, very few decision makers ignore the media. An overreliance on the press, however, especially at the expense of keeping in touch with the views of ordinary citizens, can lead to a skewing of public policy in favour of some special interest that has managed to obtain broad media exposure. In such cases, citizens may have to wait for the next election to enjoy an occasion to impose accountability.

External forces

External factors present certain constraints on our ability to act with full independence. These factors include the growth of continentalism, globalization of industry, trade and commerce, military alliances, and various agreements that Canada has entered into with other countries and with international agencies. These arrangements are often complex and therefore entrusted to expert public servants; the implications of these commitments are often not clearly understood by members of Parliament.

The Honourable Lloyd Axworthy, M.P., wrote the following observation about the impact of globalization on our democratic institutions:

> Today, the world economy conspires to erode the capacity and competence of nation states. Money moves across national borders in seconds. Economic decisions are made in boardrooms far removed from national control or accountability. Great power blocs jostle for military, economic, and political control. The global village is very much upon us, and Canada, for reasons of history and proximity, is on the front line of this phenomenon…
>
> The sensitive matter of public regulation of business, especially the need to hold accountable the increasing concentration of private wealth and economic power operating across national borders, is becoming a severe test for the Canadian political system. It must find a way to maintain the nation's sovereignty and integrity against an age of continental and international pressures.[39]

Some implications of federalism

Federalism in Canada involves two levels of government—one national, one provincial—exercising powers independently. Those powers derive from the same people, as citizens of the country and of the provinces in which they reside.

The term *fiscal federalism* describes the web of arrangements—rental of tax powers, financial transactions, transfer payments, protocols, rules and regulations governing them—that has become a central feature of federal-provincial relations over the last several decades. Many similar understandings have been implemented by the provinces and their creations—the municipalities and other forms of local governments. There are also numerous agreements on other subjects of interest to both levels of government.

Federal-provincial arrangements and their continuing administration and adaptation give rise to often delicate and protracted negotiations. Sometimes, these take place in private, away from the seat of government. Other meetings are held under the glare of public television, a concession to visible accountability. The prime minister and the provincial premiers sit as equals and engage in bargaining with little, if any, reference to Parliament and the provincial legislatures. There are also numerous meetings between federal ministers and their provincial counterparts with responsibilities such as finance or health.

So important are these federal-provincial relationships that governments maintain departments or secretariats of intergovernmental affairs to deal with their counterparts. Ministers, supported by their senior civil servants, become the architects of federal-provincial relationships, determining the practical effect of the division of powers set out in the constitution. Thus important political decisions are not taken by legislatures, or the political parties comprising them, but by levels of government, hence the expression *executive federalism.* Nevertheless, since many of these agreements require legislation to make them effective, an opportunity to debate them arises when governments place them before their legislatures. By that time, however, the die is usually cast.

Agreements reached by heads of government at federal-provincial meetings are seldom rejected, because the government leader who negotiated the agreement usually controls the majority in the legislature. Nevertheless, despite the strong support given to them by leaders at the time they were drawn up, both the Meech Lake (1987) and Charlottetown (1992) Accords failed to gain acceptance—of all provinces in the former, and of the people in a national referendum in the latter.

GOVERNMENT IN OTHER COUNTRIES

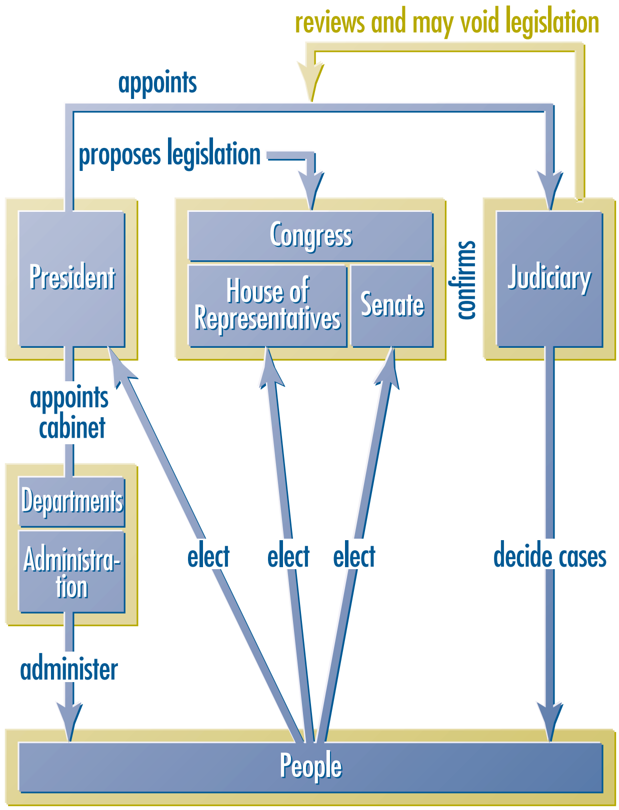
Not all countries follow the British parliamentary tradition. Even within the Commonwealth, there are republics that vest the ultimate power in the people rather than the Crown. Most of those countries, however, even those with a president, follow the parliamentary model of responsible government, with the executive chosen from among, and accountable to, the elected members of the legislature. Some non-Commonwealth countries, such as Israel, also adopt this form of governance.

The form of government in the United States is different than this. The United States has a president for whom, through the proxy of the electoral college, the entire electorate may vote. This gives the president enormous political power. To counter that power, the U.S. Constitution provides for a division of powers among the executive, the legislature and the judiciary. Unlike the parliamentary system, neither the president nor any of his cabinet are members of the legislature. The president can propose legislation, can sign into law or exercise a limited power of veto over bills passed by Congress, but he cannot on his own enact statutes.

The U.S. Congress has two houses: the House of Representatives and the Senate. Among its other responsibilities, the Senate, comprising two senators from each state elected for staggered six-year terms, has the power to approve or turn down senior presidential appointments, and both Houses can launch investigations into what the executive branch has done. The president does not, however, testify before congressional committees; that is left to appointed officials. There is no daily question period for the president and his cabinet, as there is in the parliamentary tradition.

BASIC INSTITUTIONS OF AMERICAN GOVERNMENT

FIGURE 2.2



SOURCE: PEOPLE, POLITICS AND GOVERNMENT (SCARBOROUGH: PRENTICE-HALL CANADA INC., 1995).

Like Canada, the United States is a federation, with certain responsibilities and powers given to the states. Although the mechanisms are quite different, both countries display some overlap of programs and policies at the two senior levels of government.

Much more so than Canadians, Americans vote directly for a variety of public officials. Some judges, state cabinet officials, and many local officials are elected. Views are strongly held on both sides of the question of whether this makes for better accountability.

> **Democracy is the worst form of government —except for all the rest.**
>
> Sir Winston Churchill

Elsewhere in the world, other forms of government reflect the history and nature of countries and their citizens. Some presidents are strong; others are figureheads. Some governments are fully accountable; others avoid scrutiny and criticism. Democracy takes many forms, as do dictatorial and totalitarian regimes. Names do not always correspond to reality, as has been seen in certain "people's democracies" and "democratic republics." The key to determining whether there is a good system of governance in a country is to see if the government reflects the will of the people and acts in their interest; and should that government fail in this regard, that peaceful mechanisms are available to replace it.

Private sector governance

The term *governance*, when used in the context of the private sector, usually refers to for-profit, incorporated entities (there is scant literature on nonprofit private organizations). The following deals with this interpretation and serves only as an introduction to the subject. Indeed, comprehensive treatment of corporate governance would require a separate book.

> **"Corporate governance" means the process and structure used to direct and manage the business and affairs of the corporation with the objective of enhancing shareholder value, which includes ensuring the financial viability of the business. The process and structure define the division of power and establish mechanisms for achieving accountability among shareholders, the board of directors and management. The direction and management of the business should take into account the impact on other stakeholders such as employees, customers, suppliers and communities.[40]**

Corporate governance became an issue in the late 1970s, largely as a result of the failure of company officers of some of the largest corporations in North America to provide important information not only to shareholders but to their own directors, as well. That in itself was not unusual at the time, except that in these cases the officers were in violation of the law. The most famous cases prosecuted were for illegal political contributions, bribery, and interference in the affairs of a foreign country. In several instances, the governing body—the board of directors, and the shareholders—had been kept in the dark about these felonious activities.

In the 1980s, concerns about governance focused not so much on deliberate violations of the law (although there were some serious unethical, even illegal, activities), but on the quality of decisions that had serious consequences for the corporation. Greed had prevailed over competence and prudence, and in many cases corporate performance suffered considerably. Frequently, with the approval of boards of directors—and sometimes unknown to them—corporate officials engaged in a frenzy of transactions of dubious value (for example, leveraged buy-outs, mergers, stripping of company assets). In many financial institutions, competition for funds, market share, and the quest for short-term profits led to risky lending practices. Many corporate officers had to engage in activities bordering on illegality, when not clearly illegal, simply to salvage what they could from bad deals. Simultaneously, recognition of conflicts of interest on corporate boards started to affect the credibility of many governing bodies.

While it is possible to hold corporate officers responsible for the actions that led to some spectacular debacles, the public—and indeed the shareholders—have been raising questions about corporate governance, as have financial analysts and the financial press: What if the board of directors had intervened or demanded a regular rendering of account? Did the board have sufficient independence and competence to intervene, or at least to challenge the officials? How would the latter have behaved had they known they were to be held to account by the board?

CORPORATE GOVERNANCE DERIVED FROM THE LAW

THE POWER AND LEGAL RESPONSIBILITIES OF CORPORATE DIRECTORS AND OFFICERS DERIVE FROM CORPORATE LAW. TO BE SECURE, POWER HAS TO BE LEGITIMATE, AND FOR POWER TO BE LEGITIMATE, WHETHER PUBLIC OR PRIVATE, IT HAS TO BE ACCOUNTABLE. THE MODERN BUSINESS CORPORATION IS ACCOUNTABLE ACCORDING TO ITS CONSTITUTIONAL LAW, JUST AS THE GOVERNMENT IS ACCOUNTABLE ACCORDING TO CONSTITUTIONAL LAW. THE CONSTITUTIONAL LAW OF THE BUSINESS CORPORATION IS CALLED CORPORATE GOVERNANCE, WHICH DEFINES THE ACCOUNTABILITY OF DIRECTORS TO SHAREHOLDERS AND OF OFFICERS TO DIRECTORS.[41]

Changes will come when evolving societal expectations are reflected in law.

BOARDS OF DIRECTORS

Corporate governance in North America is a process by which owners of the corporation exercise influence over its management. The corporation is governed by a board of directors whose members are elected by the company's shareholders at annual meetings.

Laws and traditions lead to differences in corporate governance from country to country. Ownership representation and insider participation are usually the major areas of difference. In some countries, owners, as distinct from management, are not represented on the governing body; that does not mean that they do not have any influence. In Japan, shareholders elect members of the board, but the latter have to be insiders. Major institutional share owners, however, exercise considerable influence on senior corporate officials through informal channels. In Canada, both corporate officials (or insiders) and outside directors are found on the boards of most large corporations.

INSIDE DIRECTORS ARE THE COMPANY'S CHIEF EXECUTIVE OFFICER (CEO) OR EQUIVALENT AND THE OTHER DIRECTORS WHO ARE FULL-TIME MANAGEMENT EMPLOYEES. _OUTSIDE_ DIRECTORS ARE MEANT TO PROVIDE OBJECTIVE AND INDEPENDENT ADVICE AND TO CHALLENGE THE ACTIONS OF THE CEO AND MANAGEMENT.

The independence of outside directors is somewhat compromised when they are nominees of the CEO, especially when the CEO also happens to be chairman of the board. This is the case in many corporations. Furthermore, outside directors are not necessarily independent when they have been named to represent a vested interest; nor are they necessarily effective when they have been appointed for symbolic reasons (or tokenism, as it is often called), or simply to give the board an air of respectability.

Currently, there are some serious debates over the structure of governance of publicly held corporations, centered on the corporate board of directors. One of the issues is the separation of the role of the chairman from that of the chief executive officer. Another is the manner in which directors are chosen. How the board will discharge its responsibility is another serious concern; at what point does the board intervene managerially or otherwise on evidence or rising apprehensions of nonperformance of the CEO? How to assess the performance of the board itself has become a central issue. Finally, and not least of all, are the issues of directors' liability and the possibility of class-action suits responding to recent legislation and legal interpretation.

Shareholders

Shareholders elect the board of directors and entrust the governance of the corporation to them. This does not mean that they play no role in corporate governance. Major institutional shareholders, for example, may regard themselves as investors, as has been the tradition, or they may see themselves as both major investors and owners, a more recent development. The difference between the two may not be immediately apparent: being involved as an investor may focus the interest on short-term issues, whereas seeing oneself as an owner involves a concern for the company's long-term prosperity. This distinction may be recognized by someone like the investment manager of a corporate pension plan, who likely has a longer-term perspective. In short, shareholders who regard themselves as owners (as distinct from those who act solely as investors) can maximize the benefits of their investments if they recognize that certain responsibilities come with ownership.

Shareholders have influenced corporate behavior in many instances, such as in the provision of additional information; sometimes shareholders' input has affected operations that they thought were politically or socially offensive.

Social responsibility

There is a growing propensity for institutional investors not only to foster the best financial interest of their clients, but also to respect the place the publicly held company occupies in the life of the community or of society in general. They sometimes reflect the values held collectively by their clients such that investment of funds is influenced by both the potential financial return and by a view of the political, societal, or moral validity of the business. The expectation is that a company be socially responsible towards the general population and that it must deal fairly with its employees.

> Since the large-scale business enterprise is the central institution of the modern world economy, the directors of these corporations have come to have responsibilities that affect every one's welfare. There is, therefore, a connection between the responsibility of the directors of the corporation and the distress of American industry in today's world economy. But it is essential to keep the causal connection straight… the boardroom is a mirror of fundamental change in business. "Cause and effect" generally run from the economy to the boardroom, not the reverse. Change in the economic environment of the present-day American business has expanded the nature of director responsibility.[42]

IN A WAY, ECONOMIC LEGITIMACY (COMPETITIVENESS), AND POLITICAL LEGITIMACY (ACCOUNTABILITY) ARE TWO SIDES OF THE SAME THING. THE FOUNDATION OF OUR CONCEPT OF CORPORATIONS IS OUR BELIEF THAT BECAUSE SHAREHOLDERS CAN BE COUNTED ON TO REQUIRE THAT THEIR OWN LONG-TERM INTERESTS BE ACCOMMODATED, CORPORATIONS WILL BE DIRECTED ALONG THE LINES MOST BENEFICIAL TO SOCIETY. THIS ACCOUNTABILITY ALLOWS US TO GIVE CORPORATIONS ENORMOUS POWER TO MAKE DECISIONS THAT AFFECT EVERY ASPECT OF OUR LIVES.[43]

STAKEHOLDERS

Insiders, outsiders, shareholders, customers, interested parties in the community, or in the wider society, constitute an impressive variety of people with interests in the corporation. Collectively, they are called *stakeholders*, a term that acquired currency not so long ago in recognition of the need for people charged with governance to account not only to owners and on the financial performance, but to a multitude of institutions and individuals on an array of issues, both business and societal.

A list of stakeholders would include the following, each of whom would need to be informed on the performance of the company:

- management;
- board of directors;
- shareholders;
- lenders;
- regulators;
- customers;
- community.

To this list could be added the suppliers and other distinct sets of stakeholders, not least the government. The challenge for private corporations is to provide governance that is responsively accountable to all these stakeholders.

STAKEHOLDERS

ACCORDING TO DON MCGILLIVRAY, A NOTED ECONOMIC JOURNALIST, AND A STUDENT OF THE LANGUAGE AND THE EVOLUTION OF ITS USAGE, THE WORD *STAKEHOLDER* GOES BACK ABOUT 300 YEARS IN BRITAIN. THE STAKEHOLDER HELD THE STAKE, THE MONEY THAT TWO OTHER PEOPLE HAD WAGERED AGAINST EACH OTHER ON SOME EVENT WITH AN UNCERTAIN OUTCOME. HE WAS ENTRUSTED WITH THE MONEY THAT EVENTUALLY HAD TO BE TURNED OVER TO THE WINNER.[44] MORE RECENTLY, THE EXPRESSION ACQUIRED A NEW MEANING TO DESCRIBE A PERSON WITH A "STAKE," A PERSONAL INTEREST IN THE OUTCOME OF AN ACTIVITY OR IN AN INSTITUTION. ACCORDING TO A DIFFERENT EXPLANATION, THE WORD WAS BORROWED FROM A MORE RECENT USAGE IN RELATION TO METAL-MINING EXPLORATION: TO "STAKE A CLAIM" IS TO RECORD OFFICIALLY ONE'S INTEREST IN A PROSPECTIVE MINERAL FIND.

TORONTO STOCK EXCHANGE COMMITTEE ON CORPORATE GOVERNANCE

In 1993, the Toronto Stock Exchange (TSE) established a blue-ribbon Committee on Corporate Governance in Canada with a mandate to conduct a comprehensive study of corporate governance and to recommend improvements for the manner in which Canadian corporations are governed. The work of the committee focused on many of the matters discussed above, and more.

Five issues were prominent in the committee's research:

- the state of corporate governance in Canada;
- the duties of directors;
- the relationship between directors and management;
- the relationship between directors and shareholders; and
- enhancing board effectiveness.

In exploring these issues and related questions, the committee received submissions from participants in all aspects of corporate governance in Canada.

A set of proposed guidelines for improving corporate governance emerged from the research. The core of this guidance is the committee's view that "the board of directors of every corporation should explicitly assume responsibility for the stewardship of the corporation and, as part of the overall stewardship responsibility, should assume responsibility for the following matters:

- adoption of a strategic planning process
- identification of the principal risks of the corporation's business and ensuring the implementation of appropriate systems to manage these risks
- succession planning, including appointing, training and monitoring senior management
- a communications policy for the corporation, and
- integrity of the corporation's internal control and management information systems."[45]

To help increase effectiveness in fulfilling these five responsibilities, the committee made recommendations in relation to the board's constitution and to the governance-related functions carried out by the board. Among other matters dealt with are the relationship between the board and shareholders, with emphasis on the need for two-way communication, and the importance of the quality and timeliness of the information published by corporations.

Good governance — a common goal

The desire to improve governance structures and performance is clearly demonstrated in both the public and private sectors. The appendix to Part I illustrates how the government of Canada has attempted, over about a decade, to strengthen its governance and accountability practices. That experience is echoed in many other parts of the Canadian public sector. The initiative of the TSE described above shows how seriously the private sector treats the subject of corporate governance.

Although the specific approaches may vary, there is substantial commonality between that of the public and that of the private sector. The five areas for which the TSE committee recommends boards of directors assume responsibility tie in closely with the characteristics of good governance presented in Chapter 1. The following table illustrates this similarity.

	Characteristics of good governance	*…TSE director's responsibilities*
1	*Comprising people with the necessary knowledge, ability, and commitment to fulfill their responsibilities*	
2	*Understanding their purposes and whose interests they represent*	*…Appoint, train, monitor senior management,* *…Manage risk, and* *…Adopt strategic planning processes*
3	*Understanding the objectives and strategies of the organizations they govern*	
4	*Knowing and obtaining the information they require to exercise their responsibilities*	*…Monitor success in implementing strategic plan* *…Appoint, train, monitor senior management* *…Integrity of internal control and MIS*
5	*Once informed, being prepared to act to ensure that the organization's objectives are met and that performance is satisfactory*	
6	*Fulfilling their accountability obligations to those whose interests they represent by reporting on their organization's performance*	*…Communication policy with shareholders*

20 *The American Constitution*, 202.
21 No provincial legislature has a second chamber any longer; they are all unicameral. With that exception, these descriptions hold for the provinces as well as for the federal government.
22 Kingdom, *The Civil Service*, 35.
23 C.E.S. Franks, *The Parliament of Canada* (Toronto: University of Toronto Press, 1987), 35.
24 Interestingly, the 1993 Conservative leadership race had a candidate who suggested that the cabinet ought to be chosen by the Party Caucus.
25 Kingdom, *The Civil Service*, 41-42.
26 *Report of the Special Committee on Reform of the House of Commons*, James McGrath, P.C., M.P., Chairman, June 1985, 6.
27 Kingdom, *The Civil Service*, 41-42.
28 Canada Communications Group—Publishing, *The New Face of Government: A Guide to the New Federal Government Structure, 2nd ed.* (Ottawa: Canada Communications Group—Publishing, 1994), 126.
29 Ibid., 126.
30 Ibid.
31 Ibid., 45.
32 Franks, *Parliament*, 215.
33 Kingdom, *The Civil Service*, 46.
34 Patrick Boyer, M.P., "The Paradoxes of Representation," *The Hill Times*, 31 October 1991. In the same article, he cites Peter Dobell in a discussion paper—see next para.
35 Peter Dobell, ibid.
36 Boyer, ibid.
37 Lobbying acquired its name from the activity of certain persons in the lobby, which is the space in a legislative building, just outside the chamber, where the public has access to meet the legislators.
38 David H. Flaherty, "Who rules Canada?" *Daedalus, Journal of the American Academy of Arts and Sciences*, vol. 117, no. 4, 1988, 105.
39 Hon. Lloyd Axworthy, "The Federal System—An Uncertain Path," *Daedalus*, ibid., 150-151.
40 Toronto Stock Exchange Committee on Corporate Governance in Canada, *Where Were the Directors: Guidelines for Improved Corporate Governance in Canada* (Toronto: Toronto Stock Exchange, 1994), 7.
41 Arthur Fleisher, Jr., Geoffrey C. Hazard, Jr., Miriam Z. Clipper, *Board Games, The Changing Shape of Corporate Power* (Toronto: Little, Brown & Company (Canada), 1988), 11.
42 Ibid., *Board Games*, 12.
43 Robert A.G. Monks, Neil Minow, *Power and Accountability* (U.S.A.: Harper Collins, 1991), 17.
44 Don McGillivray, *The Ottawa Citizen*, 12 Dec. 1992, A-1.
45 Toronto Stock Exchange Committee, *Where Were the Directors?*, 4.

Chapter 3

The Language of Governance and Accountability

Vocabulary and terminology

The development of a vocabulary to convey the subtlety of a discipline is very much part of its maturing process. In the early stages of a discipline, familiar words serve as descriptors. As the discipline develops, particular meaning is attached to the words chosen. Later, as the need arises to introduce subtler nuances, other words, often close synonyms, are introduced. The development of the language of a discipline may be chaotic at first, but usually becomes orderly through usage. This process can be accelerated if a deliberate effort is made by the professional body to standardize terminology.

This chapter explores the meanings of words and expressions used in discussions about governance and accountability. It is hoped that this will contribute to a clearer understanding of the concepts involved.

Rules and discretion

The discussion of the two terms *rules* and *discretion* together is meant to illustrate a rarely debated issue concerning the principles underlying the conduct of government at the policy level. The question is whether policies ought to be promulgated as long-standing rules or simply adjusted as conditions change. The latter approach is called *discretionary policy.*

Rules can be used to justify action or to depoliticize difficult allocative choices.[46] Standardization is often cited as the reason for creating rules and enforcing them. Rules are also used to formalize or consolidate authority or a source of power.

Sometimes, government lacks the knowledge required to adhere successfully to a discretionary policy. This is particularly true in the management of the economy. Not being able to predict the course of the economy, or aspects of it, let alone to confidently anticipate the response to governmental policies, suggests that a flexible and timely intervention might actually be detrimental to the stability of the economy in the longer run.

The alternative is preset rules. The belief is that rules reduce risk of chaos and in a way offer a better climate of confidence in the future. Conformity, order—indeed predictability—bring a greater feeling of security, of a purpose pursued by a large segment of the population. To use the management of the economy as an example, pegging of the currency at a given rate of exchange, or ruling that the money supply will rise at a constant rate are preset rules.

Complicating the problem is a phenomenon called *inconsistency of time*—the passage of time between the taking of a decision and its implementation. What looked appropriate and optimal at the time of decision taking no longer is appropriate and optimal when put in practice. This phenomenon is often attributed to the gap between theory and practice; it is more that the decision was correct in practice at the time of its taking, but in the interim, new, unforeseen factors make it incorrect today.

In the absence of a solid commitment to the pursuit of the original plan, decision makers will modify policy to suit the new circumstances. Knowing this, the people affected may well anticipate what the authorities will do and may frustrate the policymakers' intended outcome. However, this too can be anticipated, and further adjustments made to reflect it. And on it goes, up to a point where it becomes very difficult to maintain the original goal or even retain credibility.

Hence the attraction of rules. The problem is that a rule, to resist the phenomenon of inconsistency of time, would have to be perfect, which obviously is not possible given the complexity and dynamics of society. The reality is that governments resort to both rules and discretion in policy-making and implementation in the hope of reducing inconsistency and maintaining credibility. If they cannot devise rules that they believe will be effective, they may well abandon the idea of a public intervention altogether.

From the point of view of accountability, inconsistency of time has to be well understood.[47] In politics, inconsistency of time is one of its greatest afflictions. Political promises at election time may be sincere but may later turn out to be impossible to honour or deemed to be against the interests of the population. Opposition parties may well understand the situation but choose to exploit it for partisan purposes. Trying to hold the government accountable for its promises becomes a favoured tactic of the opposition. Rendering an account against an original plan without taking into account changed circumstances, however, is not good accountability.

Discretion is used in decision making when situations are unclear, when goals pursued are contradictory, when the ends are understood but the means not known, generally speaking when situations and circumstances are so volatile that they require continual adaptation.

Discretion is best understood in the context of implementation of rules and policies already established. Discretion is usually dictated by the circumstances of decision making or the status of the person exercising discretion—*ministerial discretion* in immigration cases, for instance. Such cases can be politically delicate or morally difficult. They may present some serious dilemmas, as they often involve a clash of values and interests. There may be no precedents to help in finding a solution, nor guidelines to follow. There are no doubt some principles, but insufficient links to the situation at hand. The domain may be so complex as to prevent any routinization of decision making and require that each case be judged on its own merits.

When ministerial discretion is exercised, the resulting decision is either welcome, treated with indifference, or condemned; in the latter, it will be characterized as arbitrary, whether or not the minister agonized over the decision. There are indeed decisions that will appear arbitrary in character, but not necessarily whimsical; whoever has taken the decision assumes the responsibility of the decision. The question is then, does that person accept the responsibility for the consequences, personally? As a custom, and in logic, probably yes. Should that individual be sanctioned if he or she erred? Certainly not. He or she is only acting in accord with the responsibility delegated by the legislation and should be respected accordingly.

At the other extreme, some decisions defy routinization but are so inconsequential that they are left to the discretion of a manager. Thus, discretion can be exercised on the most intractable dilemmas or on the most trivial issues.

There are situations where a person is known to be so trustworthy that imposing external rules on his or her conduct is eschewed. Some church leaders are accorded such confidence. A different case is that of the referee, the arbiter, who for reasons of neutrality or independence has to exercise discretion in the application of the rules, sometimes with no recourse. If there is no recourse, it is by design, as the chain of events that may occur as a result of a successful recourse is deemed to be worse in consequence than whatever gave rise to the erroneous decision in the first place.

Discretionary powers

A good example of discretionary powers is one that describes certain relationships between one level of government and the junior level. One province—and this is likely to be the case in several others—has municipal affairs legislation that contains an article giving the minister "discretionary power" over the actions initiated by the municipalities, no matter if such actions have been democratically endorsed by the population immediately affected or not.[48]

A case in point was the fusion of police and fire-protection services of two neighbouring municipalities. The court ruled that the minister of municipal affairs could exercise discretionary power and turn down the merger proposal. The minister could have been concerned about the legality of the initiative, the integrity of the process, or for that matter, his view of the general interest of the population. Indeed, the minister may well deem that the interest of the population immediately affected is narrower than the general interest he or she feels mandated to protect. Thus, the authority and the responsibility are reasonably clear. Accountability is not so clear, however.

Bureaucratization

Bureaucratization replaces discretion; it sets up rules, regulations, and procedures to provide a means of controlling behaviour without having to be on the premises to give instructions. Bureaucratization is the process of forming a bureaucracy. A bureaucracy is a formal organizational arrangement characterized by a division of labour, job specialization with no functional overlap, exercise of authority through a vertical hierarchy or chain of command, and a system of internal rules, regulations, and record keeping.[49]

It is assumed that most of those working in a bureaucracy in a democracy are professionals in their specialities, and that their occupational loyalties rest with their organizations rather than with a political party or other external affiliation.[50]

Bureaucracy

Bureaucracy literally means rule by office, coming from the French word *bureau* meaning office and the Greek root *kratein*, to rule. *Bureau* derives from the same word for desk, originally a table covered with a cloth known as *burel*. "Rule by office" is how corporations work, and the image of the baize-covered table in the old government *bureau* now summons up most of all the image of the corporate boardroom.[51]

While most large private sector corporations would satisfy the above description, the term *bureaucracy* commonly connotes the administrative arm of government.

In some popular usage, bureaucracy is often synonymous with lethargy. However, in some cases, a bureaucracy may have been intended to be passive, simply executing decisions taken at the political level. A good example is what the framers of the U.S. Constitution intended: "They placed their faith in periodic elections, legislatures, and an elected Chief Executive rather than in a bureaucracy, however pure and efficient. There is nothing to suggest that they believed sound administration could compensate for bad political decisions. Redressing grievances and bad political decisions [was] the function of the political process, rather than of administrative machinery."[52]

The word *technocracy* is sometimes used to describe a bureaucracy. This is a term most often heard on the European continent. Strictly speaking, technocracy is government by experts, and its particular characteristics have an impact on accountability. In such a political arrangement, government officials (nonelected) write their own rules, inspired by internally generated principles, and oversee their application. What is called a bureaucracy in the British parliamentary system is different: it is the body of administration clearly under the control of Parliament and accountable to it.

The above definition is fairly descriptive of bureaucracies in the Canadian public sector. With respect to certain public institutions, however, the network of interdependences, interrelationships, and indeed loyalties within the bureaucracy tend to be markedly different. Hospitals are an example, universities are another. And a military organization would be quite different again.

A hospital is an umbrella organization for the coordinated and integrated exercise of several professions complementing one another with the same purpose in mind: to ensure the welfare of patients. The professions were there before the institutions. The professionals' first loyalty is to the patient, naturally; the second is to the profession itself; and the third is to the hospital. That should not be construed as disloyalty towards the last. Indeed, it is through their profession that the practitioners acquired their training, standards, ethics, networks, and ensured their renewal. As a result, accountability arrangements in a hospital are more difficult to determine than in a typical government department or a large corporation.

The most cherished value in a university is academic freedom. In the minds of many, the preservation of that essential freedom should not mean that universities ought not to demonstrate their accountability to the public or ought not work to strengthen their governance and management systems and practices. Universities, they think, need to recognize that "autonomy is to accountability what rights are to responsibilities."[53] But the accountability arrangements can be difficult if they lead to making the institution accountable. To whom should one be made procedurally accountable is even a more delicate problem.

In short, within the context of a health care institution, accountability is possible but it is naturally diffuse. In the context of an educational institution, accountability is possible, too, but naturally weak, given the particular societal constraint. In contrast to these two examples is a military organization, which requires a principle of authority called "unity of command"; that is, no one in a particular organization receives orders from more than one supervisor. This concept makes it possible to create a hierarchy with clear accountability relationships between units and capable of being aggregated at the institution level.

Independence

Independence is a term associated with such nouns as *neutrality, autonomy, objectivity*, as well as such adjectives as *separate, uncommitted, unallied*. Germane expressions include *self-reliance, self-control, non-partisanship*. Within a bureaucracy or in public administration in general, a person who has a status of independence is someone who is allowed to act free from authority or from the control and influence of others.

Independence

Independence is a word formed from the English prefix *in*, not, and the Latin *dependere*, "to hang, to be suspended." An independent person does not hang on or from any creed or cluster of political ideas.[54]

Realistically, no one can be completely independent. To achieve independence requires the confluence of various circumstances. First, there has to be an officially proclaimed status either for the function within the organization or for a particular position. Second, the persons in the function or occupying the position must be recognized as being capable of independent thinking and action by virtue of their knowledge, expertise, ethics, and professionalism.

As an illustration, the government of Canada's internal auditing standards begin with the notion that internal auditors should be independent of the activities they audit.[55] Internal auditors are required to be objective in performing audits, and the organizational status of the internal auditing group should permit the discharge of its audit responsibilities in that manner. Independence permits internal auditors to render impartial and unbiased judgments essential to the proper conduct of audits.

To achieve this degree of independence, the head of internal auditing should be responsible to an individual in the organization with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of audit reports, and appropriate action on audit recommendations. Direct communication with the head of the organization is also a requirement. Organizations, in both the private and public sectors, are in many instances creating audit committees at the highest corporate level to ensure more effective and independent audit activities, orient the work of the auditors, challenge their work, and lend support to internal audit activities.

Independence and Accountability

Governments in Canada at both the federal and provincial levels are usually thought of as bureaucracies organized into ministries, with ministers responsible for them. A less orderly arrangement typical of those governments takes the shape of so-called government agencies, boards, commissions, and administrative tribunals. They may exist to deliver services, often in a regulated form, but a large number of them are regulatory agencies. Some of them are simply advisory. For the most part, all of those agencies are designed to operate at arm's length, free of political interferences. They are said to be independent. The question is, how are they accountable?

In the late 1980s, the government of the Province of Ontario initiated a review under the direction of Robert Macauley, a former conservative cabinet minister, on the subject of government agencies, their number, their growth, and their importance in society. This led to the Macauley Report.[56] Macauley addressed the problem of independence as follows:

> The word 'independent' is the wrong word to describe the relationship which in fact, and in law, exists between an agency and the Government. The proper perspective is to understand that agencies operate at arm's length in their decision-making role, but are accountable to a particular Ministry and to the Legislature for their operations and policy functions.[57]

With a different point of view, in a report to the Canadian Bar Association, in 1990, Professor Edward Ratushny reiterated the importance of an agency's independence:

> While the principle of independence of the judiciary is well established in Canadian society, the principle of independence of administrative tribunals is in its infancy… The difficulty is that governments want to have it both ways. They want to establish tribunals to reach decisions outside government, yet at the same time they seek, in certain cases, to control those decisions, often behind the scenes… The 'bottom line' is that if Parliament creates an independent tribunal or agency, then it is incumbent upon the government to respect that independence.[58]

After placing his emphasis on independence, Ratushny added this caution:

> [T]he basic point is that the principle of independence does not relieve tribunals and agencies, or their members, of responsibility and an appropriate degree of accountability. What is improper is for accountability to be to government when it impinges upon their independent fact-finding, policy development or decision-making functions.[59]

The above quotations, as well as those that follow under this rubric, are part of an article on the debate of independence and accountability with respect to Ontario's agencies.[60] Donald C. MacDonald, chairman of the Ontario Commission on Electoral Finance, remarked on the difference between the view of the courts and that of the nonjudiciary: "There is a point where compromise is not possible if agencies are to remain the creation of the legislature, established for implementation of legislatively authorized policy and therefore dependent on the legislature." The Honourable Flora MacDonald had this to say regarding legislation on the Canadian Radio-television and Telecommunications Commission (CRTC):

> While conceding that regulatory agencies including the CRTC require considerable independence, reluctantly it is the government which must bear the responsibility for the actions of the CRTC. The CRTC's independence cannot be so great that it is accountable to no one.[61]

Rosalie Abella, then chair of the Ontario Labour Relations Board, commented as follows concerning the character of the relationship between agencies and the government and its bureaucracy:

> Ministers and bureaucrats find themselves in the most awkward position. Because we are quasi-judicials, they expect independence as the courts know it. Because we are policy instruments, governments too often expect us to be accountable for our decisions as either reflective or destructive of their policy objectives. But it must be clearly and forcefully understood that while governments have the right, through law and regulations, to design the framework policy, tribunals have the exclusive responsibility for interpreting the application of that policy in each case in accordance with their statutes… The bureaucracy thus, in our policy role, sees us closer to the government; the lawyers, in our legal decision-making role, see us closer to the courts. We are spiritually closer to both but, in fact, in character we are closer to and should be treated more like courts. The policy role gives us flexibility and wide discretion, but it does not make us a government department. We are meant to replace bureaucratic decision-making, not to provide a parallel route. And the legal role, while it gives us a duty to behave with procedural fairness and within our jurisdiction, does not oblige us to be procedural mimics of the courts.[62]

Donald C. MacDonald concludes: "The issue of independence and accountability is beset with tensions between the courts and the agencies, and between the government and their bureaucrats and the agencies. The challenge is to keep them in balance."[63]

Neutrality

Neutrality can be seen as an aspect of independence. In day-to-day parlance, neutrality means not taking sides. In the context of accountability, being neutral means that lines of investigation, information gathering, reaching conclusions, and presentation of results ought to be free of bias, personal and otherwise, and not intended to achieve some predetermined purpose or to reinforce a particular orthodoxy.[64] Neutrality is the ability to do the work expertly, and to do it according to explicit objective standards, free of personal, party or other obligations and loyalties.[65]

Political neutrality

Political neutrality describes the behaviour of public servants in their support of the government of the day and the people who were elected to lead it. It is "a feature of bureaucracy whereby it carries out directives of other institutions of government (such as the chief executive or the legislature), without acting as a political force in its own right; a traditional notion concerning bureaucratic behavior in Western governments."[66]

The concept goes back a long time and is still appropriate today. In the United Kingdom, political neutrality of the civil service became a requirement in 1855 when the Civil Service Commission was established. The United Kingdom's Civil Service Pay and Conditions of Service Code contains the following statement about civil servants and political activities:

> Civil servants owe their allegiance to the Crown. In its executive capacity, the authority of the Crown is exercised by the Government of the day. Civil servants are therefore required to discharge loyally the duties assigned to them by the Government of the day of whatever political persuasion. For the Civil Service to serve successive governments of different political complexions it is essential that ministers and the public should have confidence that civil servants' personal views do not cut across the discharge of their official duties.
>
> The intent of the rules governing political activities by civil servants is to allow them the greatest possible freedom to participate in public affairs without infringing these fundamental principles. The rules are concerned with political activities liable to give public expression to political views, rather than the privately held beliefs and opinions.[67]

It is the Minister's business to compass and imagine social amelioration, economic reforms, and diplomatic patterns. From the permanent staff we ask the critical mind which can distinguish causes and consequences, distant as well as immediate repercussions and relationships, and the determination of ways and means. This relationship… gives point… to the need for the anonymity of officials. Their views, their advice, are private; their actions are anonymous. Only the Minister has views and takes action. If this convention is not obeyed, then civil servants may be publicly attacked by one Party and praised by another, and that must lead to a weakening of the principle of impartiality.[68]

Many commentators think that unless the principle of impartiality, or neutrality, is maintained, ministers would be unable to rely on civil servants for frank and full advice. This notion is an important element in the argument for the merit principle in the public service.

Autonomy

Autonomy is a lesser form of independence, although it is often used to mean the same thing. It is the context that gives rise to its particular meaning. As a country, Canada is independent and sovereign. It is not autonomous. The provinces, however, are autonomous within Canada, but not independent. Similarly, Canada viewed as part of the Commonwealth is autonomous. Autonomy is the ability to be self-governing within a larger framework of governance. In a government setting, some boards with regulating powers (as the ones found in transportation, broadcasting, and so on) are said to be autonomous, not independent. Within government policy and legislation, such boards exercise their own judgment in rendering individual decisions.

SOVEREIGNTY

"WE, THE PEOPLE." THE PRINCIPLE IS THAT WE, THE PEOPLE, CREATE THE GOVERNMENT AND ONLY WE, THE PEOPLE, CAN IMPORTANTLY CHANGE IT.[69]

SUBSIDIARITY

Not far from the notion of autonomy is subsidiarity. Recently, the term has been used in continental Europe largely in relation to the Common Market, in response to the management philosophy given to devolution, deconcentration, decentralization, and delegation.

SUBSIDIARITY IS AN OLD CONCEPT, ARTICULATED BY ARISTOTLE THROUGH HIS PHILOSOPHY REGARDING THE NEED TO PLACE LIMITATIONS ON THE EXERCISE OF POWER, AS WELL AS IN THE THIRTEENTH CENTURY BY THOMAS AQUINAS WHO BELIEVED IN THE SELF-ESTEEM AND DIGNITY OF THE INDIVIDUAL. THE CONCEPT WAS CLARIFIED WITH THE ENTRENCHMENT OF THE BILL OF RIGHTS IN ENGLAND IN 1689: INDIVIDUALS ARE SOVEREIGN, AND ONLY WHEN THEY ARE INCAPABLE OF PROVIDING ESSENTIALS FOR THEMSELVES SHOULD THEY RESORT TO A COLLECTIVE ACTION AND HAVE THE COMMUNITY ASSUME THE RESPONSIBILITY ON THEIR BEHALF. THE BELIEF IS THAT DECISIONS MUST BE TAKEN AT THE LOWEST POSSIBLE LEVEL. ONE USAGE OF THE WORD IS TO DESCRIBE THE AGREEMENT BY WHICH EACH LEVEL OF GOVERNMENT ASSUMES RESPONSIBILITIES AND POSSIBLY IS GIVEN THE AUTHORITY IN AREAS WHERE IT IS MORE COMPETENT, OR WHERE, TO USE AN EXPRESSION FOUND IN ECONOMICS, IT HAS A COMPARATIVE ADVANTAGE.

The principle of subsidiarity is largely propagated to reassure member countries of the European Community (EC) that they ought not fear some bureaucratic monstrosity concentrated in the headquarters in Brussels. The concept is naturally defended and promoted by countries with a federal system, Germany, for instance.[70]

> The concept of federalism rests essentially on two principles called subsidiarity and non-subordination. According to the principle of subsidiarity, the central government should be entrusted with only those activities which cannot be managed fairly and effectively at the local level. According to the principle of non-subordination, neither of the two levels of government is subject to the authority of the other in the exercise of the sovereign powers granted by the Constitution. Hence the necessity of a mechanism of concerted action, harmonization, joint decision-making to manage the problems of interface between the two levels of government.[71]

STEWARDSHIP

The word *steward—a* person entrusted with a certain responsibility, usually material—preceded *stewardship.* To the accounting profession, stewardship is the obligation to report on safe custody or proper disposition of assets entrusted. The word is evocative not only of the nature of the trust but also the necessity to render an account.

The Auditor General of Canada, in his 1992 Report to the House of Commons, introduced the expression "global stewardship": "a regular accounting on the entire business of government…" to reflect the full range of departmental activities. He then identified three types of information of vital importance for maintaining the confidence of Parliament:

Stewardship information: comprises information on the broader duties and obligations to preserve, maintain, and foster the government enterprise, seen from a macro perspective. Reporting on stewardship by senior management of an organization means articulating its mission in a manner that enables it to determine its success.

Financial information: reflects all of a department's financial activities, even those that do not require parliamentary spending authority.

Operational information: includes more detailed information in a variety of areas and is clearly linked to the financial information. Both financial and operational information flow out of stewardship information.[72]

Reciprocal Responsibility

This term was used by President Bill Clinton during the election campaign to define the need to rebuild a sense of community as well as a sense of individual responsibility in recipients or beneficiaries of state social programs through public service.

Vicarious responsibility

We do not hear the term *vicarious responsibility* very often in public administration, but it has become a topic of interest in the health care system, particularly in hospitals. It is widely believed—and with considerable justification—that a hospital could be vicariously liable to a patient for the conduct of any staff member employed by the hospital. This should not be confused with the direct liability of the hospital, as the hospital itself may not have been negligent in its conduct, and may have exercised due care in all circumstances. Nevertheless, it assumes responsibility for the negligence of its employees. These notions will gradually find their ways into courts.

Management and administration

While as a word, *management* has enough currency to convey its meaning simply by utterance, when related to the word *administration,* in particular *public* administration, it loses some of its convenience to summarize what people do when they are in charge. In other words, management needs the context to reveal what it actually does. For instance, *public sector management* is not the same as managing the public service. Indeed, the term public sector management is sometimes used in lieu of *public administration*. To many, the former is deemed more encompassing than the latter. The higher echelons of many government and corporate hierarchies are referred to as the management category for purposes of classifying positions according to levels of responsibilities.

Manager and *administrator, management* and *administration,* are often used interchangeably. In Canada, it is becoming accepted usage that managers are expected to achieve the mission of their organization and deliver programs, and in the case of very senior managers, advise on policy objectives, while administrators, on a lower rung of the hierarchy, are to apply and execute the rules of the bureaucracy and maintain the capability of the entity to deliver the program. By the usual rules of semantics, public administration would logically be what public administrators do. In a generic conversation, this happens to be true. In narrower contexts, however, administrators are to be found under managers. Often, administrators are attached to managers, but in a subordinate role with a title such as administrative assistant instead of assistant manager, indicating that the incumbent is concerned with only one part of the manager's role. Simultaneously, however, in the United Kingdom, the administrative class is the highest echelon of the civil service.

The use of the word *manager* in the public sector is relatively recent. It was borrowed from the private sector, which used the word to give a title to those functions that were not backed up by a professional distinction, as is the case for the chief accountant, chief engineer, chief medical officer, and so on. That usage gave rise to the production manager, sales manager, marketing manager, office manager.

Administration is often used in the specific context of stewardship: "I administer the estate of so and so." *Administration* is also another word for *government,* often preferred to the latter, particularly in the United States where executive power is exercised by "the administration," which describes the political executive branch of government. The word can be used to embrace the permanent bureaucracy, as well.

Management and Leadership

The simplest meaning of *leadership* is "to have a following." This is not necessarily true of management, which to a large extent calls for obedience and compliance.

Management is the capacity to handle multiple problems, neutralize various constituencies and work within a budget. Leadership is essentially a moral act, not—as in most management—an essentially protective act. It is the assertion of a vision, not simply the exercise of style: the moral courage to assert a vision of the institution and the intellectual energy to make that vision compelling.

A. Bartlett Giametti, the late president of Yale University and commissioner of baseball, the author of that interesting distinction, made it in the context of the elimination of athletic programs in his university. He concluded the above observation by saying:

> "Ultimately, the administration's decision to cut athletic programs reflects an impoverished view of the university, one that confuses management with leadership."[73]

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47 The substance of this section has drawn on "Schools Brief, Rules v. Discretion," *The Economist*, 2 March 1991, 71.
48 See "Ryan remporte en appel sa bataille référendaire contre deux municipalités," *Le Devoir*, 3 November 1992, A-3.
49 George J. Gordon, *Public Administration in America*, 3d ed., (New York: St. Martin's Press, 1986), glossary.
50 Ibid., 6.
51 Herschel Hardin, in *The New Bureaucracy* (Toronto: McClelland & Stewart, 1991), 14.
52 Richard S. Page, "The Ideological-Philosophical Setting of American Public Administration," in *Public Administration in a Time of Turbulence*, Dwight Waldo, ed. (Scranton, Pa.: Chandler, 1971), 63.
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58 Edward Ratushny, "Report on the Independence of Federal Administrative Tribunals and Agencies," presented to the Canadian Bar Association, September 1990, 6-7.
59 Ibid., 79.
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62 Rosalie Abella, "Canadian Administrative Tribunals: Towards Judicialization or Dejudicialization," address delivered to the fourth annual conference of Canadian Administrative Tribunals, May 29-June1, 1988, published in *Canadian Journal of Administrative Law and Practice* no. 2 (1988-89), 6-8.
63 MacDonald, *Ontario agencies*, 359.
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65 Herbert Kaufman, "Emerging Conflicts in the Doctrines of Public Administration," in *American Political Science Review*, vol. 50, December 1956, p. 1960.
66 Gordon, *Public Administration*, 608.
67 Hennessy, *Whitehall*, 368.
68 Herman Finer, *The British Civil Service* (London: The Fabian Society and George Allen and Unwin, 1937), 190.
69 Dwight Waldo, *Public Administration*, 33. "We the people . . ." are the first three words of the Constitution of the United States of America.
70 Chantal Millon-Delsol review of *L'Etat Subsidiaire*, by Pierre Drouin, *Le Monde*, 22 February 1992; see also *Le Devoir*, 21 October 1992.
71 André Burelle, former constitutional aide to Prime Minister Pierre Elliott Trudeau, in an article in *Le Devoir*, 3 May 1993.
72 *Report of the Auditor General of Canada to the House of Commons, 1992*, 167-168.
73 A. Bartlett Giametti, as cited by Jean Edward Smith in an article, "Sound body, sound mind," *Globe and Mail*, January 22, 1993.

Section 2

Accountability–Issues & Practice

Chapter 4

The Meaning of Accountability

Accountability Defined

Accountability is the obligation to render an account for a responsibility conferred.[74]

Sometimes monitoring is associated with accountability while the responsibility is discharged, as well as the notion of rewards and sanctions in the discharge of such responsibility.

Accountability is also frequently linked with unfortunate outcomes: when things do not go well, the person responsible who refuses to take the blame is often criticized for not being accountable. Curiously, the person who takes credit for a good deed is not usually described as being accountable.

Accountability is generally considered to be a very positive democratic value; it has been viewed—in liberal societies, with a characteristic distrust of large concentrations of power—as an antidote, a countervailing power to the bureaucracy of governments and big business. And since the concept is used in a wide variety of organizations, the arrangements for achieving it vary depending on the circumstances.

Accountability—Many Contexts, Many Formulations

Many writers have explored this subject, and it is instructive to examine some of their thoughts. The following quotes illustrate the range of thought given to accountability:

> Accountability [is] an obligation on the part of an individual or group to reveal, to explain, and to justify the discharge of responsibilities whose origins may be political, constitutional, statutory, or contractual.[75]

Public accountability involves three interrelated groups: (a) the general public and particularly the recipients of public services who are interested in service providers being accountable to them; (b) political leaders and supervisors of service providers to be accountable for a mixture of public policy and private and parochial interests; and (c) the service providers themselves whose objectives and interests often differ from the first two.[76]

Accountability is the working principle of our parliamentary system and a process whose effective functioning is essential to our democratic government. The reality of that system is expressed through universal suffrage and popular representation in Parliament.[77]

Accountability is the essence of our democratic form of government. It is the liability assumed by all those who exercise authority to account for the manner in which they have fulfilled responsibilities entrusted to them, a liability ultimately to the Canadian people owed by Parliament, by the Government and, thus, every government department and agency.[78]

Nothing could be simpler than the theory of parliamentary accountability. Its essence is ministerial responsibility, which means that each minister is responsible to Parliament for the conduct of his Department. The act of every civil servant is by convention regarded as the act of his minister.[79]

Accountability involves an obligation to explain or justify specific actions. Stanyer has stressed that there is always a precise logical structure involving the form and substance of the account; the occasion in terms of time, place and audience; and the consequences. Such a logical structure attaches to the exercise of accountability in any context.[80]

When systems of accountability for public expenditures are being devised, three broad issues must be considered: (a) the type of accountability; (b) the techniques of measurement; and (c) the institutions to which account is rendered. This framework provides a helpful structure for organizing discussion although there are interactions. For example, the type of accountability may determine both techniques of measurement and audience.[81]

Accountability [is] a political principle according to which agencies or organizations, such as those in government, are subject to some form of external control, causing them to give a general accounting of and for their actions; an essential concept in democratic public administration.[82]

The basic underlying framework of accountability holds democracies together under the most difficult times… It gives people a fundamental faith in the integrity of their political institutions…[83]

[Police officers should remember that] being at the service of citizens, they are accountable to the people, through the intermediary of elected officials and politicians… this game of democracy… is essential if we do not want to run the police for the police… regenerating rapidly into a fascist state, creating a police state.[84]

To be effective, accountability in the sense that it has to do with information, the rendering of account, involves the answer to a few basic questions:

- *How do you ordain the rendering of account?*
- *Through what mechanism or protocol?*
- *Who has the right to demand the information?*
- *When, from whom, and about what?*

[A]ccountability is a synonym for responsibility. It is a type of relationship that comes to existence when an obligation is taken on by an individual (or corporate entity), such as the responsibility to assume a role or discharge a task.[85]

The concept of accountability is sometimes taken as merely another name for stewardship accounting… Stewardship is the obligation to report on safe custody or proper disposition of assets entrusted… The term accountability, in contrast, focuses attention on identification of those parties entitled to an accounting and the purposes for which they are presumed to use the accounting.[86]

The missing link all along has been effective accountability for the use of authorities for which people have been entrusted…as Public Service 2000 simplifies the Public Service's administration, and more and more stress is placed on results-oriented and client-sensitive culture, the importance of effective accountability is going to become correspondingly greater.[87]

Each manager will be expected to have an agreed statement of anticipated results and performance standards.[88]… Each level of management will be accountable for results achieved…[89]

Accountability is the obligation of a deputy minister to answer to a person or group for the exercise of responsibilities conferred on him or her by that person or group… Management responsibility is the requirement for deputy ministers to respond to the concerns of individuals or groups within the overall context of their accountability obligations… Answerability is the obligation of deputy ministers to provide information and explanations to Parliament on behalf of their ministers and the government.[90]

Individual versus Institutional Accountability

Some people argue that it is the institution as a whole that should be held responsible, not the individual. Conventional wisdom has it, however, that in the final analysis only individuals can be made responsible and accountable because only they are entrusted with specific responsibilities. If an institution is not as accountable as it should be, it is because the individual or individuals in charge prevent it from being so. That debate has never been entirely resolved in a convincing manner because the issue is usually posed in the form of a dilemma.

The following definition, formulated by Paul C. Light, a prominent scholar, has enjoyed currency over the years—and still does, particularly in the United States:

> Despite experiments with performance incentives, such as merit pay, and occasional investments in civil service reforms, the definition of accountability in government has remained relatively constant over the past fifty years: limit bureaucratic discretion through compliance with tightly drawn rules and regulations.[91]

This definition emphasizes the constraints imposed on people in a position of public trust and may well help promote a healthy responsible attitude, but it does not make explicit the obligation to render an account. What makes this definition appear old-fashioned is its emphasis on governing and managing according to rules, honesty, and with a minimum of waste. In the words of Professor Light, it is a command-and-control approach to public administration, possibly in conflict with currently fashionable values such as initiative, creativity, innovation, and the taking of risks. Light also cites two other short definitions of James Fesler and Donald Kettl, the result of dividing accountability into two dimensions:

> One is accountability; faithful obedience to the law, to higher officials' directions, and to standards of efficiency and economy.
>
> The other is ethical behavior: adherence to moral standards and avoidance even of the appearance of unethical actions.[92]

The following definition also does not make explicit the need to render an account and seems to be the product of different values. It introduces the notion of punishment, which serves as a constant reminder for the need to behave responsibly and honestly. Most cultures use reward and punishment as strong motivators to guide action:

> [Accountability] is found where rulers readily delegate authority, where subordinates

Curiously, some time ago, an international conflict led to a retaliation of one country against another. The initiative was called "Operation Accountability." It is not known why the name was chosen; one can only speculate. The word *accountability* has a certain aura of legitimacy, of duty. The launching of the retaliation—justified or not—may have come from a felt obligation to act or an attitude to that effect. Or it may have been directed at the enemy, "now is the time to account," "bring to account," or to "settle an account," hence giving accountability a punitive meaning: "Those who take up arms against us must pay the price for their impudence," as someone said. One can speculate that Operation Accountability was the translation of something closer to "reckoning" or "comeuppance."

confidently exercise their discretion, where the abuse of power is given its proper name, and is properly punished under a rule of law which stands above political faction.[93]

Still another definition links accountability to performance directly, in the sense of results and effectiveness; it does not mention the resort to sanctions to promote accountability, and it has an interesting leading observation:

> In the vocabulary of management, people "accountability" threatens to become one of those buzz words that can take on whatever meaning a speaker or writer wishes to convey without strictly committing himself. Nevertheless, when expressed with care and precision, accountability is an invaluable concept for focusing organizations and individuals directly on established goals and objectives.
>
> Accountability includes mission statements, responsibility assignments, results measurements, reporting, and evaluation. It promotes disciplined use of management by objectives and other executive tools. It has impact from the top level of an organization to the lowest managerial rung…
>
> Accountable organizations and persons know their purposes and responsibilities and are able to differentiate between essentials and nonessentials. Accountability means being responsible for and responsive to acts and results that relate to the mission. To attain results is to realize the mission, or objectives, of the organization.[94]

The above quotes define accountability and, in most cases, set out its boundaries. Let us add one more illustration, which served as the inspiration for the short definition that appears at the beginning of this chapter. The Report of the Independent Review Committee on the Office of the Auditor General of Canada (Wilson Committee) defined accountability as :

> [T]he 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.[95]

The Wilson definition—or the meaning it generally conveys—has gained wide acceptance in the last decade and is the one this book follows.

The root of accountability

In the definitions given above there are three separate but related notions: responsibility, accountability, answerability. These words, particularly *responsibility* and *accountability*, are often used interchangeably. They nevertheless convey different meanings.[96]

As a word in our day-to-day work, accountability has gained currency only recently in spite of the fact that the term is old and the notion biblical. "What have you done with your talents?"—a question, according to the apostles, that will be asked of all mortals by St. Peter, is a very early indication of the need to provide accountability for one's actions.

In trying to understand these different terms, it is easiest to distinguish between them on the basis of attitudes. Feeling responsible is the primary notion. It starts with the sense that you owe it to yourself to discharge your role according to expectations. Failing this, feeling responsible means that at least you owe it to those who have assigned you your role to act according to their expectations.

The notion of responsibility is as old as the concepts of power, authority, and freedom, and acquires meaning only when viewed in the context of those concepts. In the absence of power, authority, or freedom of action, feeling responsible is not possible, nor even necessary. It is a counterpart to freedom or counterweight to power. There are no particular rules or laws to impose a sense of responsibility. Instead, it emerges from individuals according to their culture, beliefs, and values—in short, their humanity—and in line with the power or authority they have been given.

The sense of responsibility is not equally developed in everyone. Basic urges—for love, revenge, justice and glory, food, shelter and clothing, success and security—all wrestle for satisfaction within the human heart. Self-interest is mitigated by a recognized need to benefit from the "common good," the advantages that come from being a part of an ordered society. The aggregation, or the netting out of all these primary urges within each of us—some noble, some less noble—defines our character. It takes a certain amount of civilized maturity to acquire and maintain a sense of responsibility. It is largely inherited or developed from one's culture and upbringing. It is inevitable that some people are more responsible than others.

Being accountable starts with an attitude. Becoming accountable is a natural extension of feeling responsible by formalizing the notion into a procedure. This technical modification, the act of accountability, constitutes the fundamental acknowledgement of responsibility. You feel that you have to render an account to someone in particular on the responsibilities conferred; you are in a situation of accountability.

This attitude needs a conducive environment to flourish. The person conferring the responsibility has to expect accountability; the person who has been given the responsibility must be prepared to render an account.

The philosophy [underlying accountability, management representations, and audit]… is an important one and bears repeating. It places upon management the responsibility, and hence the accountability, for its actions. It implies a level of trust between management and the governing bodies. And ultimately, it boils down to a sense of values that requires management to internalize a sense of accountability. Without the integration of this value system, all the systems and practices in the world will not be sufficient to protect the investment of public funds.[97]

A situation of accountability is generated each time a rendering of account is demanded or volunteered. That rendering of account, even if it occurs only occasionally, establishes the accountability relationship.

The central feature of a democratic government is holding elected representatives to account for their actions. This constitutes a highly visible accountability situation. Modern governments are supported by bureaucracies staffed with nonelected personnel entrusted with the substantial responsibility of administration. The requirement for accountability on the part of the bureaucracy is as vital as for elected politicians, but, because of the relative anonymity of bureaucrats, its fulfillment is less visible and more difficult to ensure.

Professor C.E.S. Franks, a noted political scientist, makes an interesting distinction between the concepts of objective accountability and subjective accountability:

In objective accountability, someone is responsible *for* something and accountable *to* some person or body in a formal way, through clearly defined rules and mechanisms.

In subjective accountability, a person feels a duty towards the profession of public service or a sense of the public good and the nation which determines and defines conduct even though there are no formal mechanisms through which this accountability can be enforced.[98]

The use of the word *answerable* in the literature of public administration is even more recent than the use of *accountability* and is probably found less frequently. Often it is a synonym for *accountable.* Elsewhere it describes the onus on senior public servants to answer questions by legislative committees while not being accountable to them.

Some Historical Notes

Some believe that responsibility and its formalization into accountability originated with the creation of modern states. The Magna Carta issued in 1215 by King John of England under pressure from the feudal barons was a charter of liberties. It was intended to prevent the king from using his royal prerogative arbitrarily to increase feudal dues. Exacting accountability from the king by his subjects was an attempt to instill a sense of responsibility. It is obvious that King John did not have it in him as he soon repudiated the charter. His successor, Henry III, had a more noble disposition and reissued the charter in 1216. Other kings reconfirmed the charter in subsequent reigns. Interestingly, the concept of taxation without representation introduced in the seventeenth century was read as an interpretation of the Magna Carta.

Before the Glorious Revolution of 1688, which led to the Bill of Rights of 1689, the interpretation of the monarchy as a divine right took precedence over the authority of the Parliament. This meant that the monarch felt responsible but only to God from whom he had received his authority. As a matter of fact, the earlier challenge of the barony and churchmen in the thirteenth century had to do with replacing a divine right with a constitutional and later a parliamentary monarchy.

Closer to home, Melancton Smith, a prominent New York City merchant and an anti-federalist, sided with the proposed U.S. Constitution, inasmuch as the money put in the hands of government had to be accounted for. This occurred in 1788, at the New York Ratifying Convention.

In Canada, there is not much evidence of parliamentarians debating the specific subject of responsibility and accountability per se until introduced in a House of Commons debate on March 22, 1921, regarding Canadian National Railways (CNR). It was in the early sixties at the time of the Glassco Commission that accountability as a precise topic was really discussed in a deliberate and orderly fashion.

More historical material can be found in the literature of public administration, however scant it may be. For instance, Dwight Waldo, a prominent public administration scholar in the United States, had an article in the proceedings[99] of a seminar organized by l'Ecole nationale d'administration publique. He explores the historical development of the notion of accountability going back 6,000 years! He does it by developing several "numbered points" with no attempt, for lack of space, to connect them. Here is the gist:

1) When government, the state, appeared as a central part of the human story 6,000 years ago, accounting as a concept and process became an integral part of it, for example, the taxing-fiscal-economic management apparatus part of it. Written language and mathematics are closely connected with this accountability. *Statistics* has as its root the word *state.*

2) The monarchical states are indebted to the Christian feudal millennium (Middle Ages). Then there is the spell of Rome: "The King is emperor on his own realm." The Romans developed accountability devices

woven into the Roman law. The Continental legal system, above all the administrative law code and courts, reflect this background.

3) In the modern period, private business enterprises and capitalism emerge as a significant factor in the development of concepts and devices of accountability. Without capitalism, the accounting profession would not have risen as it did.

4) The hierarchical dimension is an integral part of government organization. Historically, government and religion, state and church, were one: authority came from above. But in modern times, authority comes from below with the rise of democracy. Authority and legitimacy in democratic regimes are conceived as rising from the people. Rulers, those nominally at the top of government, are deemed to be accountable to the people, at least to the electors. And the people, acting on the theory of popular sovereignty, may feel free to enforce accountability not only indirectly via the rulers and the hierarchical chain but directly through various arrangements (for instance, elected judges and outside audits) that create a direct A-B-C pattern, or cutting through the hierarchical chain.

Demonstrating accountability

Those who feel accountable and answerable will want to demonstrate their accountability. They will try to provide information about how they have been successful in discharging their responsibilities. Given the varied interpretations of what performance means and the difficulty of assembling credible indicators to substantiate it, such a demonstration can be very difficult.

While objectivity can be vigorously pursued, value-laden opinions will inevitably be part of the assessment of performance. This assessment will involve the weighting of multiple, often competing and sometimes contradictory objectives and measures.[100] Most people have some criteria with which to gauge the success of an undertaking, and such criteria may vary over time and with changing circumstances. They also vary according to the point of view of the person assessing performance. Hence, demonstrating accountability can be a very difficult, but not impossible, task.

External inducement for accountability

Accountability often does not come easily; not everybody has the proper attitude, or a natural disposition reinforced by a strong set of personal values or ethics. Sometimes accountability is legislated, and sometimes it is promulgated as an institutional value and becomes a managerial policy. Often, accountability remains merely an exhortation.

Where there is an insufficient natural disposition for accountability, for assumption of responsibility, or for a rendering of account, an external pressure becomes necessary. It may take the form of legislation that is quite specific. Or it may be a social pressure, quite general and ill-focused. Sometimes, the pressure takes the form of rewards and punishment. There is a widespread belief that such a regime is sound and appropriate and that many people humanely react to it. Nevertheless, it has limitations.

Rewards and punishments

"The impulses to praise what is noble and to punish what is depraved are fundamental to human experience."[101] This observation is readily understood but conceals a long-standing debate among philosophers and ideologists. One view has it that punishment is needed, if only to underline the significance of praise. Another view looks at punishment as retribution, or retributive justice: you get what you deserve. A third view is that a sanction should not be imposed as a retribution but as a deterrent designed to prevent harm to others or to ensure future social cooperation. Much of the debate focuses on the relationship between crime and punishment, and on that score is not so relevant to bureaucratic behaviour that is more afflicted by negligence, ineptitude, lack of proper motivations, misguided beliefs, or simple bungling. Nevertheless, several elements of the debate regarding the notion of rewards and punishment are relevant in a bureaucratic environment.

Depending on people's cultural backgrounds and the values that inspire them, reactions to external inducement vary. First, for those who are *naturally* disposed to volunteer a rendering of account, an encouragement through rewards and punishment should theoretically be indifferent. When situations are not perceived as fair, however, people with a noble disposition may well modify their attitude. Among those who are not prepared to be accountable unless coerced, the tendency will be to assess the trade-off between reward and no reward, punishment and no punishment and, indeed, reward against punishment.

In many large institutions, particularly public institutions such as government departments, rewards are difficult to arrange; often they are largely symbolic or honorific, not tangible. The reason is that there are usually many people involved in decision making and administering a program, and it is difficult to pinpoint where to place the credit for good performance.

Similarly, the creation of a system of punishment can be as difficult—particularly when it comes to identifying the nature of the sanction and targeting the individual to be punished—owing to the diffusion of responsibility characteristic of a large bureaucracy. The risk of attributing errors to the wrong person is considerable. In addition, where "no one is really responsible, but everybody is," the individual's complicity in collective disrespect is less deserving of punishment than in situations where each individual's responsibilities and failure to assume them can be clearly identified.

The process of rewarding and punishing has to be visibly and convincingly fair and not used to achieve other purposes. In cases where there is already an excellent climate of accountability, creating a regime of rewards and punishments can be seen as insensitive and misplaced. Somehow, rewards and punishments do not promote transparency; institutional and personal values do, and transparency leads naturally to greater accountability.

Thus, while a regime of reward and punishment is intuitively appealing, on practical grounds it is difficult to make it an effective incentive for individual accountability.

Sanctions without rewards

It is possible to envision a regime under which punishments overshadow rewards. This may occur where, although sanctions are clear, rewards are not deemed important or appear to be unfairly granted. Rendering an account under such a regime may suffer from lack of comprehensiveness, pertinence, honesty, candor; moreover, it could be done to cloak rather than inform, even to deceive. Whatever truth remains risks being obfuscated. Thus, a system of rewards and punishments will not be successful if employees consider that the latter overshadows the former.

Promise of No Sanctions

In some institutions, volunteering information that may reflect badly on the person taking action is protected by a promise of *no sanction*. The principle is that no harm will accrue to the person who has volunteered information. The belief is that reporting has to be made a comfortable process to ensure a constant stream of important information.

This approach is often used in program areas in which safety of people and material is regarded as absolutely vital. Examples are the requirement for pilots to report any incidents and occurrences,[102] and for hospitals to be told of all pharmacological errors. In such cases, there is no reward, nor is there a punishment, following the report. This allows for one's individual sense of responsibility to be more deeply felt and expressed. Where the mistake could have been avoided, the resulting feeling of guilt becomes, in a way, the sanction. The external control has been replaced by a personal value.

Sanctions are sometimes viewed as inappropriate in promoting good behaviour. It is often seen as a juvenile approach to behaviour or rather not quite effective with adults. That does not mean that the opposite—rewards—is viewed in the same negative manner.

Legislating accountability

The situation is paradoxical. While accountability starts as an attitude or a penchant, the fact remains that in most instances accountability has to be exacted, extracted, legislated; it is rarely volunteered.

> [I]f we really want to see accountability delivered on in the next decade in the public sector, we must recognize that good accountability will not happen by itself. We have reached a different stage of evolution that makes it reasonable to shape accountability regimes in legislation in ways that have not been done in the past.[103]

> Not surprisingly, no one… embraces accountability voluntarily. None of us like having to account to others and it takes a certain amount of reflection about the nature of the systems that we operate in to acknowledge that a measure of accountability is warranted.[104]

One argument against legislating accountability comes from the belief that most people do not react positively to commands, which is what laws turn out to be. They react better to inducements, benefits, privileges. Moreover, the uneven enforcement of a law is not much better than unconvincing inducements. An excessive number of laws, rules, and regulations augments the risk of their not being adhered to and runs the risk of breeding cynicism towards the lawmakers.

The argument in favor of legislation is usually the guarantee that everybody will be treated evenly. Legislation concerning accountability is designed not just to ensure that the reluctant become compliant, but also to demonstrate to everyone the solid and ethical intention of the government and legislators, and to provide an objective and reasonable basis for dealing with mal- and nonfeasance. Legislating or establishing rules on accountability clarifies the accountability relationships and is a normal feature of public administration.

In the view of many people, a positive disposition towards accountability must precede legislation. Elected people have to be sufficiently convinced to demand it from administration and become more fully accountable to their constituents. Managers also need to be convinced that whatever they do in relation to reporting performance will be used constructively.

The Friedrich-Finer Dispute:

(subjective accountability versus objective accountability)

A debate took place more than fifty years ago between two prominent political scientists, Carl J. Friedrich and Herman Finer.[105] Carl Friedrich argued that administrators, if they have the technical knowledge and a good grasp of what is expected from the population being served, will naturally feel responsible and act accordingly. This attitude will be reinforced by loyalty to one's own standards, particularly if he or she was in the professions. Herman Finer did not have the same confidence in human beings. He thought that sooner or later the absence of external punitive controls would lead to abuse of power.

The debate was really over whether a sense of responsibility—and by extension, of accountability—can be achieved by relying on the moral sense of the individual administrator (or by resorting to internal checks only) or whether it requires some external political checks.

Friedrich believed that public service was a profession that would define its own standards and accountability. As a moral person, the administrator would have proper regard for existing preferences and standards or expectations of the community being served. Finer, on the other hand, thought that responsibility and accountability ought to be formal and direct to elected officials, to the legislature, and ultimately to the electorate.

Friedrich and Finer did not put forward their points of view as absolute; they recognized that a combination of the two approaches was needed. Experience indicates that this is right; one approach needs to be balanced by the other.

In other words, relying on a system of external checks, rewards, and punishments would, to some, be reassuring, although that system would need to be so complex as to be unwieldy. The essential point is that while mechanisms and procedures be positioned to ensure that public servants act responsibly, the ultimate safeguard is in the character and inclinations of bureaucrats.[106]

Assistant Auditor General of British Columbia, Peter Gregory, maintains:

> Once the concept of accountability is accepted, the message should be translated into legislation not as a means of coercion, but for the benefits that using legislation will bring. And I think there are several benefits.
>
> One is that everybody starts at the same time. At present, there are many that would be willing to provide accountability, however they are not prepared to be the first thereby violating a fundamental rule in the bureaucracy.
>
> The second benefit is that it promotes a consistent approach. Legislation would set parameters that would ensure that all entities are subject to the same level of accountability. The more it is left to individual choice, the more likely that poor performers will find ways to evade the accountability net.
>
> Another benefit is endurance. Legislation is hard to change; also, it is more likely to survive changes of political masters.
>
> And lastly, I think public debate itself is a benefit. By involving the Legislative Assembly in the process, a better understanding by other parties would result and the public would be well served as well.[107]

Regardless of legislation, however, true accountability requires the development of a personal culture of accountability and a strongly felt desire to have transparency in processes and activities.

United States Government Performance and Results Act

A clear example of a legislated accountability regime is the United States Government Performance and Results Act (GPRA), passed in 1993.

Described as "landmark legislation [that] seeks to fundamentally change the focus of federal management and accountability… the GPRA establishes a legislative framework for having agencies set strategic goals, measure performance, and report on the degree to which goals were met."[108] Dozens of pilot projects were under way in 1995. By 1997, agencies are to submit a strategic plan to the Office of Management and Budget (OMB) and to Congress. Beginning in fiscal year 1999, each agency is to submit to OMB an annual program performance plan. By March 31, 2000, each agency is to submit an annual program performance report to the president and Congress, covering the previous fiscal year. This report will discuss performance achieved against goals identified in the annual performance plan, and actions needed to address performance shortfalls.

While discussion about the GPRA points to the value of having statutory planning and reporting requirements as a basis for encouraging commitment and promoting continuity, it is also recognized that legislation alone cannot make it happen. Developing and sustaining top management commitment, building capacity, creating incentives, integrating GPRA activities into ongoing operations, and enhancing congressional oversight are all seen as key challenges.

The environment for accountability

A number of factors must be present for accountability to be effective; it has to rest on a solid psychological foundation. In proximity to accountability reside ethics, morality, and codes of conduct, all serving to compensate for obscure accountability links or to reinforce them. Like accountability, ethics starts as an attitude, a penchant. Fully informed and morally fit people are able to make highly defensible decisions and naturally feel responsible and are accountable.

> **Accountability does not just happen—appropriate conceptual frameworks and mechanisms need to be developed and put in place. It is not something that "trickles up" to the Board—it needs to be led, insisted upon and carefully nurtured by the Board and equally supported by hospital management and professionals.[109]**

Having a proper attitude, a healthy disposition towards accountability is not sufficient. It requires a technical structure, one that is organizationally sound.

In addition, the circumstances around an accountability event (for instance, the consideration of accountability reports by a governing body)—the timeliness, the place, the degree of commitment to the notion of accountability, the time allowed—must be conducive to the effective exercise of an oversight role. There has to be an opportunity to challenge, to develop facts or arguments. Over time, the failure of governing bodies to exact proper accountability, or appropriately to consider fairly, if at all, accountability reports rendered to them, will turn a responsible attitude into indifference. Eventually, indifferent people will cease being accountable, to the detriment of everyone.

> **Few would dispute that we now live in conditions in which it is difficult to say precisely what we mean in practice by accountability in administration, and even more difficult to assert with confidence that we know how to enforce it.[110]**

The institutional ethos is extremely important. It may come with tradition, which in turn may be reinforced by a good set of values, particularly a strong sense of ethics among leaders who will act in an accountable fashion even if not specifically called upon to render an account. Such public service values in those who possess them are often viewed as superior to formal structures in the promotion of accountability.

Inappropriate attitudes

Sometimes accountability is simply not demanded by the governing bodies that are supposed to expect it. Even worse, in some cases, people who are publicly accountable count on their subordinates to ensure that as little as possible rendering of account is offered, to shield them from their own accountability obligations.

A further example of a distorted view is the sincere belief held by some that, once entrusted with a responsibility, they should be exempted from having to render an account. They should be trusted implicitly to do the right thing, to act responsibly; otherwise, why would they be made responsible? they ask. These views are not only held by certain people in responsible positions who believe in their own trustworthiness, but also by some who are affected by their actions and would consider it inappropriate or disrespectful to demand an account from such obviously honest and capable individuals. It is not that these people do not act as responsibly as they would if they were accountable, it is simply that their sense of responsibility does not extend to accountability.

In some cases, people entrusted with a responsibility believe that to be in an accountability arrangement with the person or governing body that gave them legitimacy is an inferior position, a servant/master relationship, a state of dependence. They are not comfortable with the notion of rendering an account. It is unfortunate that the concept of accountability lends itself to that interpretation. In reality, accountability is the recognition of the interdependence among the several agents, not of dependence in the bureaucratic or hierarchical sense of the word.

Inappropriate accountability arrangements

Something is happening to a natural disposition towards accountability if in actual practice the notion is eschewed. The problem is most likely to be found in the leadership, in the governance.

Poor accountability may result where arrangements for it are so complicated and so burdensome that they discourage the best-intentioned people. There are also cases where accountability arrangements and formal systems have been put in place that are too diffuse to be truly useful. Sometimes, the structure of an organization does not provide a natural conduit for accountability; the accountability links are unclear because actual accountability relationships are not overlaid on the organization chart. For instance, there have been cases where an organization has had a number of relatively narrowly defined programs, each with a strict vertical chain of command. As a result, integrated decision making can only take place at the apex, and therefore there is little overall corporate accountability; there is no provision for accountability for the coordination of delivery of its various programs in the field.[111]

Some large organizations rely on a teamwork approach. If the team leader has little or no say in selecting and keeping team members, handing out tasks, getting appropriate resources and necessary collaboration, he or she cannot be held accountable. Accountability in an organization or a team can be achieved only by clarifying and rationalizing the responsibilities and authorities of the leader and all subordinates so that together they can deliver on their promises.

Autonomy and accountability

Certain institutional arrangements, particularly in government, have conferred a status of independence or autonomy to particular agencies that have to be managed free of political interference, or dealt with at arm's length, given the politically sensitive nature of their activities. There are many such agencies: the central banking authority, the state broadcasting system, grant-giving agencies in support of culture and science, regulatory and quasi-judicial agencies, and so on. They are placed at a deliberate distance from the very body—Parliament or the government—that created them. This autonomous status should not exempt them from being accountable, although some would argue that to make them directly accountable to the body that created them is to invite interference.

Autonomy versus Accountability: An Illustration

An outcome of the Diefenbaker government's conflict in 1961 with James Coyne, the governor of the Bank of Canada, over policy differences was a procedure by which the governor would maintain his independence in controlling monetary policy. If, however, the minister of finance did not agree with the manner in which the governor was exercising his authority, he could send him a letter or issue a policy directive. Two governors since then have said they would resign if they received such a letter. The negative consequences with respect to the money markets are highly predictable. Would the government ignore such consequences? Probably not. And because of that, it would not send the letter. Could it wait until the seven-year term expires? Yes, probably, particularly if the governor is nearing the end of his term. But not reappointing a governor who is ready to undertake a second term would likely send the same kind of signals in the money markets, with the same consequences, so the conventional wisdom goes.

Irrespective of the individuals concerned, the technical structure for accountability is somewhat cumbersome, to say the least. The Governor is independent, as he should be. But that may be interpreted as making him unaccountable to anyone, save to himself. He will say that he is acting responsibly as he has a moral obligation to act according to the dictates of his conscience. He may add that he has a board to which he is accountable. Thus, one could say it is the Bank of Canada as a whole that wields all this power. This is probably true but not useful, as it ignores the impact of the traditional manner in which the central bank governor personifies not only the institution but his policies, as well. Whatever is done to the incumbent is done to his policies, hence his tremendous power. At times when monetary policy is the only instrument of economic policy being pursued, as has been the case at times, the most important person in Canada affecting the daily life and future of all Canadians in some unmistakable fashions, as it turns out, is not an elected representative. According to some critics, since he has to remain independent of those who are the elected representatives, that makes him unaccountable, period. His power is absolute. The governor, however, might see it differently.

Dimensions of accountability

In the literature of public administration, one finds many attempts by different authors to recognize a variety of accountability relationships or simply to pinpoint the locus of responsibilities. The following classification, more or less modified to suit the particular needs of these authors, has appeared recently in numerous articles or studies. Some of the issues surrounding certain types of accountability receive more elaborate treatment in subsequent chapters. Meanwhile, the following acquaints the reader with the essence of these accountability distinctions.

Internal and external accountability

Internal: a rendering of account from the lowest echelons to the top, in a hierarchy. Objectives are defined at the top and transmitted to lower levels for execution. Authority is delegated accordingly, followed later by the rendering of account and possibly the application of a reward system. Within a government structure, for instance, the rendering of account would take place at successive echelons up to the deputy minister. In turn, the latter would be accountable to the minister responsible for that particular department. Generally, this internal accountability is not public; it remains within management.

External: a rendering of account by management to their governing bodies. This rendering of account is public when it takes place, for instance, at the assembly of the people's representatives, the elected body, or when it is directed at stakeholders.

Political accountability

Constitutional: the accountability of the government to Parliament, the so-called ministerial responsibility, is said to be a constitutional requirement.

Decentralized: the establishment of local authorities, regional boards as a response to the overload in a central or a provincial government engenders a dispersion of accountability and possible conflicts between the centre and the locality.

Consultative: representative democracy is supplemented by participatory democracy. Elected representatives feel obligated to consult the population; they have a close rapport with special interest groups and even feel a certain accountability to them. Such groups operate outside the electoral process and are not necessarily representative of the broad constituency they claim to represent. The accountability relationships are not very clear in such circumstances.

Managerial accountability

Commercial: when government services are financed by user fees rather than by budget appropriation, they may be judged as much, if not more, on their commercial performance as on the attainment of their public policy purposes. The framework of accountability of many Crown corporations or state enterprises would assume this character.

Resource: accountability for resources is typically indicated for nonmarket provision of services. Budget-control frameworks must ensure efficiency and be capable of evaluating management performance. Resource accountability can be divided into:

- financial-management accountability framework;
- human-resources accountability framework; and
- assets-management accountability framework.

The human-resources component within the context of an administration at the service of a representative government takes on a special dimension. Merit is the principle of competence, and the so-called merit system characteristic of our public service has some definite implications on accountability for human resources.

Professional: the allocation of resources in a public institution is often largely influenced, when not decided, by professionals who owe their standards to a self-regulating body. In the name of professional freedom, they appear to operate largely outside the democratic control, although they do owe to the legislator the right to exercise their profession.

Legal accountability

Judicial: the government allows reviews of public servants' actions through judicial review of cases brought by aggrieved citizens (in the Federal Court of Canada, for instance).

Quasi-judicial: largely in the form of recourse with respect to application of the law where a great deal of administrative discretion is prevalent because of the necessity to operate at arm's length from politics. A specialized tribunal like the Tax Court of Canada is an example of an entity operating within a quasi-judicial framework of accountability.

Regulatory: some regulatory agencies (the CRTC, for example) operate with a large degree of independence, applying broad legislative mandates affecting the individual interests of citizens by rendering administrative decisions free of political interference. This is possibly one of the most complex accountability situations.

Procedural and consequential accountability[112]

Procedural: in the sense that if all the requirements with regards to inputs are satisfied, the output, or the intended outcomes or results are deemed assured. Emphasis is on the management procedures, practices, and systems, as well as on compliance to rules and regulations.

Consequential: the most significant signals emanate from the monitoring of the output to determine if intended goals have been attained, presumably as a result of the efforts that went into the initiative. Outputs may not all lend themselves to retracing the corresponding inputs. The emphasis is on results, eventual outcomes, impacts, and constitutes an enlargement of the scope of accountability into what is called effectiveness.

Accountability depends on a variety of mechanisms that reflect the diversity and complexity of the machinery of government and other public institutions. In such a situation, accountability relationships are not always clear. It is because of this fragmentation that it is important for public bodies to assume their responsibilities and be in a position to explain and justify the manner in which they have discharged their responsibilities. This is essential to the functioning of the democratic political system.

In summary

Accountability, as a personal trait and as a logical response to expectations and pressures, will not naturally lead to the institutionalization of formal accountability regimes. This is in spite of the growing number of officials, managers, and members of governing bodies who do adhere to the appropriate values and are imbued by a sense of responsibility and accountability. Good faith and a noble disposition are not sufficient.

Ideally, what is needed is a focus on issues of accountability by governance: the elite, parliamentarians, members of governing bodies, senior management, all those who are well placed and, given the ties to their respective constituencies, have a good understanding of public expectations.

Effective procedures of governance to guarantee accountability are needed, including a challenge process, appropriate arrangements for rendering an account, a broad role for program and policy monitoring and auditing bodies, as well as appropriate protocols for all participants and stakeholders in this process. It follows, too, that selection standards used in recruiting and promoting senior managers have to ensure a stream of managers naturally disposed to serve in a responsible and accountable fashion.

Perhaps the easiest way of summarizing what has been discussed is to describe truly accountable managers. They are people who have:

- said what they were going to do, how they were going to do it, and to what ends;
- believed in what they said;
- done what they have said they would do; and
- showed what they had done.

74 *Report of the Independent Review Committee on the Office of the Auditor General of Canada* [Wilson Committee] (Ottawa: Information Canada, 1975) 9.
75 Atkinson, *Governing Canada*, glossary.
76 The World Bank, *Governance and Development*, 14.
77 Royal Commission on Financial Management and Accountability [Lambert Commission], *Final Report* (Ottawa: Minister of Supply and Services Canada, 1979), 369.
78 Ibid., 21.
79 C. E. S. Franks, *The Parliament*, 227.
80 David Heald, *Public Expenditure* (Oxford: Martin Robertson, 1984), 154.
81 Ibid., 155.
82 Gordon, *Public Administration*, 607.
83 Paul Lohneis, "Accountability, Cooperation, Receptivity," in *AccounTability*, Newsletter of Financial Management Improvement Latin America and the Caribbean, April 1992, 3.
84 Henri-Paul Vignola, former head of the Montreal Urban Community Police, in his 1982 book, *Police, the Challenge of 21st Century*, as cited in an editorial of Ottawa's *Le Droit*, 21 July 1993, and reproduced, translated, in the *Ottawa Citizen* editorial page, 26 July 1993.
85 Timothy W. Plumptre, *Beyond the Bottom Line: Management in Government* (South Halifax: The Institute for Research on Public Policy, 1988), 182.
86 Skinner, *Accounting Standards*, 636.
87 *Public Service 2000, The Renewal of the Public Service of Canada* (Ottawa: Minister of Supply and Services Canada, 1990), 89.
88 Ibid., 90.
89 Ibid., 91.
90 Gordon F. Osbaldeston, *Keeping Deputy Ministers Accountable* (Toronto: McGraw-Hill Ryerson, 1989), 5-6.
91 Paul C. Light, *Monitoring Government, Inspectors General and the Search for Accountability* (Washington, D.C.: The Brookings Institution/The Governance Institute, 1993), 12.
92 James Fesler and Donald Kettl, in *The Politics of the Administrative Process* (Chatham, N.J.: Chatham House 1991), 317.
93 John Lonsdale, "Political Accountability in African History" in *Political Domination in Africa*, Patrick Chabal, ed., (New York: Cambridge University Press, 1986), as cited in The World Bank, *Governance and Development*, 13.
94 Barry M. Mundt, Raymond T. Olsen, Harold I. Steinberg, *Managing Public Resources* (Peat Marwick International, 1982), 3-4.
95 Wilson Committee, 9.
96 A fourth word, *liability*, was central to Lambert's definition cited earlier. At that time and in that context, it may have been preferred to the word *responsibility*, thus making the notion look more formal while conveying the same intent. Today, in the language of accountability, it is necessary to separate responsibility from liability because the latter has reacquired its strong legal connotation, particularly in corporate governance—as in director's liability—and in the environmental field.
97 George Anderson, president of CMHC, in *Reporting and Auditing Effectiveness: The CMHC Experience*, CCAF Applied Research Series [hereinafter *CMHC*] (Ottawa: CCAF, 1990), ii.
98 Franks, *Parliament of Canada*, 229.
99 Dwight Waldo in CEPAQ-ENAP, "Débats sur l'imputabilité", Actes du colloque sur l'imputabilité, Château Mont Ste-Anne, Que., 9 et 10 juin, 1983.
100 CCAF, *Effectiveness Reporting and Auditing in the Public Sector* [hereinafter *Effectiveness Reporting*] (Ottawa: CCAF, 1987), 64.
101 Stanley C. Brubaker, "Rejoinder to Rawls," *The Public Interest*, no. 99, Spring 1990, 133.
102 See *Commission of Inquiry into the Air Ontario Crash at Dryden, Ontario (Canada) Final Report*, vol. III, (Ottawa: Minister of Supply and Services Canada, 1992), 1165 for an elaboration of that principle and a controversy surrounding its application.
103 Keynote address of Ross Walker to CCAF's 13th Annual Conference, in *Delivering on Accountability: The Need for Legislative and Regulatory Reform*, (Ottawa: CCAF, 1993), 11.
104 Edward Waitzer, Chairman of the Ontario Securities Commission, in an interview on the theme of "In Search of Effective Governance" reproduced in a CCAF video script, 1994, 9.
105 Carl J. Friedrich, "Public Policy and and the Nature of Administrative Responsibility," in *Public Policy*, 1940, no. 1, pp. 3-24, and Herman Finer, "Administrative Responsibility and Democratic Government," *Public Administration Review,* Summer 1941, 335-350.
106 Gordon, *Public Administration*, 564.
107 Peter Gregory speaking in the Subject Forum on "Changing the Face of Accountability Legislation " at the CCAF 14th Annual Conference in Ottawa, November 1993.
108 Testimony of Johnny C. Finch, Assistant Comptroller General of the United States General Accounting Office before the Subcommittee on Government Management, Information and Technology, Committee on Government Reform and Oversight, House of Representatives, *Managing for Results: Status of United States Government Performance and Results Act* (GAO/T-GGD-95-193, June 27, 1995).
109 Michael Decter, Ontario Deputy Minister of Health, in *Reporting on Effectiveness, The Experience of The Queen Elizabeth Hospital*, CCAF Applied Research Series, [hereinafter *QEH*] (Ottawa: CCAF, 1992), 3.
110 N. Johnson, "Defining Accountability," *Public Administration Bulletin*, no. 17, December 1974, 3, as cited in P. M. Jackson, *The Political Economy of Bureaucracy* (Oxford: Philip Allen, 1982), 212.
111 See *Commission of Inquiry into the Air Ontario Crash at Dryden,* p. 1035 for a discussion on problems of accountability arising from the organization and the structure of authority.
112 See James Cutt, *Comprehensive Auditing in Canada, Theory and Practice* (New York: Praeger, 1988), 53-54. Professor Cutt has used the distinction frequently as a basis of exposition.

CHAPTER 5

ACCOUNTABILITY OBLIGATIONS

The development of responsible government can be seen as a struggle by the people to control, through their elected representatives, what had previously been the absolute power of the monarchy. That struggle is now virtually complete, with the Crown now performing in little more than a ceremonial capacity. But modern governments have assumed enormous power. That power is exercised by ministers (typically elected representatives) through substantial bureaucracies. The issue, therefore, is not how to control the monarch, but how to hold ministers and their civil servants accountable.

In a parliamentary democracy like Canada, the electorate has only infrequent opportunities to voice its opinion of the government in a general election. The day-to-day oversight falls to the free press and, importantly, to the legislature. Political scientist Kenneth Kernaghan emphasized this role in a paper published in 1979.[113]

There seems to be no dispute that ministers have a responsibility to account to Parliament for their actions and policies. As a Privy Council Office submission to the Lambert Commission on the constitutional responsibility of ministers stated: "Ministerial responsibility is a fundamental principle of the constitution. It requires that a minister be *personally* answerable to the House of Commons for the exercise of power."[114]

What is not so clear is the extent to which ministers should be held responsible for the actions and decisions of their public servants. Also in dispute is the extent to which public servants are answerable and must provide information to legislative committees.

KERNAGHAN ON PARLIAMENTARY OVERSIGHT

A comprehensive and coherent system of responsibility in government requires the maintenance and the meshing of political and administrative responsibility. In Canada's parliamentary system, where the cabinet dominates Parliament, concern over the state of government responsibility centres on the actions of ministers and public servants. Parliament's performance in checking the exercise of ministerial and bureaucratic power depends largely on the capacity and inclination of opposition members in the House of Commons to control or influence ministers. The power of Parliament over the public service is wielded primarily in an indirect fashion through questioning and criticism of ministers responsible to Parliament for the administration of their departments. Since ministers are the formal constitutional intermediaries between parliamentarians and public servants, Parliament's ability to affect the recommendations and decisions of public servants rests heavily on the interpretation and application of the constitutional convention of ministerial responsibility. Thus, Parliament's success in preserving and promoting administrative responsibility depends directly on the interpretation of ministerial responsibility. Ministerial responsibility is in turn tightly bound up with the conventions of political neutrality and public service anonymity. These three constitutional conventions (or doctrines) are central to the achievement of administrative responsibility in that their definitions and usage shape to a large extent the pattern of interactions between public servants on the one hand and parliamentarians and ministers on the other.

The traditional view

The traditional or purist view is the one inherited from British convention. It holds that ministers are personally responsible and accountable for the actions of their public servants. In return for this protection, public servants are to be politically neutral, and the advice they give their ministers is kept confidential, assuring the anonymity of bureaucrats. Simply stated, the traditional view holds that public servants are accountable to ministers who, in turn, are accountable to Parliament.

Thus, ministers are really responsible and accountable to Parliament for the conduct of their departments. This responsibility includes:

- political accountability for policies and other political acts and decisions;
- administrative accountability for management and administration; and
- financial accountability for the use of funds.[115]

Sympathetic to this view is Jim Mitchell, a former senior civil servant, who adds: "I see no need… to modify in any way the fundamental relationships of accountability that have existed over at least two hundred years of parliamentary tradition among parliament, Ministers and their officials."[116] Mitchell is particularly concerned with the possible loss of neutrality of the public service if officials were directly accountable to Parliament. He argues that the public profile given to senior civil servants and the potential controversy generated by such an accountability arrangement would certainly have some unpredictable consequences on relationships between ministers and their officials.[117]

President Dwight D. Eisenhower On the Issue

[T]he government of the United States has become too big, too complex, and too pervasive in its influence on all our lives for one individual to pretend to direct the details of its important and critical programming. Competent assistants are mandatory; without them the Executive Branch would bog down. To command the loyalties and dedication and best efforts of capable and outstanding individuals requires patience, understanding, a readiness to delegate, and an acceptance of responsibility for any honest errors—real or apparent—those associates and subordinates might make. Such loyalty from such people cannot be won by shifting responsibility, whining, scolding, or demagoguery. Principal subordinates must have confidence that they and their positions are widely respected, and the chief must do his part in assuring that this is so.[118]

The traditional view argues that for ministerial accountability to be effective it has to be clear and unambiguous, in spite of the immense complexity of modern public administration. The clarity comes from the fact that in this principle the minister is personally accountable to Parliament in a formal and visible manner.

The debate

There are other views. Some observers argue that in the early years of the Canadian Confederation the concept of ministerial accountability was appropriate as life, governing, and administering were so simple as to be seamless. Ministers were able to stay current with events in their departments. Obviously, this is no longer the case, they insist, and it is now unrealistic to expect a minister to be aware of, and hence accountable for, all the actions of the sometimes thousands of public servants in today's governmental departments.

In addition, given the complexity of modern government, it is argued that senior public servants are deeply involved in policy development and should be held accountable for the advice they give ministers. With the recent streamlining of the federal cabinet and similar initiatives in certain provinces resulting in considerably fewer (but often larger) ministries, senior bureaucrats will likely have more to do with shaping the policy agenda than ever before. Not only does this erode the actual responsibilities of ministers, it also argues for appropriate public mechanisms for holding public servants accountable.

A thoughtful elected representative observed that "the current system is inadequate and we must find ways to ensure that senior public servants who will be given greater responsibility are held fully accountable, so that we politicians, in turn, can be answerable to our constituents."[119] The Lambert Commission thought that the minister should be relieved of responsibilities specifically assigned to deputy ministers. The implication is a profound change in ministerial responsibilities.

> **"Parliament should hold deputy ministers accountable for administrative matters while holding politicians accountable for political decisions." According to C.E.S. Franks, the rationale for this is to align the doctrine with the practice.[120]**

The concern over this view is that a regime of accountability *within* the government would become part of the accountability regime *between* government and Parliament. The continuing accountability of government to Parliament is a constitutional convention and is satisfied by the concept of ministerial accountability to Parliament. If the minister were to share his departmental responsibility with the deputy minister in Parliament, it would mean that internal accountability would become part of external or public accountability. In this arrangement, some people see a dilution of ministerial accountability on the one hand and the erosion of public servant anonymity and neutrality on the other.

The debate still rages.

The Osbaldeston view

The 1988 report *Keeping Deputy Ministers Responsible*, by former Clerk of the Privy Council and secretary to the Cabinet Gordon Osbaldeston, argues that "ministerial responsibility was fundamental to responsible government, and that to subtract whole areas of public administration from ministerial responsibility would be to break the chain of responsibility from the public to the minister of the Crown and back again."[121]

Osbaldeston's solution to the debate was to differentiate between answerability and accountability to Parliament. Deputy ministers, he said, have an "obligation to provide accurate and complete information to parliamentary committees and to help… explain departmental policies and programs." This essentially agrees with Privy Council suggestions to the Lambert Commission:

> Officials *are accountable to their ministers*, who must answer to the House for their use of the authority conferred upon them in law and by virtue of their responsibility to the House of Commons. It is, however, possible to distinguish between a deputy's accountability *to* his minister for all that occurs under the minister's responsibility, and his accountability *before* parliamentary committees for administrative matters so long

> as they do not call directly into question the exercise of the minister's responsibility. The accountability of officials before parliamentary committees for administrative matters cannot be said to alter the *formal* and *direct* responsibility of the minister personally to Parliament for any matter within his discipline for which the House chooses to hold him answerable.[122]

Osbaldeston said more simply that deputy ministers are answerable to Parliament, while ministers are accountable to it. Such a clear distinction is instinctively appealing. Experience shows, however, that when an official appears before House of Commons committees and provides information about something the opposition sees as government extravagance, the reports in the media lead one to believe that the official who was answerable and who answered was the person directly responsible, leaving the minister off the hook. This may explain, in part, the frequent absence of ministers from committee meetings.

The view of the McGrath Committee

The Special Committee on Reform of the House of Commons held that:

> The idea of a minister being responsible for everything that goes on in a department may once have been realistic, but it has long since ceased to be so. A minister cannot possibly know everything that is going on in a department. The doctrine of ministerial responsibility undermines the potential for genuine accountability on the part of the person that ought to be accountable —the senior officer of the department…
>
> We have heard many arguments that a new doctrine of deputy ministerial responsibility relating exclusively to matters of administration should be established. In this context administration includes policy implementation. Such a doctrine would set out the obligations of senior public servants and include the obligation to testify before parliamentary committees on matters of administration. Under this system, the testimony of deputy ministers before committees would be an everyday occurrence. Furthermore, regular open contact between the senior public service and Members of Parliament should lead to a more realistic understanding of administrative practices and more precise pinpointing of accountability.[123]

Canada and the British Tradition

The Canadian doctrine of ministerial responsibility is largely inspired from British traditions. It should be remembered, however, that Canada differs from Britain. For instance, in Britain the deputy minister, who is called the "Permanent Secretary," is also the "Accounting Officer": this is the person who signs the accounts of the department, vouches for their veracity, defends them before the public accounts committee, and assumes the responsibility for errors in them. The intent is to keep financial administration away from ministerial or political control. This is according to both law and practice. Canadian practice holds the minister responsible and accountable to Parliament for all aspects of policy and administration.[124]

A view about ministers and Public Accounts Committees

In 1980, the Canadian Comprehensive Auditing Foundation's (CCAF) board of governors published the results of its first research project in

The Deputy Minister

The relationship of deputy ministers and senior officials to elected governments is complicated and ambiguous—rather like the process of governance itself. Yet if there are few absolutes in the relationship, the main elements become clear enough if one steps back a bit. Officials serve elected governments, but are not of them. We bring to our jobs a good deal of knowledge, a fair capacity for hard work, and as much political neutrality as could reasonably be looked for in humans. If we can no longer be as anonymous as we once were, we also know that we belong only at the edge of the public stage; the centre is reserved for those who earned a place there by getting themselves elected.[125]

the form of a book titled *Improving Accountability—Canadian Public Accounts Committees and Legislative Auditors.* The study produced a number of recommendations including the following: "Ministers be called as witnesses before Public Accounts Committees only when they have been personally involved in decisions under examination."[126]

This recommendation was largely shaped by provincial and federal deputy ministers interviewed during the research project. Those officials felt that it was both fair and proper that they themselves should answer for actions and decisions they take on their own authority. Two arguments were put forward in favour of that position: first, the presence of ministers at committee meetings is an invitation to partisan political discussion, something that those committees should definitely eschew; second, the availability of a minister should not be used to shield public servants from answering for actions they have taken in the administration of a program.

Interestingly, when ministers were interviewed, opinions were divided. One view was the strict interpretation of the doctrine of ministerial responsibility—the minister assumes responsibility for everything in his or her department. Another view proposed that the Public Accounts Committee's interest is in policy issues (a possible misinterpretation of the role of the committee), and for that the minister could not leave the answering of questions to his public servants. A third view argued that ministers are responsible for determining policy, not their execution or administration, and therefore could not be held accountable for decisions taken in the administering of departmental programs.

The Privy Council view

The government of Canada seemed to have retained the classical view of ministerial accountability on the basis of the following statement in the 1990 White Paper on the renewal of the public service, *Public Service 2000:*

> Ministers are individually and collectively responsible to the House of Commons for the activities of government including the management and conduct of the Public Service. Individually, Ministers are responsible for administration of the decisions of the Government and the activities of Public Servants falling under their jurisdiction. Collectively, they are responsible for the decisions of the Government as a whole and the activities of all of their colleagues.[127]

In the subsequent report issued on June 30, 1992, on implementation of *Public Service 2000* initiatives, the Privy Council Office inserted a clarification on the issue of ministerial responsibility. The report came on the heels of a debate about the expedited entry into Canada of the former Iraqi ambassador to the United States. The clarification reads as follows:

> The most important point to be clear on is that the constitutional principle of ministerial responsibility requires that Ministers, and only Ministers answer to the House of Commons for the activities carried out in their names. Ministerial responsibility does not signify the Ministers must resign when an official makes a mistake or acts inappropriately. In such circumstances, Ministers exercise their responsibility by taking any necessary remedial measures. In point of fact, there is not a single case since Confederation of a Minister resigning because of an error or other action by an official.[128]

This statement is not inconsistent with the position outlined in the 1990 report. It does, however, vary from the classical position, the one observed even in recent years in the British Parliament.

The Privy Council Office report went on to deal with the fundamentals of that position, described as reflecting current practice, the issues of 1992:

- Ministers… are constitutionally responsible to the House of Commons for their actions and the actions of their officials.
- … the power of the state is to be exercised under the authority of elected officials accountable to the representatives of the electorate.
- Public servants are responsible to Ministers…Officials do, of course, answer on behalf of their Ministers to committees of the House provided this does not draw officials into partisan controversy.
- Ministers fulfil their responsibilities and are called to account… in accordance with practice and convention… Ministers cannot know everything that is done under their authority…
- The way in which Ministers exercise their responsibility for the actions of their officials will depend upon the circumstances and whether an official has acted, for example, in a clearly unacceptable manner of which the Minister had no knowledge.

The report cites certain eminent authorities in support of its position. On the question of assumption of responsibility, one authority says: "When action is taken of which the Minister disapproves and which he has no prior knowledge, there is no obligation on his part to endorse it, to defend the errors of his officers, or to resign."[129]

On the remedial action, another authority says: "It is now universally accepted that it is unreasonable to hold a minister personally responsible in the form of resignation for the administrative failings of subordinates… The usual practice is that the minister informs Parliament that the fault lies with his officials and he promises that the offenders will be disciplined and their mistakes corrected."[130]

Accountability of Public Servants

On the accountability of public servants the *Public Service 2000* report said:

> The doctrine of ministerial responsibility imposes obligations on public servants as well as on Ministers. Ministers depend on the quality and continuity of advice and information from their officials in order to fully exercise their responsibility to the House. Public servants must therefore ensure that their conduct will not get their minister into difficulty, and they must ensure that the Minister is fully aware of any significant matter that could give rise to public comment. "Why was I not told?" is one of the most serious indict-

ments of an official that a Minister can make…

In short, officials, particularly senior officials, are paid to exercise their judgement, and first and foremost this means deciding what the Minister needs to know.

Public servants are accountable for their mistakes and errors of judgement to their Minister, who in turn must answer to Parliament. The accountability of officials is rendered through the chain of command to the Deputy Minister who has overall responsibility for the conduct of the members of his or her department. Officials are subject to a statutory disciplinary code prescribed by Parliament that encompasses a spectrum of sanctions, of which the most serious is dismissal…

And when things go wrong, Ministers must take their responsibility, cause enquiry into the circumstances and ensure that the Deputy takes whatever remedial action may be necessary to correct procedures and exercise disciplinary action as appropriate.[131]

On the anonymity of public servants, the report has this to say:

It is obvious that Ministers cannot possibly know everything about all the activities of their departments. Moreover, Ministers are required to provide extensive amounts of information to Parliament through a variety of mechanisms such as written and oral questions, motions for papers, study of the estimates, scrutiny of government bills, and review of the Public Accounts and the reports of the Auditor General. Public servants are, therefore, called upon to support ministers in their answerability to Parliament.

Without prejudicing its right to hold ministers responsible, Parliament has increasingly accepted that officials answer (always on behalf of their Ministers) for matters that are unlikely to involve the House's confidence in Ministers…

[T]he practice of asking officials to answer to Parliamentary committees on behalf of their ministers has affected the traditional anonymity of the Public Service. In this era of constant parliamentary and media scrutiny, officials are far more likely than in the past to be known publicly. This has not, however, altered the fundamental principle that officials are accountable to Ministers and Ministers are responsible to the House of Commons.[132]

The jurisprudence

The subject of ministerial accountability is not one on which the courts have had frequent occasion to rule. The Bhatnager case is an exception.[133] The issue before the Supreme Court of Canada was whether two ministers could be held in contempt of court because their officials had failed to comply with the terms of a court order issued to the ministers. The ministers had had no personal knowledge of the court order. The Federal Court, trial division, had ruled there was no contempt; the appeal division had ruled that there was.

In his reasons for the Supreme Court judgment, The Hon. Mr. Justice John Sopinka wrote:

In the case of Ministers of the Crown who administer large departments and are involved in a multiplicity of proceedings, it would be extraordinary if orders were brought, routinely, to their attention. In order to infer knowledge in such a case, there must be circumstances which reveal a special reason for bringing the order to the attention of the Minister…

This does not mean that Ministers will

> be able to hide behind their lawyers so as to flout orders of the court. Any instructions to the effect that the Minister is to be kept ignorant may attract liability on the basis of the doctrine of willful blindness. Furthermore, the fact that a Minister cannot be confident in any given case that the inference will not be drawn will serve as a sufficient incentive to see to it that officials are impressed with the importance of complying with court orders.

The unanimous decision of the court was that the two ministers were not in contempt.

While this decision may clarify ministers' legal position in respect of the activities of their officials, it does not necessarily resolve the issue of ministerial accountability to Parliament for officials' actions, which is a matter of convention, not law.

The Westland case

Parliamentary crises, like revolutions, bring out the best and the worse in people. The Westland episode in Great Britain in late 1985 and early 1986 gave rise to inquiries by House of Commons committees.[134] One such inquiry focused on the duties and responsibilities of civil servants to ministers (the Treasury and Civil Service Select Committee). Another one (the Defence Select Committee) produced a report critical of improper ministerial and official behaviour in the affair. Subsequently, the government published a reply to the Treasury Committee in which it restated the traditional constitutional view of accountability:

> The Government endorses the committee's [the Defence Committee's] two basic propositions on accountability: that ministers and not officials are responsible and accountable for policy; and that officials' advice to Ministers is and should remain confidential. Constitutionally, Ministers are responsible and accountable for all actions carried by Civil Servants of their departments in pursuit of Government policies or the discharge of responsibilities laid on them by Parliament.[135]

This statement of ministerial accountability doctrine is extremely simple, but even a simple accountability arrangement can generate serious problems. The minister involved in the alleged improper behaviour resigned. Another minister accepted full responsibility for the actions of the five civil servants who were alleged to have behaved improperly by leaking a document, a most damaging act, under the circumstances. He resigned. But the prime minister, who publicly identified the officials instead of protecting their anonymity, did not assume any responsibility for their actions. To complicate matters, the five named officials were prevented by their minister from defending themselves.

While the restatement may sound reassuring for those who have particular affection for the traditional doctrine, it did not go down well with the top civil servants' union as a way to fill the breach caused by the Westland affair:

> It… seems that the conventions regarding accountability are no longer accepted. Individual civil servants have been placed in an intolerable position, both in relation to their own conduct and by being asked to account for the veracity of minister(s), and there is no reason to believe this may not happen again. One should not underestimate the effect this has on general as well as individual morale. Senior civil servants are not shrinking violets, they are perfectly capable of giving a robust account of themselves and rebutting criticism if allowed to do so. At present they are not.[136]

Advice and anonymity

Members of House of Commons committees often question officials on particular items of administration, policy, and the nature of their advice to ministers. That does not mean that public servants will reveal the nature of the advice, but may feel under pressure to do so. In addition, the traditional anonymity of public servants, which is part of this simple accountability doctrine, has also been broken on certain occasions and public servants have been named in political declarations.[137]

> [T]he requirement to explain complicated programs, and to consult the public about proposed courses of action, is far in excess of what any minister could possibly manage. For officials to take on these kinds of functions in support of their ministers makes practical sense, always provided that we don't forget what our place is in the scheme of things. Deputy ministers' names should not be household words, now or in the future.
>
> It follows from the description I've just given that the text book formula of an elected government that makes policy decisions and a public service that carries them out is a considerable over-simplification. The knowledge of officials is not limited to the management and technical aspects of the department. They also know the issues that go with the portfolio; they have lived through past attempts, successful and otherwise, to deal with these issues; and they can have a fairly extensive knowledge of the department's client population.
>
> For all these reasons, the advice provided by deputy ministers and senior officials includes advice that is 'political'—not *partisan* in the sense of advising the government how to do in the opposition, but political in the sense of giving ministers assessments of likely reactions, particularly by the department's clientele, to a course of action that is under discussion. There is nothing improper about this.
>
> … The suggestion is sometimes made that the principle of keeping confidential the advice we give the ministers exists for the purpose of protecting officials. The truth is the exact opposite: it is to give ministers the maximum scope for judgement in arriving at their decisions. Minister's jobs are quite tough enough already; they should not have to contend as well with being second-guessed in public by their officials. More fundamentally, a minister is entitled to assume that the advice he or she gets is the best that officials can come up with, and is not influenced by any consideration of playing to the galleries.[138]

A case in point

In Canada, an interesting event took place when the deputy minister of finance resigned on the heels of the November 1981 budget, which had been widely and publicly criticized. His department and his officials had been the object of severe and sometimes personal criticisms in the press. His letter of resignation made the following points: first, he assumed full responsibility for the kind of advice he had given to his minister and the cabinet; second, he assumed full responsibility for the work of his subordinates, as a leader should. He was reaffirming the tradition of neutrality, objectivity, and anonymity of the public service. And he deplored the fact that, being possessed by these very noble attributes, his subordinates could not respond publicly to criticism.

Curiously, some of the most serious elements in the media ignored the restatement of essential constitutional principles and interpreted the deputy minister's resignation and indeed the letter as accepting responsibility for the budget, leaving the elected officials off the hook. In accepting the resignation, the prime minister reiterated the fundamental principles and agreed that civil servants are responsible for the advice, not the decision. This reassurance did not produce lasting effects, however, as over the years there have been several senior civil servants who took the brunt for their ministers while the latter were left relatively untouched. Thus, over the years, the traditional doctrine of ministerial responsibility has been severely shaken.

113 Kenneth Kernaghan, "Power, Parliament and Public Servants in Canada: Ministerial Responsibility Reexamined," *Canadian Public Policy-Analyse de Politiques*, vol. 3, 1979, 384.
114 *Submissions to the Royal Commission on Financial Management and Accountability* (Ottawa: Privy Council Office, 1979), 1-3.
115 Franks, *Parliament*, 227.
116 Jim Mitchell, "Accountability," *Optimum*, Summer 1992, vol. 23, no. 1, 13.
117 C. Lloyd Brown-John, a professor of Public Administration in the Department of Political Science at University of Windsor, criticized Jim Mitchell's earlier article, ibid. See the Spring 1993 issue, vol. 24, "Accountability re-revisited."
118 Gordon, *Public Administration*, 104.
119 Jean-Robert Gauthier, Chairman of the House of Commons Public Accounts Committee, at the 13th Annual CCAF Conference, 23 November 1992.
120 Simon McInnes and Perry Billingsley, "Canada's Indians; norms of responsible government under federalism," *Canadian Public Administration*, Summer 1992, vol. 35, no. 2, 219.
121 Gordon Osbaldeston, *Keeping Deputy Ministers Responsible*, (London, Ont.: National Centre for Management Research and Development, 1988), 159.
122 Privy Council Office, *Submissions to the Royal Commission on Financial Management and Accountability*, 1-51.
123 *Report of the Special Committee on Reform of the House of Commons*, 21.
124 See Franks, *Parliament*, p. 244, for an elaboration on the doctrine.
125 Arthur Kroeger, "On Being a Deputy Minister," *Policy Options*, vol. 13, no. 4, May 1992, 5.
126 *Improving Accountability—Canadian Public Accounts Committees and Legislative Auditors* (CCAF: 1981) 20.
127 *Public Service 2000: The Renewal of the Public Service of Canada* (Ottawa: Privy Council Office, 1990), 8.
128 *Public Service 2000: A Report on Progress* (Ottawa: Privy Council Office, 1992), 94.
129 Geoffrey Marshall, *Constitutional Conventions*, 2nd ed. (Oxford, 1986), 65, as cited in ibid., 96.
130 Kenneth Kernaghan, "Power, Parliament and Public Servants in Canada: Ministerial Responsibility Reexamined," *Canadian Public Policy-Analyse de Politiques*, vol. 3, 1979, 386-387.
131 *Public Service 2000, A Report*, 96-98.
132 Ibid., 98-99.
133 *M.E.I. et al* v. *Bhatnager*, [1990], S.C.J. no. 20771, Sopinka, Dickson, Lamer, Wilson, La Forest, L'Heureux-Dubé, Gonthier, Cory, McLachlin, 21 June 1990.
134 Westland refers to the British helicopter firm of that name. The issue was over the financial rescue of the firm either by a European saviour as the secretary of state for defence wished or by an American firm as the prime minister and the secretary of state for trade and industry preferred. The secretary of defence tried unsuccessfully to persuade the Cabinet and then went public in a manner that brought him wide support. This episode created substantive confusion in the machinery of government and raised some interesting constitutional issues.
135 Hennessy, *Whitehall*, 305.
136 Ibid., 306.
137 For example, the Al-Mashat affair in Ottawa, and the Westland affair in the United Kingdom.
138 Kroeger, *On Being a Deputy*, 4.

Chapter 6

Accountability in Certain Other Circumstances

Accountability in the private sector

For a long time, a company's performance has been assessed through traditional indicators of success: profit, share prices, price-earnings ratios, and so on. In recent years, there has been a more frequent use in annual reports of management discussion and analysis of operating results and financial condition—MD&A. This material helps explain variations in financial results and the causes behind them. It does not, however, render a full account of the effectiveness of all aspects of the enterprise.

The private sector generates a great deal of relevant information that can be used to assess performance. Stock prices and volume, product price, quarterly reports, assessment by bond-rating services, and similar indicators are all publicly available.

The conventional wisdom is that the private sector, because of its "bottom line" as the ultimate indication of effectiveness, carries its own accountability. Hence, by contrast, the absence of such a quantification in the public sector forces it to create a substitute for the purpose of demonstrating effectiveness. Nevertheless, the sought-after introduction of more businesslike methods in public administration, would not overcome the lack of such a simple, single indicator of effectiveness.

Difference between private- and public sector accountability

The automatic accountability provided by market data for private corporations is useful but notably narrow. It deals only with the parties to the market transactions. The concern in the public sector is much wider. For instance, it is possible to keep track of contributions of workers and employers to the unemployment insurance fund as well as of payments of benefits to unemployed workers. The concern of elected officials and taxpayers, however, extends beyond the efficiency of transactions between beneficiaries and the unemployment insurance commission. The effectiveness of the public intervention as a whole is a major concern and is not readily captured by the workings of the administration.

In a democracy, the opportunity for taxpayers (consumers) to shift allegiance (preference) to a different government through elections every four or five years constitutes accountability. It does indeed, but it is not punctual, nor are the signals very rich in information to guide other than global decisions. To use the business vocabulary, elections tell more about consumer preference with regard to the supplier than with regard to the goods themselves.

Government in and out of business

It can be argued that as a result of the nationalization of an enterprise, when hitherto privately produced/distributed goods have been moved to the public sector, accountability with regard to the supplier will have been transformed but not with regard to the goods themselves. Theoretically, the consumer can still alter his or her preferences with respect to the goods and services. Thus, in a nationalized context, some built-in accountability remains, particularly in reference to basically commercial activities. In reality, however, nationalization has usually taken the form of a monopoly, and the range of options available to consumers is severely restricted. As for the public policy aspect of a nationalized company, accountability does not arise mechanically and may indeed become unclear.

Conversely, in a privatization, a built-in accountability regarding price is being acquired, but any accountability for the public policy aspects will have been lost unless it is artificially maintained. But it may not be necessary to maintain it. For example, if a provincial government decided that its only interest in the distribution of alcoholic beverages was the revenue it provides, it might abandon its liquor stores and get the revenue from private distributors. It would not feel the need to account for what it considered to be nonexistent public policy issues.

A different example is the initiative in the United States to privatize some penitentiaries. Such privatizations had at least a partial built-in

Accountability In the Market System: The Mechanics

Although today, hardly anyone believes that the bottom line addresses the complete range of effectiveness issues facing a corporation, the workings of the market nevertheless produce a lot of useful information. A simple model of activities in the private sector could explain how it does that.

Private sector accountability operates at two related levels. Perceived dissatisfaction at one level (towards the goods) will, in time, cause dissatisfaction at the other level (the firm).

In the private sector, the market economy, the interactions of the market itself, constitute a form of accountability. It is the competitive nature of the market, to the extent that it is indeed competitive, that allows consumers to shift their preferences to another supplier—or to alternative goods or services from the same supplier—in cases of dissatisfaction or change of taste. Alternatively, consumers may well abandon their intention to buy altogether. Thus the supplier/producer must respond to shifts in consumer preferences. This responsiveness is necessary to maintain profitability.

A public company's profit, expressed numerically in its financial statements, represents a simple form of accountability from the firm to its owners, the shareholders. In the event the shareholders are unhappy with their firm's performance, they can dispose of their shares, since ownership can be traded like any other good or asset.

In this sense the free market system forces its agents to be responsive, hence accountable. For this reason, the private sector is said to have a built-in accountability mechanism, and its price signals are a permanent referendum on performance. The accountability is punctual and indeed continuous; the system produces a vast array of signals of use not only to shareowners and consumers, but as a feedback to the supplier, as well. In turn, because of the simplicity of the arrangements, the company can react or respond quickly.

Thus, in the private sector, accountability can be seen as the system itself. It is, in effect, the allocator of resources. This attribute confers, ostensibly at least, a superiority over accountability in the public sector, which has to be created and constantly nurtured.

Nevertheless, there are several aspects of effectiveness that the data automatically generated by the market does not readily reflect, at least not in the short or medium term.

accountability system: costs of operating the facilities were easy to calculate, and the inmates were kept inside as they should be. But obviously the costing system could not shed light on the efficacy of the rehabilitation of prisoners, one of the objectives of the institutions. This points to the need to maintain a public sector approach to accountability at least for the public policy part of an otherwise commercial operation that has been privatized.

Accountability in a monopoly

For companies—public or private—that are monopolies, being accountable implies achieving positive results within the intent of the policy that gave rise to the granting of the monopoly. Clear attribution of costs is needed to provide the right information for management to achieve cost-effective performance. Ignoring the discipline of market prices—or the markets, in general—is tantamount to being nonaccountable. Structuring the organization along business lines will usually help to clarify accountability by identifying the costs of specific aspects of the enterprise.

In certain monopolies, electric utilities, for instance, years of adjustment to market situations and responses to public policy have led to permanent structures of cross-subsidization between the types of services (production, transportation, distribution) and between types of client, (government, commercial, industrial, residential). The result is that, while the nature of the business would lend itself easily to the discipline of the market and its ability to reveal performance, this cross-subsidization makes it difficult, if not impossible, to identify the costs associated with different functions. Furthermore, because prices charged for certain services do not directly reflect costs, little incentive exists for customers to be particularly concerned with consumption. In such circumstances the so-called discipline of the marketplace is somewhat of an illusion.

With the current pressure to reduce costs, many analysts think that such organizations ought to be restructured according to lines of business so as to benefit from the market orientation and generate, both internally and externally, more accountability information. It is thought that the discipline this would bring ought to allow decision making leading to increased performance and better cost-effectiveness; here again the link of accountability to performance would be clearer.

The private nonprofit sector

The private nonprofit sector comprises a variety of institutions devoted to public causes, organizations often managed and governed in much less formal ways than government or private corporations. Nonprofit institutions, many of them classified as charitable, often have such nobility of purpose, they escape both the discipline of the market and the kind of scrutiny to which governments are typically subjected. There are relatively few regulations constraining the operations of nonprofit organizations. Models of governance of these bodies are not usually explicit with regard to accountability arrangements.

Governance of a Not-for-Profit Interest Group: A case

One not-for-profit advocacy organization is substantial in terms of annual revenues, physical assets, number of employees, and the number of countries in which it operates. In many respects, it looks like a multinational corporation. It plans its activities carefully to ensure a comfortable stream of donations. The head of the national branch in one European country was quoted as saying:

"I manage this organization like any chief executive in the business sector. I make plans, I prepare budgets, and I really run the show." The observer summarized the privileged situation of the organization: "The head of the organization is a very fortunate manager; he has no shareholder to reward, no supporters to whom he owes a rendering of account. The organization is a foundation maintained entirely and solely by donors; there is no need for an annual meeting. The dream of any CEO!"[139]

139 Roger Cans, *Le Monde*, Paris, France, as reproduced in *Le Devoir*, Montreal, 14 January 1993.

Chapter 7

Control and Controls

Control

There is no accountability without responsibility. A responsibility cannot be fulfilled without commensurate authority. The exercise of authority requires a structure, a procedure—*control*—and chosen instruments to effect it—*controls*. Accountability will thrive under a suitable management philosophy, an appropriate approach to control, and well-chosen controls.

One has to distinguish between control, which is the exercise of power or authority, and controls, which are the chosen mechanisms or instruments to effect control. Control starts with the will to exercise authority, to manage, to administer, to intervene.

To be "in control" is:

- knowing where one wants to go in relation to available resources;
- being well-organized to get there;
- being as cost-effective as possible;
- understanding what results are to be accomplished;
- recognizing the actual results achieved; and
- demonstrating what has been achieved.

To be in control implies having agreed-upon performance expectations: program objectives and operational objectives, as well as service standards. Moreover, to be in control implies being able to demonstrate that you are indeed in control.

The design of controls is largely influenced by the societal culture and the management philosophy of the organization. The nature of the organization has a strong influence, too: controls appropriate for a bank may be out of place in a doctor's office.

A broad view of the concept of control—one that describes control in terms of people, structure, and processes and that sees control processes as dynamic, constantly interacting with and adapting to the organizational environment—is reflected in guidance put forward by the Canadian Institute of Chartered Accountants (CICA).[140] This guidance sets out a control framework, including a set of related criteria, to assist people throughout an organization in thinking about control as it relates to their particular circumstance and to develop, assess, and change control.

Control and the Change in Organizational Culture

Canadians enjoy a great number of individual rights *vis-à-vis* their governments: rights to express opinions, to choose, to be consulted, to participate, to protest, and so on. Moreover, the state has gradually made available means for citizens to exercise their rights. It was just a matter of time before citizens laid claim to similar rights in the private place—the workplace—by asking how much of the liberty enjoyed in public can be carried into the job. Should not the rights of an employee be the same as those of a citizen? is a different way of describing this.

BUT WHAT IS GOVERNMENT ITSELF BUT THE GREATEST OF ALL REFLECTIONS ON HUMAN NATURE? IF MEN WERE ANGELS, NO GOVERNMENT WOULD BE NECESSARY. IF ANGELS WERE TO GOVERN MEN, NEITHER EXTERNAL NOR INTERNAL CONTROULS ON GOVERNMENT WOULD BE NECESSARY. IN FRAMING A GOVERNMENT WHICH IS TO BE ADMINISTERED BY MEN OVER MEN, THE GREAT DIFFICULTIES IS THIS: YOU MUST FIRST ENABLE THE GOVERNMENT TO CONTROUL THE GOVERNED: AND IN THE NEXT PLACE OBLIGE IT TO CONTROUL ITSELF. A DEPENDENCE ON THE PEOPLE IS, NO DOUBT, THE PRIMARY CONTROUL ON THE GOVERNMENT; BUT EXPERIENCE HAS TAUGHT MANKIND THE NECESSITY OF AUXILIARY PRECAUTIONS.[141]

JAMES MADISON
(FEDERALIST 51, 1788)

In the last decade or so, many large organizations—governments, public institutions, private sector corporations—have undergone fundamental changes in their approach to management, a definite shift in their internal conduct. The so-called managerial revolution not only seeks to introduce more efficient methods, but as a precondition requires a change in the culture and attitude of employees to guide their work-related actions.

Organizational culture became a central theme of the transformation. The positive attitude or disposition of the employee, either natural or induced, was to replace conformity to preset rules and procedures as the driving force behind the attainment of corporate goals. To some extent, matching the personal goals of the employees with those of the organization became a central purpose and is responsible for the widespread practice of involving employees in the drafting of mission statements for the organization and value statements for the employees.

TWO MODELS OF MANAGEMENT

DELEGATION

DELEGATION HAS ALWAYS BEEN A TRAIT OF LARGE BUREAUCRACIES; THEY CANNOT OPERATE WITHOUT IT. SOME SENIOR MANAGERS HAVE FOR A LONG TIME BEEN DELEGATING OUT OF THE SAME BELIEFS THAT INSPIRE THE MOST RECENT MANAGERIAL REVOLUTION. NEVERTHELESS, THERE ARE INSTANCES IN WHICH DELEGATING HAS BEEN A PRETEXT FOR ABDICATING RESPONSIBILITY, OR ASSERTING POWER OVER SUBORDINATES WITHOUT ACCEPTING THE RESPONSIBILITY: DELEGATING THE BLAME, TO PUT IT SIMPLY. FINALLY, DELEGATING CAN BE A COVER FOR INEPTITUDE. NEVERTHELESS, DELEGATING IS ESSENTIAL TO SOUND MANAGEMENT.

One can contrast two models of management: the traditional model and the new approach. Interestingly, much of the literature condemns the traditional one by calling it an "excessively bureaucratized organization" and promotes the second one as the "effective organization." Of course, the old approach, where and when the sociology of the times and the workplace required it, was just as effective as the new one, in theory at least. Be that as it may, they can be described as follows:

The "excessively-bureaucratized organization"—the traditional model—has the following characteristics:

- centralized, top-down decision making, vertical organization;
- layered hierarchy (many levels of management, some without or with very little value-added—more people in head office, fewer people in the field, where the action happens to be);
- tight links between management, supervisory levels, and the executants—decisions or instructions from the top are transmitted downward intact;
- stated goals, targets often quantified—such

objectives inspire the nature of the rules to effect controls;
- such controls are tied to a system of reward and punishment; and
- the rhythm of business, the pace, is set by the top; the organization cannot move faster than its senior managers.

The "effective" (sometimes called "empowered") organization, in contrast, displays the following traits:
- decentralized decision making, (decisions made in the field or close to it—employees are empowered to make decisions, less traffic of information upward and downward);
- horizontal organization (fewer layers of management, consultative approach to decision making, employee participation, client input);
- loose links and room for maneuver, innovation and risk taking; and
- influence of organizational values and professional standards greater than reliance on in-house rules and procedures.

Delegation and Empowerment

In a command and control management culture, delegation is usually understood to involve handing over tasks to employees who follow guidelines, avoid taking risks and who carry out duties in traditional and sanctioned ways. Empowerment, by contrast, encourages managers, supervisors and employees to try new ways of achieving goals, motivating them to be creative and innovative in improving the service they deliver. Empowerment asks employees to assume responsibility for change and to be accountable for their actions within an environment which accepts a degree of risk-taking and acknowledges intent as well as results.[142]

In effect, the second model of management:
- is more concerned with effectiveness than with controls;
- defines effectiveness both in organizational and professional terms;
- develops confidence in the professional and support staff;
- monitors performance, but allows considerable discretion and authority in the field; and
- knows that institutional values in the "flat" organization are propagated faster and with a minimum of distortion.

To change from the traditional style of management to the new approach, large organizations have to take highly visible actions accompanied by well-orchestrated efforts designed to propagate the new beliefs, sometimes using slogans and acronyms as rallying cries for the forces of revolution.

Improperly controlled delegation—street-level bureaucrats

Too much local interpretation of overall policy and procedures could result in the delivery of something not originally intended. It could also lead to a dilution of national or corporate standards, thus compromising the program and possibly notions of fair and equitable treatment. Public administration literature in the United States has referred to this excess of delegation and empowerment as "street-level policy-making." It is an expression derived from the action of so-called street-level bureaucrats—for example, public health nurses, social workers, teachers, and police—who naturally have a lot of discretion in discharging their responsibilities and making decisions on their own. Often, demands made on their services are greater than the resources at their disposal to satisfy

On Hierarchies

Hierarchies have been around for a long time. The concept is strongly imbedded in our culture. It starts with the family arrangement for the exercise of authority in which parents are responsible, indeed accountable, for their children.

Organizations achieve their purposes by means of a management structure. A manager gets the work done through subordinates, and while each of these is responsible and accountable for his or her assigned tasks or roles, the manager is accountable to the higher echelon for the work performed at the lower echelon by subordinates. The level of the manager, his or her place in the ladder, marks the level of responsibility.

Managers transmit the mission, the objectives, the goals of the organization to the work force. They play two main roles: to exercise control and to provide leadership. Regardless of how professional and proficient employees are, they will expect leadership. In the absence of leadership, they might even create it. This is not to say that a hierarchy is the answer to everything. Sometimes it can be a hindrance and the shift to working groups, project management, and task forces, is the way to regain momentum or accelerate it. Such arrangements, however, are still attached to a hierarchical system.

those demands; choices must be made to balance policy directives and standards with public demand.[143]

> When faced with a situation in which they need to reach an accommodation between their seemingly limitless responsibilities for making decisions about clients' problems and their limited capacity to effect resolutions (due to the lack of authority, expertise, support, or time), street-level bureaucrats remake policy by setting new or altered priorities, limiting or controlling clientele's demands, rationing services, and modifying goals. These accommodations and coping mechanisms form patterns of behavior that become the government program that is actually delivered or implemented. Thus, street-level bureaucrats become policymakers.
>
> Controlling the street-level bureaucrat's discretion is an enduring problem confronting human services agencies. Limiting discretion is necessary to ensure a fairer distribution of services to clients and to enable the evaluation of a program to meet the public demand for accountability.
>
> Management control systems usually fail to oversee discretion because managers neither impose a routine on the unpredictable nature of street-level interactions between bureaucrats and client, nor do they monitor the large number of encounters that take place beyond the surveillance of program supervisors.

Thus, street-level bureaucrats remake policy as they implement it. They make decisions in their respective work areas to fit the realities of their day-to-day tasks. They may not even be conscious of it. Sometimes the reality of the situation facing them is not what the policymakers had expected while preparing directives. Sometimes the execution deviates from the policy because of a difference in value systems between those who conceived the policy at head office and the people who interpret it at the local level. Sometimes the policy is clear, but the accompanying directives are not.

The discretion exercised by street-level bureaucrats is consistent with the contemporary emphasis on clients, service, and results. Empowerment acknowledges and sanctions what is being done already, and in light of frontline realities, it is possible for a policy to be modified to be more respectful of local conditions without compromising its basic thrust. It requires a process of adaptation.

It should be recognized, however, that when the policy is for a deliberate public intervention to modify citizens' behaviour in particular situations (sometimes called social engineering), street-level policy-making may be counterproductive. Service providers sometimes get so close to the community they serve, they unconsciously adopt some of its values. It could be that these are the very ones the program is designed, at least in part, to alter. This can happen when there is little contact between top management and the field, or when procedures allow maximum discretion and little feedback—or no accountability. To the extent that this happens, it would constitute an obvious loss of control, albeit probably insufficient to condemn empowerment as an approach. What is needed is better communication and a more effective balance between the amount of discretion one is prepared to allow and the amount of control one must have. As the model changes from rule-book interpretation to empowerment, it puts a premium on accountability and reporting.

Delegation and the Difficulty of "Letting Go"

Embracing the new managerial culture does not come naturally to everybody in the system. First, when confronted with the necessity to delegate, those who are autocratic by nature will not let go easily. They are the silent apologists for the status quo. Second, those very senior managers who attained their positions by learning the system and honing their skills at running things from the top are not likely to give up controls readily. They are often replaced by people of the same persuasion pending the emergence of new standards of selection. Third, many employees find it comfortable and secure to work in an environment of control with minimal risk; they are not ready or eager to accept new responsibilities. Frequently, they, too, are replaced by people with the same disposition.

140 The Canadian Institute of Chartered Accountants, *Guidance on Control* (Toronto: CICA, 1995).
141 *American Constitution*, 235.
142 *Service to the Public Task Force Report* (Ottawa: Privy Council Office, 1990), 51-52.
143 The following paragraphs borrow largely from a paper presented by Juanita Cebe at an American Evaluation Society meeting in Washington in 1990 (pp. 15-16). This particular topic was given very elaborate treatment by Michael Lipsky in "Street-Level Bureaucracy," *Dilemmas of the Individual in the Public Services* (New York: Russell Sage Foundation, 1980).

CONCLUSION

KNOW THE BUSINESS

The introduction to Part I includes a statement that effective audit practice starts with a thorough understanding of the context within which the client and other key stakeholders operate. This context involves both the governance and management processes and the accountability arrangements that bind them together.

Part I opens up notions of accountability and governance in an attempt to help those who may be in the future or are now involved with comprehensive auditing and/or performance reporting. The material relates primarily, but not exclusively, to the public sector.

In effect, Part I addresses a vitally important underpinning not only of audit but of any disciplined approach to designing or developing management and information systems; the principle is simply that those who do so must have a sufficient knowledge of the business of the organization in question. Failure to sufficiently understand the business is tantamount to driving a car while blindfolded—it introduces the risk of almost certain failure.

As J. R. M. Wilson wrote in 1953: "[A]ccounting is more properly described as an art than a science, because accounting, unlike science, has no rules which are in the nature of fundamental truths… this is a field in which judgment is necessary at every step… "[144] The problem that Wilson talked about in 1953 becomes exacerbated when auditors are asked to give assurance on a broader span of information. Compounding the challenge is that the information that they seek to provide some level of assurance on will often be developed by people from disciplines other than financial accounting.

Having a sufficient knowledge of the business in an audit context will help practitioners to make the sound judgments in relation to assessing risk (both audit and the client's), determining scope and related intended degrees of audit assurance and materiality (significance) thresholds, the most appropriate manner of reporting, the nature of controls that may be most effective and those that might be least effective, the nature and reliability of different forms of audit evidence, the nature of the performance reporting principles that may be most appropriate, and so on. In other words, all key aspects of the audit process and judgments are affected by the quality of the practitioner's knowledge.

Several dimensions to the knowledge of the organization are required by those who undertake to audit or design management systems and practices including performance information systems.

The first is at the level with which Part I deals. That is, with respect to the overall environment within which the organization operates, and in particular with reference to understanding the governance and accountability precepts, principles, approaches, and arrangements that give rise to the existence of the organization and that determine the manner in which it is mandated and given authority and resources to accomplish its mandate. Included in this understanding are the principles, types of arrangements, and behavioural issues associated with the broad mechanisms that have been adopted to control, exercise stewardship for, and account for the performance of institutions at all levels. At this level, the principles apply to virtually all organizations in the public sector, and to many in the private sector.

Accountability does not exist in a vacuum. It needs some form of a doctrinal basis to determine reference points—a value framework. To guide their actions, people have their culture, their ethics, their value system, and they usually bring these into the workplace. The organization develops its own value system. That system is largely influenced by the one espoused by the organization's leaders, by the one that employees bring with them or share with their leaders, and by the one that is dictated by the corporate purpose, legislation, rules, regulations, indeed the tradition, and the need to maintain a good reputation. Some of these values are reflected in established procedures; some are not.

An audit has to be conducted with an understanding of the value framework from which the relevant accountability regime is derived.

This constitutes possibly the greatest professional challenge to practitioners of audit. Audit is largely a normative discipline. It tends to observe deviations from the norms or the failure to respect them. Auditors would naturally revert to their own personal value systems—their own standards and their own perceptions—in the absence of a generally accepted framework of accountability. But they must not. Nevertheless, given the conflictual nature of our social arrangements, such frameworks, when they exist, are not always entirely relevant, nor widely or generally accepted. Audit, even though it has given itself a set of principles absolutely pertinent to its calling, must be practiced in a very imperfect world. But running into dilemmas is a normal feature of audit, and much of an auditor's effectiveness lies in the ability to handle difficult choices.

Familiarity with parliamentary frameworks of accountability, contemporary management cultures and frameworks, generally accepted standards, and accountability regimes, is not only relevant on its own, but also brings consistency in the practice of auditing. Some regimes or protocols are mandated, some are not. Different hierarchical arrangements pose their particular challenges with respect to accountability structures and it is necessary to develop a good understanding of their peculiarities.

There are situations where the accountability framework itself has undergone profound transformations, over a period of years, involving changes in both institutional and managerial cultures, accompanied by corresponding procedural ramifications. Auditors, in such cases, within the shifting paradigm, must develop a plausible and realistic set of norms to guide their work.

The second area of knowledge auditors require involves the nature and typical operating and managerial processes and approaches that are associated with, and that are derived from, the specific nature of the services, products, and activities undertaken or provided by an organization. Part I does not attempt to deal with this level of knowledge; to do so would be a task beyond the scope of one publication. This level of knowledge is best acquired as the practitioner or student becomes engaged in a specific assignment.

Effectively leading and ensuring the quality and efficacy of comprehensive audits (and/or designing and developing performance reporting approaches in support of governing bodies and management) requires an ongoing knowledge-building process about the matters introduced in Part I. Real understanding is largely contingent on in-depth experience gained over time. Part I is also intended to be only a starting point to the knowledge that auditors require of the organization(s) they examine.

Organizational knowledge checklist

The preceding section underlines the importance of understanding by auditors of the governance and accountability regimes and background of clients of comprehensive audits. The following is a list of areas for which a good understanding is required. The range of these issues is substantial. Even so, in certain circumstances, there may be other areas where a good understanding is necessary for a satisfactory audit. In preparing for an audit, auditors should ask themselves:

Do I (or we) understand:

- the informal and formal ways in which this institution and those from whom it derives its mandate and authority interact, including the legal governance and accountability frameworks that are in place?
- the ways in which the principal decision makers within the organization and those who influence it interact to develop policy, choose delivery mechanisms, establish performance goals, and manage risk?
- the fundamental purposes and responsibilities of the governing body and have reasonable expectations of them?
- the differences between the purposes and responsibilities of the governing body and those whom the governing body has empowered to manage the resources and administer the policies established by it?
- the areas where governing body members and management share responsibilities and the interdependencies of both groups (especially as these pertain to policy setting, strategic planning, stakeholder communications, control, and stewardship)?
- what constitutes an appropriate mix of people with the requisite knowledge, ability, and commitment to exercise stewardship and ensure the long-term effectiveness of the organization in question?
- how the governing body interprets its purposes and distinguishes itself as a body politic from the interests of individual governing body members or the particular interests of those that specific governing body members represent?
- how the governing body acts to ensure that the organization it is accountable for meets its objectives?
- how the governing body fulfills its accountability obligations to those whose interests they represent and who have empowered them?
- how the governing body addresses the need for its own efficacy and manages the quality of governance itself?
- the meaning of accountability in both its formal and discretionary dimensions and the evolution of the concept in respect of the organization in question?
- how concepts of independence, neutrality, answerability, autonomy, stewardship, and leadership are exercised in both their formal and informal senses?
- the impact of historical and current value systems and ethics, mind-sets, and cultures on the governance and accountability arrangements in place?
- the extent to which and the manner in which governing bodies and management share power both formally and informally?
- the status of and major factors that have influenced the quality of trust between the governing body and management?
- the major formal and informal inducements, rewards, and punishments that have been provided to encourage accountability, relationships based on trust and respect, "reasonable man" or rational behaviour, and the fulfillment of fundamental obligations of accountability?
- the formal and informal inducements, rewards, and sanctions, for governing bodies to undertake their responsibilities with due diligence, including such jurisprudence as may exist?
- the delineation between internal accountabilities and political and managerial accountabilities and how these delineations are dealt with in the organization?
- the specific role, and the manner in which it is formally and informally executed, of the

governing body as a whole and segments of the governing body in respect of accountability and stewardship and any trends or directions which relate to it? The efficacy of these groups?

- comparable approaches to accountability and governance between the public and private sectors, the strengths and weakness of each, and the manner in which each may contribute to the other?
- the exigencies that affect the operation of accountability and governance mechanisms and approaches in different types of public- or private sector institutions—for example, commercial or quasi-commercial monopolies as compared to competitive or quasi-competitive government enterprises, mixed enterprises as compared to wholly owned enterprises, enterprises that operate at arm's length as compared to those that do not?
- the formal and informal linkages and delineation-of-control concepts versus accountability concepts and how these delineations and linkages are recognized and provided for in the organization?
- the bases on which the governing body and management arrive at agreement on acceptable risk levels and at a balance between risk and control?

Answers to these questions, or to those that are relevant in the circumstances, should be sought, discussed, and digested before detailed planning of an audit begins.

144 H. C. Dell & J. R. M. Wilson, *Auditing Procedures*, 3d ed. (Toronto: The Canadian Institute of Chartered Accountants, 1951), 21.

Appendix

A Case of Change In Managerial Culture

Numerous large organizations have successfully made the shift from the one style of management to another.[145] Out of familiarity, and because of the considerable documentation on the subject, the government of Canada is chosen as an illustration. As one would expect in any organization interacting with a changing environment and learning from its own experience, the specifics of the federal government system continue to evolve. This illustration, which focuses on a number of key developments over a decade, provides a glimpse into the thinking, considerations, and processes that have marked this transition in management culture and style. The forces in operation and the principles articulated likely apply to all large organizations. After all, governments—be they federal, provincial, or local—and large private sector corporations share common management and control issues, and they all use a bureaucracy to conduct their business. Governments have central agencies (such as treasury or management boards) and departments; corporations have head offices and branches. In many respects, it is all the same.

A substantial portion of new management theory has been promoted or put into practice in the federal government. Some of the procedures described below may not have survived, as is often the case in large bureaucracies; some may have been modified, while others have been ignored or abandoned. The culture may have remained, however. The following describes the original plan, where the links between the theory, concepts, and procedure are the clearest.

The first step the federal government took was to modify the relationship of the Treasury Board (the agency responsible for overseeing the financial and administrative practices of the government) with the departments and agencies. In 1986, the board undertook a program in which departments, in full consultation with it, assume greater responsibility in allocating resources and planning expenditure levels and ceilings, for a period of three or four years. The second step was the development of a new managerial culture within the departments, largely resulting in delegation to and empowerment of frontline civil servants. A third step focused on those relations between the Treasury Board and departments that did not lend themselves to delegation of authorities.

The Treasury Board

The Treasury Board of Canada is a cabinet committee of the executive. It establishes and communicates to departments government-wide management and administrative policies, ensures that management policies and accountability frameworks are in place in departments, and reviews their effectiveness.

Increased Ministerial Authority and Accountability

The first step was referred to as IMAA, an acronym for Increased Ministerial Authority and Accountability. It was based on the conviction that by delegating decision making to departments and then holding them accountable for their actions, the government would be removing some of the obstacles to cost-effective decision making. The aim was to create an environment where decisions can be made by the managers responsible for program delivery.

The characterization of the IMAA regime as expecting accountability reporting as a *quid pro quo* for administrative delegations is more mundane than the stated intent, which was to consider both delegation and accountability reporting as part of a mature and productive relationship between line departments and government-wide management. One desired outcome was to relieve Treasury Board ministers from the tedium of examining thousands of departmental submissions annually. The board, in time, would become more effective by moving away from a case-by-case approach towards governance at a higher level. IMAA was a deliberate attempt to introduce the new approach to management and control in the government.

IMAA Antecedent

The accountability process proposed by IMAA closely parallels the process that the Ontario government already had in place for some time.[146]

IMAA delegations

IMAA delegations had both a universal and a departmental-specific component. The universal delegations represented significantly increased authority limits—or, in some instances, complete delegation—in designated administrative policy areas. Compliance was to be monitored by cyclical audits and reported in annual management reports. The particular delegations represented specific authorities sought by the minister and the department. For the most part, they were negotiated between officials from the secretariat of the Treasury Board and from the department. One *quid pro quo* for these further delegations was an agreed-upon reporting of results-based program-performance information (with targets, as appropriate) to replace operational information, particularly that which uses inputs as a proxy for the measurement of effort.

Ex-ante Controls

Ex-ante controls are general rules in advance of decision making and/or specific rules at times of decision making. Within the Government of Canada, general rules (or interpretations of those rules) are likely to be service-wide, originating from:

- legislation: such as the Financial Administration Act, the Public Service Employment Act; and
- Treasury Board: in the form of administrative and personnel regulations, policies, and guidelines.

There are also departmental rules or interpretations of legislation and regulations or of Treasury Board policies and guidelines to suit the particular circumstances and distinctiveness of the department in question.

This approach implied a reward, and early "memoranda of understanding" between the president of the Treasury Board and the departmental minister specifically identified the areas of control being delegated, as well as the nature of accountability sought in exchange. The expectation of an annual accountability report referred to as an Annual Management Report, and subsequently an in-depth review report in the last year of the period covered by the agreement, summarized the nature of the *quid pro quo*. It was also understood that the accountability reports would cover more than just the specifics of the new delegations. In retrospect, deciding on what powers ought to be delegated was comparatively easier (except for a natural resistance to "letting go") than the actual formulation of the accountability arrangements.

Memoranda of understanding

A memorandum of understanding like the one developed under the federal initiative (for the purpose of the IMAA procedure) can help sort out some complex accountability relationships. In organizations like the federal, provincial, and local governments, there are multiple relationships one has to recognize involve the substance of accountability, as well as the identification of the parties to the accountability relationship. The following is a comprehensive, but by no means exhaustive, checklist[147] of issues to resolve in the development of a good memorandum of understanding between such parties. It is intended as a guide to questions that may arise in the negotiation of an understanding.

As an accountability agreement, a good memorandum of understanding would dwell on the following:

- clarifying the task or the responsibility;
- the extent of the delegation;
- clear identification of the parties to the agreement;
- the nature and timing of reporting back;
- the criteria of performance and selection of indicators; and
- the accountability contract.

And it would be necessary to clarify what the departments would be accountable for:

- resource utilization;
- service efforts;
- accomplishments;
- results, effects, outcomes;
- compliance with Treasury Board policy/guidelines;
- administrative, management; and/or program performance.

However, it is difficult to formalize a memorandum of understanding unless the parties understand to whom the departmental minister is accountable for the delegated responsibilities:

- the president of the Treasury Board;
- the prime minister;
- Cabinet;
- Parliament (through standing committees of the House of Commons).

It would be necessary to distinguish between:

- the collective responsibility of the minister, and
- the departmental responsibility.

Similarly, it becomes necessary to agree to whom the deputy minister is accountable:

- the prime minister;
- the minister;
- the Clerk of the Privy Council;
- the Committee of Senior Officials under the Privy Council Office (COSO);
  the president of the Treasury Board, the ministers of the board;
- the secretary of the Treasury Board; and in certain matters
- the chairman of the Public Service Commission.

To complicate the question, assuming that the answer is that the deputy minister is accountable to any of the above persons, it is necessary to specify just what he or she is accountable for:

- departmental performance;
- own personal performance;

- his or her relationship with the minister;
- only resource utilization.

In any event, what performance do we have in mind?

- administrative;
- managerial;
- policy;
- leadership.

And in respect of what values, what criteria?

- prudence, due diligence, probity, integrity, equity;
- economy, efficiency, effectiveness (which can include the above);
- attributes of effectiveness (for example, the CCAF approach which includes all of the above).

Pursuing what purpose?

- departmental;
- superior objectives of the government (equity, regional concern, bilingualism and multiculturalism, and so on).

How often?

- annually;
- three or four years from now with an in-depth review;
- ongoing monitoring.

How detailed?

- highly summarized;
- comprehensive;
- on significant matters only;
- by exception;
- tactically;
- strategically.

Precise answers to every one of the above and similar questions are not likely to be found. Some experienced people think that such answers may not even be necessary. They would like to see accountability relationships established at a higher level of generality. Although they recognize that while the relationships ought to be relevant with the respective responsibilities of the parties to the agreement, they would like to see the latter less specific and sufficiently aerated to allow for an effective stream of comfortable reporting and not lost in the tedium of a contractual agreement. Parties to an accountability agreement or understanding ought to feel good about each other. Otherwise, the accountability relationship will remain largely procedural, and in a way, sterile.

Reporting on program delivery

One serious challenge raised by IMAA whose solution remained elusive is the specification of program results and reporting on program delivery. There are significant difficulties with aggregating multifaceted departmental activities, the costing of these products or services, and their monitoring and control against predetermined benchmarks, often because of an absence of service-quality standards.

Measuring immediate or ultimate outcomes of government activity is difficult. Government programs tend to produce many heterogeneous and highly disaggregated outputs. It may be possible to measure the output and some of the outcomes with respect to one specific product or service. It's more difficult to find a set of measures that capture the essence of a complex program. The more one aggregates, the more outside factors enter the equation to affect the outcomes, making accountability more arduous and less clear. Compounding the problem sometimes is the unjustified belief in "simple" indicators of performance of a complex process, a view that often places expediency ahead of common sense.

Another factor that is difficult to assess is the extent to which using a known criterion to measure performance will actually result in a concentration by program managers on that aspect of performance, perhaps at the expense of broader considerations.

Departmental versus government-wide responsibility

Another issue raised by IMAA is that of departmental freedom versus government-wide corporate responsibility—the bureaucratic version of the issue of individual versus the collective responsibilities of a minister. Briefly stated, the more one delegates to departments the power to make decisions unfettered by central-agency oversight, the less one can confidently undertake government-wide initiatives to respond to governmental priorities.

Public Service 2000

The term *Public Service 2000* (commonly referred to as PS2000) was chosen to indicate the federal government resolve in the late 1980s to modernize its civil service by embracing the latest tenets of the managerial revolution that was taking place in Canada and abroad in both the public and the private sectors. The reform was intended not only to modify the system but also to alter the culture of the bureaucracy. It was largely undertaken in response to citizens' growing dissatisfaction with the government. One of the major purposes of this vast undertaking was to establish the primacy of the citizen—the taxpayer, the client—in the day-to-day provision of government services.

PS2000 had four main themes:[148]

- improved service to the public through focus on results and client-oriented delivery;
- empowerment of public servants to use resources in the most creative and responsible manner;
- dealing with public servants in a way that reflects the critical importance of people to successful government operations; and
- emphasis on accountability.

Delivering Quality Service to Clients

Aiming to improve quality of service to clients raises a conceptual problem because quality means different things to different people. For some, quality is simply value for money. For others, quality is when the goods are delivered on time, error-free, and hassle-free. To someone else, quality is found in equity and fairness, and equality of opportunity. Finally, to activists, quality is largely a function of the extent to which they have had an opportunity to participate in the decision making concerning the program in question. There is validity in each of these views.

IMAA and PS2000 go together; one followed the other. PS2000 would have been possible without IMAA, but probably ineffective. PS2000 was actually an extension of IMAA within the departments, pushing the delegation further towards frontline civil servants. Delegation, empowerment, and accountability form the basic vocabulary of the new culture. Controls were to be relaxed, and fewer; those that remained were meant to be more strategic and penetrating. Rules and procedures were to be reduced and simplified. The application of what remains was to be delegated, to the extent possible. Frontline civil servants were to acquire a new authority: they would interpret the rules and be encouraged to exercise judgment—even accepting reasonable risks. In short, they were to be empowered. Thus, programming or service decisions would increasingly be inspired more by the

Empowerment

Empowerment is not the abdication of responsibilities. Nor is it simply the delegation of authority. True empowerment means that managers with delegated authority are provided with the information, the tools, the training and the support they need to achieve desired results.[149]

The following is borrowed from the Treasury Board of Canada:[150]

The objective of empowerment:

Leadership and management practices and behaviors that empower employees by:

- enabling them to exercise authority, with discretion and good judgement, over their areas of responsibility;
- placing authority as close as possible to the point of service delivery, removing obstacles; and
- providing the framework and support needed for client-focused responsiveness and innovation.

The indicators of empowerment:

- a better working understanding of empowerment, including the conditions under which creativity, initiative, trust, teamwork, and excellence in the delivery of government services can flourish;
- availability to managers of information, concrete examples, exemplary practices, and specialist support that further appropriate empowerment of employees, particularly those providing frontline service;
- an increase in delegation that puts authority where it has the most impact on service and supports service-related empowerment of employees; and
- identification of human resources implications of operating budgets and development of models and concrete approaches that make it easier to use operating budgets effectively from a human resources perspective.

reality of the situation at hand than by rules and procedures emanating from departmental headquarters or the Treasury Board.

In this evolving environment, achieving results in a cost-effective manner and the necessity of demonstrating their effectiveness become the essence of the role of frontline civil servants and their supervisors. Accountability is expected. In the absence of feedback from the field to headquarters or Treasury Board, the government could not possibly gauge the effectiveness of the public intervention and the continued need for it.[151] The same is true for large private-sector corporations.

Empowerment is not always limited to the managers and employees of an organization. There are many public declarations intended to empower the citizen or the customer, spelling out their rights and manner of redress and offering a say in decision making. Some hospitals in Canada have a Bill of Rights of the Patients. In the United Kingdom there is a Tenants Charter, a British Rail Passenger Charter, a National Health Service Patients Charter, and others.

In the first move, Treasury Board, which was the custodian of the "rule book" and indeed its interpreter, passed it to the department under an IMAA agreement. In the second move, the departmental headquarters gave the rule book to the frontline civil servant or supervisor. This was a PS2000 procedural change.

Shared Management Agenda (SMA)

In 1991, the introduction of SMA followed PS2000 and IMAA. It was derived from the notion of partnership, an administrative doctrine that acquired currency in the late 1980s and begot the expression "shared agenda." SMA is simply the perception of management, internal to an institution, or a government department or agency, as a partnership. It is construed as a forum of discussion, largely paperless and highly personal. The process was intended to have Treasury Board and the department agree to share a limited number of managerial and administrative issues at a high level—that is, between the Treasury Board Secretary (TBS) and the departmental deputy minister.

Shared Management Agenda

SMA is the most recent in the long line of acronymic managerial frameworks that Treasury Board has fostered over the last three decades: PPBS, OPMS, MBO, OPFS (Operation Planning Framework System), IMPAC (Improved Management Practices and Control), PEMS (Policy and Expenditure Management System), IMAA, PS2000, TQM, and this one, SMA. Each of these initiatives responded to the evolving needs of the time and contributed to the next one.

Parallel and complementary priority setting on managerial issues within TBS and the department was the main focus of SMA. Areas in need of mutual support were identified, and agreement was reached on departmental initiatives and resulting submissions to the Treasury Board.

SMA also served the annual TBS department management assessment as an input for the COSO (Committee of Senior Officials) performance evaluation of deputy ministers.

The SMA differed from IMAA in several respects: IMAA operated at the political level, the Treasury Board ministers and the departmental minister. SMA was at the managerial/administrative level, the Secretary of Treasury Board and the deputy minister. The main focus of IMAA was comprehensive and largely on delegation and accountability; that of SMA had to do with selected management issues, which can be construed as an aspect of managerial accountability.

While SMA as a TBS initiative was created chronologically later than IMAA, it is intended to stand alone.

From the point of view of accountability, IMAA provided the vehicle for ministers to be accountable with respect to the authorities delegated by the Treasury Board. Only indirectly can IMAA be seen as providing an assessment of the personal performance of the deputy minister. The SMA process, with the emphasis it placed on departmental management and its adherence to government-wide administrative policies, provided a good mechanism to assess the actual performance of the deputy minister in areas of relevance to the Treasury Board. This assessment was then fed to COSO which is responsible for the overall personal performance evaluation.

SMA outlined the global criteria to guide the assessment of departmental management. It used as a model a contemporary framework that includes attention to results, the client, leadership, employee participation in decision making, accountability, and so on: in short, all of the notions propagated by the PS2000 initiative. As such, SMA was the realization of PS2000, assessing departmental management and the deputy minister using its precepts as criteria. It also encouraged the response of departments to such government-wide obligations as downsizing, employment equity, official languages, and in extending cooperation to other departments, sharing of good practices, and transparency in the department's dealings with the central agencies.

Was control lost?

Taken together, IMAA and PS2000 were redefining control and controls in the federal government, a fact that generated skepticism in certain quarters. There have been serious debates among senior management, financial managers, and auditors alike over the apparent reduction in control at a time when some concerned Canadians and critics are calling for more or at least better.

Nothing in the description above suggests that control had been lost. The Treasury Board was still very much in control. In a way, IMAA was the control; so was PS2000, its extension. Controls, however, changed. There was no abdication of control because of delegation, just a change in the mechanisms to exercise it, the controls themselves. The rules were still there. The rule book, instead of staying in the Treasury Board, was shared and placed in the hands of frontline civil servants for interpretation and application. They have to follow the rules. But not every situation that can arise in the field will have been foreseen by the authors of the rule book. This well-understood possibility led the framers of PS2000 to empower frontline employees and exhorted them to use their judgment in such cases. Thus, the interpretation of the rules was to be made in the light of the local situation instead of "checking with head office" for a ruling by someone who cannot have a feel for the situation and who has only the possible advantage of having heard of similar problems previously.

Some people in senior management do not feel comfortable with this type of delegation as they are used to formal procedures and top-down controls. Some employees who have received delegation are not used to handling such responsibilities, being accustomed to acting on instructions, doing what they are told, and deriving a certain level of comfort from that approach.

Some Have Reservations...

There has been some cynicism about these new approaches. Many people look at them as fads. Use of such terms as *empowerment* and *total-quality management* and their vacuous repetition without translating them into their bureaucratic implications does not help put theory into practice. To be successful, empowerment has to be incorporated in the actual procedural workings of the organization, and to date there has been much more talk than action. In addition, low quality and lack of responsiveness to the customer may have far more to do with the structure of the organization, its basic processes and procedures, or its lack of vision and purposes, than with the employees themselves.

Senior managers who are concerned about delegation ought to feel equally worried about empowerment. They would be right if there is reason to believe that frontline employees have insufficient knowledge and understanding to be able to reconcile the intent of the program with the nature of an unforeseen demand being made on it. In principle, however, if the employee is familiar with the program, is properly trained, knows the rules, knows the clientele, gives indications of being responsible, and is held accountable, there is no reason for senior managers to apprehend a loss of control.

Many of those who feared a loss of control under the new approach believe that the old, more detailed and centralized system guaranteed compliance. However, substantial evidence indicates that, under the previous managerial culture, central control and centralized controls through a hierarchical top-down management structure were *not* a guarantee of compliance. The existence of many levels of control or supervision—indeed, the excessive layering—made the process so heavy and paperburdened that in some cases frontline civil servants became adept at exploiting loopholes in the rules. They effectively ignored directions cascading down from headquarters and ended up doing what they judged was best, presumably in favour of the client. They might as well be empowered, with the added safeguard of being held accountable; they already felt responsible.

The transition continues

In February 1995, the federal government announced the establishment of a new expenditure management system.[152] One of its objectives is to "enhance accountability through a focus on performance and better public information."

Two key features of this system are departmental Business Plans and departmental Outlooks. Their introduction built on the philosophy of past initiatives, such as the IMMA regime and SMA process, but replaced or modified their procedural aspects. These Business Plans and Outlooks are intended to provide departments, Treasury Board, and Parliament with the means to understand, communicate, and review where the department or agency is going, how it's going to get there, and related resource and service implications.

Departmental Business Plans are based on the service lines or major businesses of departments. They are intended to draw departmental ministers and deputy ministers into direct dialogue with the Treasury Board on issues of strategic import, including the impact of planned adjustments in service, potential funding pressures, and program risks.

Business Plans are change documents that they place emphasis on the incremental nature of activities. They integrate the key program, resource and policy elements that are critical to a department in making business adjustments, and they provide a basis for departments and the Treasury Board to work together to address related challenges. Moreover, they provide the means by which departments can propose specific authorities or flexibility that they need in order to implement change strategies.

Departmental Outlooks expand the scrutiny role of parliamentarians. They assist parliamentary committees in carrying out their new responsibilities for reviewing future expenditure trends and priorities, and provide a context for their examination of Estimates.

These Outlooks are documents that departments, through their ministers, provide to their respective standing committees. They draw on the results of the business-plan process and, based on resources allocated in the budget, set out departmental strategies to adapt to the fiscal and policy environment and to meet specific service targets. As a starting point for discussion with standing committees, these Outlooks explain the background context for departmental strategies and changes, departmental priorities, new directions and their implications, key initiatives being taken to adjust to significant change, the issues and challenges related to important stakeholders such as other departments, and performance indicators to gauge the impact of adjustments on the quality and level of service.

The managerial revolution: cultural and procedural

PS2000 and similar initiatives in both the public and private sectors have been labelled a cultural revolution. The original belief was that the change in culture would be slow—some were saying one generation—while the systems could be changed quite quickly. Some observers think that the culture was already largely there: frontline employees were ready; middle management, to a large extent, was ready; it was only a matter of time before senior management would notice and take appropriate action. Those observers would also note that it is taking a long time for the philosophy to be translated into operational procedures.

The managerial revolution may well be the only appropriate framework for the emerging generation of managers and non-managers alike. The managerial class of today was largely brought up to enjoy greater freedom than was allowed to previous generations; culturally, the family setting preceded the workplace.

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145 Examples of experiences in British Columbia and Ontario are given in *Canadian Public Administration/Administration publique du Canada*, Summer 1992 and Spring 1991, by Kenneth Kernaghan and Brian Marson, respectively.

146 For a full description of the approach of the Ontario government, see *Annual Report of the Provincial Auditor of Ontario for the fiscal year ended March 31, 1986.*

147 Several elements of the checklist may have been used under IMAA. However, this particular check-list was developed by one of the authors of this book using some material from IMAA procedures but largely relying on the logic and understanding of the machinery of government.

148 Ian Clark's presentation at a CCMD (Canadian Centre for Management Development) Armchair Discussion on 5 March 1992, "Shared Management Agenda: improving management through partnerships".

149 *Report of the Auditor General of Canada to the House of Commons*, 1992, 204.

150 Human Resources Development Branch of the Treasury Board Secretariat on behalf of the Human Resources Development Council, "Strategies for People, An Integrated Approach to Changing the Public Service Culture," July 1992.

151 This, of course, is not true of all services, or all levels of government. The population and its representatives do not need the same kind of accountability of front-line civil servants to find out if some services are effective or not, for example if the water is cut off, if the snow is not removed, or if the hydro blacks out.

152 See Planning and Communications Directorate, Treasury Board of Canada, *The Expenditure Management System of the Government of Canada* (Ottawa: Treasury Board, 1995).

Part II

Performance Reporting

Part II

Performance Reporting

Report me and my cause aright.

William Shakespeare, *Hamlet*, v. ii. 353

Introduction

Accountability, as we have seen, is the obligation to render an account for a responsibility conferred. Part II focuses on the manner in which that responsibility is discharged.

The ways in which people discharge their accountability obligations has been a matter of much public attention. Over the years, the Canadian public sector has been subjected to studies by royal commissions, parliamentary and departmental committees, special inquiries, and academic and consultant assessments. A number of these relate directly to how the organization defines and conducts its business and how it reports on what it has done.

Some of the traditional means of reporting the performance of public bodies have continued unchanged; others have changed substantially; still others have been abandoned. New mechanisms have been introduced: systematic external and internal audits of performance, for example, are relatively new tools, as is professional program evaluation. The concept of management representations on performance is newer still.

Rules governing the self-regulating professions and legislation affecting accountability reporting in the private sector have been periodically reviewed and amended to conform to evolving norms and expectations. Canadians can by no means be accused of ignoring their accountability practices. Part II discusses the current theory and practice of accountability reporting. It focuses on

A Brief History

The history of the machinery and administrative practices of the government of Canada in this century, echoed to a greater or lesser extent in the provinces, is one of almost constant flux. The accountability regime has not been immune from change. Patronage in personnel matters was substantially overcome by the introduction of the merit system in 1918. The subsequent unionization of public servants, with its accompanying grievance system (the growth of collective bargaining really took off in the 1960s and 1970s) introduced what some see as a new accountability regime. Swings between centralization and decentralization have been relatively frequent. A comptroller of the Treasury was created in the 1930s to handle the preauthorization of all expenditures formerly done by the auditor general. That position was abolished in the 1960s. The Office of the Comptroller General was established in 1978, but in 1993 its functions were absorbed into the Treasury Board Secretariat and the Secretary of the Treasury Board assumed the additional title of Comptroller General. Various managing and budgeting techniques have been introduced (with a virtual hail of acronyms) and then abandoned. Government-owned business corporations were formed; privatization pursued.

Flux indeed. Seen in these terms, one might conclude that Canadian public administration has been in the hands of people prepared to abandon promising initiatives in favour of the latest management acronym. Not so. The history of public administration is one of a continuous search for better control, effectiveness, and accountability in the provision of public services. Incremental change is the only option where there is no perfect solution.

reporting about performance or effectiveness by management to governing bodies and by those bodies to the constituencies to which they are accountable; in short, with reporting on the discharge of established policy. Accordingly, Part II does not discuss performance reporting at lower levels in an organization. Furthermore, in keeping with the intent of the book, its focus goes well beyond the reporting of financial performance, though this is an important subject.

The term *reporting* connotes much more than the physical act of making a report. It involves the conceptual framework underlying reports: the determination of the audience and that audience's needs; the decisions of what should be reported, how, and how frequently; and consideration of what must be done to obtain the information reports will contain. Reporting on performance can and should be distinguished from measuring it. While Part II refers to measurement at various points, its emphasis is on reporting, not measurement, techniques. It provides a set of principles that, when put into practice, can draw on the best practices and products of such existing measurement and analysis processes as policy research, program evaluation, and program monitoring.

While the discussion concentrates on the public sector, many of the principles discussed apply to the private sector, as well.

The term *management* as used here refers to that group of individuals who are the full-time, paid leaders of organizations. Some members of governing bodies have management responsibilities and must, in certain circumstances, be considered in this category. For example, at the federal and provincial levels of government, cabinet ministers have specific management responsibilities, assigned by law, that they fulfill in collaboration with their deputy ministers and public service management teams. Analogous situations exist in the municipal, health care, and other parts of the public sector. In the private sector, executive officers of corporations frequently find places on the company's boards of directors. By extension, management includes the management cadre of an organization: that hierarchy of managers responsible, as delegated, for the performance of various functions or programs of the organization.

The term *governing body* refers to the group of elected or appointed officials who exercise oversight and general direction of organizations. Examples of governing bodies are:

- federal and provincial legislatures;
- municipal and regional councils;
- boards of directors, governors, and trustees of hospitals and school boards;
- appointed and elected boards of governors, trustees, directors, or academic senates of universities and community colleges;
- advisory, planning, and regulatory councils and agencies;
- boards of social service agencies, charitable organizations, arts, cultural, interest group, and professional organizations;
- boards of state enterprises, majority owned or effectively controlled by governments or their agencies;
- in the private sector, boards of directors of private or publicly held corporations.

It is to such governing bodies that management must report.

Performance entails accomplishments as related to efforts or capabilities and intent. The word *performance* is often accompanied by a contextual modifier, such as *public sector* performance, *administrative* performance, *management* performance—indeed, the performance of a manager or of the team, program performance, or organizational performance. To be effective means to have the capability to cause an intended result, or to have actually achieved it. The word *effectiveness* in management and administration literature and in daily parlance is also often modified by the same words as *performance: program* effectiveness, *managerial* effectiveness, *organization* effectiveness, and so on. Thus, in the context in which they are used, performance and effectiveness share meanings and, as in this book, are often used interchangeably, although effectiveness is the term most used from here on. A more careful examination of the concept of effectiveness is found below.

Part II is organized into two sections. Section 1 reviews the ways that performance has commonly been reported and discusses some of the conceptual issues involved. Section 2 suggests a framework and approach for such reporting.

Although contemporary organizations typically produce a wide variety of information (as described briefly in chapter 8) both for internal use and external distribution, it is often difficult to obtain a complete picture of an organization's effectiveness. A major reason for this is that the concept of effectiveness is itself difficult to grasp. For management to be truly accountable, and for governing bodies to discharge fully their fiduciary responsibilities, it is essential that this difficulty be overcome.

As chapter 9 explains, no single definition of effectiveness offers a practical basis for determining the extent to which an organization is effective. It is possible, however, to determine what characteristics an organization should display if it is to be successful in fulfilling its mission. The *twelve attributes of effectiveness* presented in chapter 10 cover the most important aspects of an organization's success, or lack of it. Depending on the organization or circumstance, some of those attributes will be more important than others. Indeed, in certain cases, one or more of them may be irrelevant. Nevertheless, by obtaining reliable information respecting these attributes, or all that are relevant in the circumstances, a good overall view of an organization's effectiveness or performance can be obtained.

The contention is that responsible management should be prepared to analyze its performance and report its findings to the governing body. Management—and management alone—has, or should have, the information upon which to base such a report. Only by doing this will management be truly accountable. And only with such information can a governing body make the informed decisions necessary to discharge its responsibilities appropriately and with confidence.

In chapter 10, a mechanism for performance reporting is suggested: management representations. These are explicit statements that senior management makes to its governing body about an aspect of the organization's effectiveness or performance. If management makes representations on all the relevant attributes of effectiveness, an informed conclusion may be drawn about the quality of its stewardship of funds and other resources entrusted to it for the accomplishment of the organization's mission.

Preparing management representations on effectiveness is no easy matter, as chapter 11 explains. Experience shows that few organizations have all the necessary information upon which to base reliable representations on the suggested attributes. Nevertheless, most organizations that have attempted such performance reporting have found it possible to draft representations that significantly improve the information on which the governing body can rely in exercising its oversight responsibilities. Where gaps are found in the information needed to prepare representations, decisions can be made subsequently about whether to fill them and, if so, how.

Certain preconditions should be met before an organization embarks on making management representations on effectiveness. Paramount among these is a degree of trust between management and the governing body. Organizations that have been successful in preparing these representations usually have a history of trying to improve their information and accountability systems. Organizations in a state of major transition or crisis probably should wait until senior management, which is vital to the success of the exercise, has sufficient free time to devote to the difficult issues that must be dealt with in preparing representations.

Chapter 12 offers detailed advice about how management could go about the difficult task of drafting appropriate representations. The approach outlined in chapter 12, however, is not the only approach that can be taken by management. Indeed, it is essential to recognize that different circumstances may call for different approaches.

There is, of course, the danger that management's reporting may be either biased or incomplete. Where this is an issue, or where the governing body wants added assurance that what it is receiving is fair and complete, independent validation can be engaged. The role of auditors in this context is discussed in detail in Part III of this book.

The suggested framework and approach to performance reporting is not intended as a template or a panacea. There is no intention to be prescriptive. All or part of the framework may be useful in particular circumstances. Nor is it being suggested that the measurement and analysis processes and systems operating within an organization (for example, evaluation, internal audit, policy research) and feeding into the production of the necessary information should be reshaped in the likeness of the framework. On the contrary, the framework is intended as a flexible tool or broad set of principles to help management and their governing bodies consider the performance of their organization and determine which aspects need to be reported, and how to achieve that so as to convey a fair and complete picture of performance. The framework and suggested approach are designed to provide a benchmark against which to apply the completeness test for the performance reporting made, accepting that the internal processes used and the form and structure of the actual report eventually made may vary from organization to organization and circumstance to circumstance.

Section 1

The Theoretical Basis for Performance Reporting

Chapter 8

Existing Reporting Practices

Managements report on their performance to their governing bodies through a wide array of mechanisms. Some are found in both the public and private sectors, others are specific to the organization concerned.

Public sector reporting mechanisms

Oral reporting

Probably the best-known way that governments account for their performance is through the question periods of provincial and federal legislatures. Television has given this daily exposure to rigorous examination an importance and public familiarity not always comfortable for hard-pressed ministers of the Crown. Ministers take these sessions seriously, spending time to prepare for the coming ordeal. Although it has been described as the essence of parliamentary democracy, several factors conspire to make Question Period an incomplete accountability reporting mechanism.

The legislature is a political forum. It is the cockpit of partisan dispute. As a result, questions and answers tend to focus on what will score points for political advantage. Often concentrating on issues found in the headlines, questions are frequently designed as much to embarrass as to extract information. Because topicality plays such an important role in determining what questions will be asked, there is no attempt to hold all aspects of government activity to account, and no occasion for ministers to tell everything that they might want to make public.

In answering questions, ministers are constrained not to lie—the sanction if they are caught out is usually resignation. Nevertheless, at times, it is expedient, even necessary, to shade or shelter the whole truth, for any number of reasons, some quite honourable. And apart from what can be discovered by investigative reporters or assiduous opposition researchers, there is no independent check on the replies that are given to questions in the House.

Debates on the floor of the House provide other opportunities for ministers to account for their actions, and for opposition members to comment on performance. In general, debates suffer the same drawbacks as Question Period: the forum is political, and the subject matter limited.

Somewhat similar constraints apply in meetings of legislative committees, although the partisan tone is usually substantially reduced, and often public servants are present to provide factual information. Since their procedures are usually less formal than House debates, committees can dig deeper into details than is possible in the House. In addition, most legislatures structure their committees to cover the entire range of government activity, providing at least the opportunity for comprehensiveness. In reality, however, time constraints limit the areas than can be explored in depth. Except when explosive issues are being discussed, media coverage of committee proceedings tends to be minimal.

> **I repeat... that all power is a trust—that we are accountable for its exercise—that, from the people, and for the people, all springs, and all must exist.[153]**
>
> Benjamin Disraeli

Outside the legislatures, ministers find many opportunities to explain their actions: in public speeches, meetings with constituents or interested parties, interviews with the media, and so on. Although not perfect vehicles, these occasions are a significant part of a minister's accountability reporting regime.

Outside the senior governments, nearly all public sector bodies provide some opportunity for the governing body to question senior management and for managers to give an account of their performance. The degree of formality may vary, and the scrutiny given to such reporting may range from the intense to the casual. Where meetings are public and the governing body is publicly elected, as with municipal councils, the questioning of management may sometimes assume a political, if not partisan, cast. In other circumstances, as where the board is the captive of the CEO, compliant acquiescence may be the order of the day. Given the number and variety of organizations, there is bound to be a wide range of practice.

Written reports

Governments produce a plethora of information in a variety of forms. Many of these have nothing to do with reporting on performance or accountability: gazettes with their legal information, guides to obtaining government services or completing government forms, calendars for garbage collection, volumes of statistical and other information, and booklets promoting such diverse matters as health, industry, cookery, tourism, and recreational activities or events are only a few examples. Some reports, however, have a direct bearing on our subject.

Senior levels of government

Until recently, it was the practice of ministers in the federal government to issue annual reports of their departments' activities. The provinces continue to do this. These reports seldom reflect a standardized format and tend to concentrate on activities undertaken in the relevant fiscal period. In most instances, the reports give no indication of the reliability or completeness of the information they contain. Nevertheless, they provide information on government activity that might otherwise not be readily available. Typically, these reports are made public after tabling in the House, where they are available for members to use in debates, questions, and committee discussions. Late filing of these reports—in some cases, up to two years after the end of the fiscal period—limits their usefulness as accountability documents.

Reporting on financial matters is of direct concern here. While it is not our intention to present a treatise on financial administration in government, an overview of the various documents involved is germane.

At the two senior levels of government, the financial cycle starts with the presentation in the House of the annual budget, a document given wide public attention. This document outlines the government's spending intentions and indicates how it will be raising money. Emphasis is usually given to changes from existing levels of outlay and income. Debate on this document provides legislators with an opportunity to discuss any subject of interest to them.

The concrete details of the government's spending intentions are presented to the House in the printed document *Estimates*. Although practice varies, these *Estimates* typically provide little in the way of performance information, in terms of either what has gone before or what will result from the intended expenditures. In an attempt to overcome this deficiency, the federal government introduced what are called *Part III Estimates* in the early 1980s. *Part IIIs*, published as one document per department or agency and written in a way intended to be easy to read, display forward-looking information on spending plans, even beyond the year of appropriation, as well as information on past performance. Importantly, they display actual expenditures against previous plans. They also explain the mission of the department or agency, its near-term orientation, structure, and past performance. In effect, *Part IIIs* have replaced annual reports and brought the added advantage of presenting information in a manner consistent with what was actually approved by Parliament. While they have become the most important documents for reporting to Parliament by a department or agency, *Part IIIs* are still incomplete accountability documents. While they contain some evidence that demonstrates the efficiency of the department, they do not, for example, take into account related tax expenditures (that bypass the system of spending proposals and appropriations and are hidden but important holes in the public purse). Nor do they provide sufficient information upon which an informed assessment of overall effectiveness can be made on entire programs at a level that is meaningful to parliamentarians.

After the *Estimates* are tabled, legislation is introduced and passed giving the government the legal authority to spend and raise money as it has indicated it wants to. Expenditures are authorized by an Appropriation Act; and separate bills, such as those amending taxation legislation, deal with various means for raising revenue. Some expenditure programs, such as federal payments under the Canada Assistance Plan, do not require annual legislative approval, as they are governed by statutes of continuing force.

The *Public Accounts*, published some months after the end of each fiscal year, display the government's financial position and detail the ways money has been received and spent. The form in which these documents are cast makes it exceedingly difficult for nonexperts to gain a clear insight into events.

Of much more interest to legislators and the public are the reports of the legislative auditors—the Auditor General of Canada and his provincial counterparts. These reports contain the results of the auditors' examination of the *Public Accounts* and of other such audits they have conducted during the year. With the comprehensive audit (value-for-money) mandates the vast majority of these auditors now have, the reports contain assessments of various aspects of government programs, activities, and functions, and recommendations for ways in which administration could be improved. Their legislation, however, does not allow most auditors to examine the effectiveness of government programs, constraining them not to comment on policy. Despite this limitation, these reports, combined with the *Part III Estimates* and their provincial equivalents, offer the most detailed, authoritative reports on governmental performance available at present.

The comprehensive auditing mandates are significant, as they usually mean that governments are to be audited by the legislative auditor with respect to:

- financial management and control;
- reporting to Parliament on performance;
- attesting to the financial statements and the authority of transactions;
- management controls;
- economy, efficiency, and effectiveness; and
- adequacy of electronic data processing (EDP) and other information systems.

And the auditors' reports, of course, contain findings on government performance in these areas.

Both the *Public Accounts* and the auditor's report are typically referred to the Public Accounts Committee of the legislature for examination. Usually chaired by a member of the opposition, these committees tend to concentrate on the audit report, as it is more understandable than the *Public*

Accounts and comments on issues of interest to legislators. Committee reports are tabled in the legislature and usually contain recommendations for action by the government. These reports are seldom debated in the House.

In addition to these annual publications, over the years there have been numerous royal commissions, parliamentary, ministerial, interdepartmental, internal audit, program evaluation, and other *ad hoc* reviews to assess many aspects of government policy and administration. Some of these reports contain a wealth of information and useful comment on the aspects of government operations their authors were charged to examine. Many of these reports, though by no means all, have had a direct effect on what governments do and how they go about doing it.

One government initiative, the enactment in 1984 of Bill C-24, an Act to Amend the Financial Administration Act in relation to Crown Corporations, demonstrated the government's resolve to take concrete steps in the matter of the control, direction, and accountability of federal Crown corporations.[154] The legislation clarified the responsibilities of these corporations in matters of management, information, and oversight by their boards of directors. The act introduced a novel approach to audit for Crown corporations, including some specific attention to the notion of effectiveness.

More precisely, the legislation requires that auditors provide positive assurance that the corporation's systems and practices "were maintained in a manner that provided reasonable assurance that… the operations of the corporation and each subsidiary were carried out effectively."[155] It also requires management to report on the performance of the Crown corporation with respect to the attainment of objectives in the year in question. It even specifies the value system to inspire the management of the corporation: the safeguarding and control of the assets, economy, efficiency, and effectiveness.

OTHER PUBLIC SECTOR ORGANIZATIONS

It is difficult to generalize about performance reports emanating from the public sector outside the two senior levels of government. Typically, there are budgets and audited financial statements. The amount of detail they contain and the distribution given to them vary greatly.

In recent years, there has been a significant increase in the amount of information that some funders require from the nonprofit service agencies to which they give money. Often, agency budgets must be accompanied by or incorporated in what are sometimes called service plans before the funding government will decide on the amounts to be given. These service plans often include information on what the organization has accomplished in the past and what it expects to do in the future. While these plans provide much more information than simple financial budgets supply, they tend to concentrate on inputs—hours of care, number of students taught, and so on—rather than on the outcome achieved by the goods or services produced. It is impossible to say how many, if any, of these plans are distributed outside the organizations themselves and the government departments on which they rely for funding. It is significant that nongovernmental funding agencies such as the United Way show a similar tendency to ask for more performance information from the organizations they support.

Certain areas call for mandatory performance reports. An example is the quality assurance reports required from various hospital departments. Such reports are regularly considered by the governing board and forwarded, in some jurisdictions, to the provincial health ministry. The following letter indicates how seriously these reports are taken.

Letter from the Chairman of a Hospital's Quality Assurance Committee to Heads of Department, 1993

Quality assurance reports have improved substantially over the last two or three years. While the Quality Assurance Committee includes health care professionals, it also has very attentive members of the Board of Trustees. Authors are gaining experience in writing clearer reports, which is at least partly the result of the implementation of guidelines and their continuous improvement. As well, the trustees are getting better at reading the reports, through their growing familiarity with the substance of the hospital, their careful analysis of the reports, and their raising of increasingly incisive questions.

The words chosen by the authors of the reports are important to the trustees in helping them to understand the evidence offered for assuring quality. On occasion, however, health care situations have been described using qualifiers with strong emotional overtones. We can understand the frustration of some authors in describing some situations, or the apprehension of others from failure to take corrective action or in the failure to obtain the resources necessary to solve the problem. If a situation is serious, then rather than using emotional qualifiers, it deserves to be addressed in a manner that explains why the situation is not satisfactory, what criteria or standards are not met, what has influenced the judgement, etc. If the emotional is used as an opportunity to champion a cause when the internal priorities system did not favour this particular situation, it should not be done in a manner affecting objectivity or preventing the committee from understanding the real implications.

The QA Committee works better when the information provided to it:

1. allows the Committee to provide oversight on matters in which it has governance responsibility or interest;
2. serves to identify and explain key issues, choices, challenges with which management and the Board must contend;
3. is conveyed in such a way that suggests the type of necessary corrective measures to be taken; and
4. assists an informed dialogue between the departments, management and the Board on matters that are considered of corporate significance.

We are taking this occasion to thank you for your excellent cooperation in this important aspect of hospital governance.

There are numerous examples of nonprofit organizations providing information on their accomplishments. In many instances, these are anecdotal accounts of selected programs offered in conjunction with fund-raising campaigns. Few nongovernmental organizations have attempted to assess and distribute information on the overall effectiveness of their performance.

Information on performance tends to be selective, partial. A major study was conducted of not-for-profit institutions in the United States[156] (hospitals, colleges and universities, human services organizations, state and local government units, trade and professional associations, philanthropic foundations) many years ago but is likely still valid today. Its findings are probably valid for Canada, too. The study reported the following:

- evidence of service effort and accomplishments reporting was found in every kind of organization;

- information was found more readily on efforts than accomplishments, efficiency than effectiveness;
- reporting of outputs was common and much of this information was quantified, while there was less information reported on results, and in some cases it was totally absent.

Private sector performance reporting

Private sector reporting requirements range from providing information to satisfy the demands of public regulators and professional financial analysts, to information intended for a more general audience. They must satisfy the needs of many interested parties, including government agencies, self-regulating bodies such as stock exchanges (where securities are issued publicly), shareholders, creditors, potential investors, financial commentators, and any other current or potential stakeholders.

Provincial securities legislation governs the information that companies must make public. To protect the investing public, the regulators require corporations that issue securities to the public to provide full, timely, and continuous disclosure of all significant information. These requirements, together with strict rules governing insider trading, are intended to ensure that all investors have the same information on which to base decisions—a level playing-field.

Increasing attention has been paid over the last decade to the potential of providing more information than is found in the financial statements. The report of the Commission to Study the Public's Expectations of Audits (Macdonald Commission), made the following recommendation in its report issued in June 1988:

> The CICA [Canadian Institute of Chartered Accountants] should look favorably on additional financial disclosure of a softer, more subjective nature in a Management Discussion and Analysis section of the annual report. The CICA should assist and cooperate with securities commissions in the development of standards for information in the MD&A.[157]

In 1991, the CICA published a major research study on the subject of reporting entitled *Information to be Included in the Annual Report to Shareholders*, in recognition of the need for more information than is offered in the financial statements.

Many readers will be familiar with these trends. The instruments are referred to as AIF (Annual Information Form) and MD&A (Management Discussion and Analysis), narrative reporting tools supplementing financial statements. The AIF offers background information on the company, its products and services, the environment in which it operates, as well as its exposure to risk and uncertainties. In the MD&A, management explains in narrative form the company's current financial situation, performance, and prospects for the future. It places emphasis on explaining variations in the results portrayed in the financial statements, particularly in the last two years, as well as known trends, events, uncertainties, and significant risks having an impact on the company's operations.[158]

Regulatory bodies such as the Ontario Securities Commission and the Commission des valeurs mobilières du Québec have turned their attention to both AIF and MD&A in recent years owing to certain shortcomings, and have issued disclosure requirements regarding them. The regulators found that:

> Part of the problem was that narrative information, imprecise by nature, was subject to less scrutiny. Although financial statements must conform to generally accepted account-

> ing principles (GAAP), there were no comparable standards for other narrative disclosures. This left scope for manipulation, allowing companies to present information in a biased manner or omit material information. Moreover, professionalism and judgement, which are crucial for reporting narrative information, were often lacking. The result was promotional and unreliable disclosure.[159]

The new disclosure requirements are intended to overcome these weaknesses. And because substantial advantages accrue to companies which obtain regulatory approval of their reports, the information now generally meets these heightened requirements. A company that issues securities to the public would typically have to prepare the following reports:

- annual audited financial statements and quarterly unaudited statements;
- annual report to shareholders, usually including MD&A, historical financial and operational information, relevant statistics, prospects for the future, and so on;
- Annual Information Form;
- notice of annual general meeting, with accompanying proxy solicitation and information circular;
- immediate press release regarding any event potentially affecting the company's operations significantly, with subsequent report to regulator;
- report to the government agency (federal or provincial) under whose jurisdiction it is incorporated;
- reports to taxing authorities; and
- reports to other regulating (such as environmental) and statistics-gathering agencies.

In addition, many companies issue press releases of information for which the regulators do not require disclosure. And if the company intends to issue securities to the public, it must prepare, have approved, and issue a prospectus containing a wide range of required information.

The foregoing clearly demonstrates that a great deal of information is currently being generated and disseminated to various audiences. Within organizations, information is generated from as many perspectives as there are levels and diversity of operations. People monitoring performance use indicators that may be significant to one manager but quite meaningless to others or to senior management.[160] As a result, adding together all such reports will not necessarily satisfy the needs of the senior managers or governors of an organization. After all, the information needs of a member of a board of directors are substantially different from those of a plant manager; on a functional basis, the perspective on performance of the chief accountant will be different from that of the marketing manager.

Despite all the attention given to reporting on performance, the information that is made available is very often limited in perspective and fails to provide a comprehensive view of how well an organization is doing in all significant respects.

Some recent initiatives in reporting on performance

Recent years have seen a number of initiatives by governments and others (public institutions, private sector, professional bodies) to improve the quality of performance reporting within organizations, and from them to those who govern and are served by them. The reporting frameworks relating to these initiatives differ somewhat in their scope or character. Nevertheless, they share a common emphasis on the importance of bringing forward information about the results (ranging from outputs, to client satisfaction, to achievement of broader goals and objectives) that are being achieved, each commenting that all too often the preoccupation has been with inputs and process. For the most part, these initiatives also share a common general purpose: to provide information that has greater strategic value for decision making and that will enhance greater transparency and accountability.

These initiatives have focused on developing and reporting against key performance indicators, usually within the context of a multi-year strategy that recognizes that finding the right indicators, the means to report against them, and how best to present and use the resulting information are matters that take time and repeated effort to sort out.

A brief overview of some of these initiatives follows.

Initiatives in the United Kingdom

The national Citizen's Charter is a ten-year program launched in 1991. It is linked to a series of earlier initiatives (Financial Management Initiative, Next Steps) stretching back over more than ten years and all aimed at the broad objective of administrative reform. The charter was put forward as a comprehensive program to improve quality, increase choice, secure better value for money, and enhance accountability. It is based on the following six principles:

- Standards—publishing standards and progress against commitments enables customers to put pressure on those responsible for public services to deliver a high-quality service;
- Information and openness—to make best use of their public services, people need information about how they are run, what they cost and how well they perform;
- Choice and consultation—the charter aims to give members of the public a greater say in the way their public services are run;
- Courtesy and helpfulness—public servants are expected to be courteous and helpful to the public they serve;
- Putting things right—the charter stresses that if sometimes things go wrong, public services should offer an apology, a full explanation, and a swift and effective remedy;
- Value for money—providing high-quality public services, focusing on the essentials and ensuring that services are delivered in the most efficient and effective way.[161]

The national Citizen's Charter applies to all public services, and each key public service (health, education, employment, social security, and so on) has its own charter—now forty in all. There are also many thousands of local charters covering local service providers such as police forces and fire services. Consultation allows the public to help set standards by determining the priorities and targets that are important to them. The national Citizen's Charter itself has no statutory basis, but is a matter of agreed government policy.

At the local level, however, the government has enacted legislation (1992) to require all local authorities to publish details of the performance they achieve against a set of indicators. In England and Wales, this work is spearheaded by the Audit Commission (by the Accounts Commission in Scotland), an independent body responsible for auditing local authorities. The Audit Commission has developed a wide range of indicators against which individual local authorities must measure themselves and then publish the results. In addition to providing a basis for reporting to the public, "[T]he indicators were chosen to give information which will also be useful to council staff and elected councillors… They can use the Citizen's Charter indicators to help build their own systems for monitoring performance."[163]

Charter-related Initiatives

Two related initiatives are the Competing for Quality program and the Departmental Efficiency Plans system.

Under the Competing for Quality program, departments and agencies are reviewing their activities. The 1994 report on the Citizen's Charter indicates that the key in this regard is to look at the job to be done and then to work out how best to do it, applying a number of tests, with the aim of introducing choice and competition wherever possible. This encourages public services to respond to their customers' needs, to reward innovation and to improve the effectiveness and job satisfaction of staff.

Key questions are:

- does the job need to be done at all?...
- if the activity must be carried out, does the government have to be responsible for it?...
- where the government needs to remain responsible for an activity, does the government have to carry out the task itself?...
- where the job must be carried out within Government, is the organization properly structured and focussed on the job to be done?[162]

A further related initiative is the system of Departmental Efficiency Plans that are intended to provide departments and agencies with a basis to help them decide how public services are to be delivered in the most efficient way.

The indicators developed by the Audit Commission fall into four broad, and to some extent interrelated, groups:

- indicators of performance, including efficiency and effectiveness
- indicators of cost
- indicators of quality
- indicators providing background information, for example, regarding how much a service is used or about population make-up.[164]

Initiatives in the United States

Several initiatives are in progress at the federal, state, and local government levels to broaden and enhance performance reporting as a basis for improved decision making and accountability. This initiatives include those mandated by specific legislation.

By way of illustration…
at the federal level:

The United States Government Performance and Results Act

As noted in Part I, the Government Performance and Results Act (GPRA) was passed in 1993. One of its key features is a requirement for all federal agencies to submit a program performance report to the president and Congress. These reports will discuss performance achieved against previously stated goals, and describe actions that the agency intends to take to address areas where these goals are unmet.

The essential purpose of the GPRA is to focus accountability reporting within and by federal government agencies on the *results* being achieved by programs, instead of on inputs and process. This results-oriented information is expected to lead to improved decision making (including resource-allocation decisions), better performance, and more effective congressional oversight. Currently, there are several pilot projects operating across the government. Beginning in 1999, agencies will be expected to prepare annual plans setting performance goals, and then to provide performance reporting against these plans the following year.

…and, at the state and local government levels…

Governmental Accounting Standards Board—Reporting on service efforts and accomplishments

The Governmental Accounting Standards Board (GASB) establishes standards for financial accounting and reporting for state and local governmental entities. These standards guide the preparation of external financial reports of these bodies. The GASB also develops concepts to provide a frame of reference for resolving accounting and reporting issues.

Regarding these concepts, the GASB has conducted extensive research on reporting on Service Efforts and Accomplishments (SEA). "[Such] information is necessary for assessing accountability and in making informed decisions; therefore, to be more complete GPEFR [general purpose external financial reporting] for governmental entities needs to include SEA information."[165]

In 1990, the GASB released a major research report summarizing the efforts of two dozen researchers looking at twelve significant program areas of state and local governments. The report recommended a number of indicators that might serve as a useful starting point for expanding and improving external reporting.[166] Subsequently, these ideas were incorporated in the 1994 GASB Concepts Statement related to Service Efforts and Accomplishments Reporting. The Concepts Statement itself does not establish SEA reporting requirements for state and local governments. Instead, it provides a framework of ideas around which further consideration and experimentation can be done in relation to such external reporting.

The SEA reporting framework has three broad categories of measures:

- measures of service efforts (input indicators, both financial and nonfinancial);
- measures of service accomplishments (output and outcome indicators, focusing, respectively, on what has been produced and on what has been achieved); and
- measures that relate efforts to accomplishments (efficiency and cost-outcome indicators).

It is anticipated that SEA reporting may also include explanatory information to "help users understand reported SEA measures, assess the entity's performance, and evaluate the significance of underlying factors that may have affected the reported performance."[167]

The Concepts Statement discusses some of the limitations of SEA information, recognizing that these measures are but one component of the information used to assess accountability and make decisions. It also outlines ways in which some of these limitations may be mitigated.[168]

Reporting initiatives at the state and local levels—Oregon, an illustration

A number of states are taking initiatives to establish and expand performance reporting to the public. One such initiative is the Oregon Benchmarks program, launched in 1989. At that time, the legislature created the Oregon Progress Board, a panel of statewide leaders charged with monitoring the achievement of the state's strategic goals.

The framework within which such reporting has occurred consists of an extensive series of benchmarks, or quantitative measures, that are used to track the extent to which Oregon's strategic goals are being met. The emphasis of these benchmarks is on results.

Altogether, in the 1995 report to the legislature (the third such biannual report), there are over 250 such benchmarks, of which approximately twenty have been designated as core measures.[169]

The city of Portland, Oregon, has been very active in the area of service-efforts and accomplishments reporting. A public report is produced annually, which contains a wide range of performance information on the city's largest and most visible programs. The information in the report is independently checked by city auditor staff.[170]

A number of other states (for example, Minnesota, Texas, Iowa, Arizona) are also experimenting with what some have termed "results-oriented governance." Cities such as Phoenix (Arizona), Sunnyvale (California), and Milwaukee (Wisconsin) are examples of other local governments acknowledged to be in the upper tier of those doing work in the area of performance measurement and accountability.

Initiatives in Western Australia and South Africa

Initiatives in Western Australia and South Africa are linked to the enactment of specific legislation—in the case of Western Australia, the Financial Administration and Audit Act (1985); and, in the case of South Africa, the Reporting by Public Entities Act (1992), which has recently been proclaimed.

In Western Australia, government organizations are required to prepare an annual report that, among other matters, "contains performance indicators as measurements of efficiency and effectiveness."[171]

In South Africa, the legislation requires the board of directors to submit to the responsible minister an annual report that, among other matters, contains relevant performance information regarding the economic, efficient, and effective application of resources.

A key issue for many organizations in both governments concerned how best to organize and present the required performance indicators and information in a way that both those sending and receiving them will judge to be fair and complete and germane to their needs and interests.

Initiatives in Canada

Part I of this book includes a discussion of initiatives undertaken by the federal government to enhance performance reporting and accountability to Parliament. In addition to these, there are several other related initiatives concerning departments, agencies, and Crown corporations and variously involving members of governing bodies, management, and auditors. Recently, initiatives are also springing from other sources—both governmental and nongovernmental. For example:

The Province of Alberta

In May 1995, the provincial legislature of Alberta passed the Government Accountability Act. The act requires the government and individual ministries to prepare and publish annual reports that, among other matters, discuss actual performance results against desired results previously outlined in their respective business plans. Later that same year, the government released its first annual report using, as a starting point, twenty-two core indicators as a basis for overall government reporting.[172]

The Society of Management Accountants of Canada

In 1994, The Society of Management Accountants of Canada (SMAC) issued a guideline introducing a framework for performance indicators that seeks to bring together historical and future-oriented information, information related to external relationships as well as internal activities, and information that is financial and nonfinancial in nature.

Arguing for the need for a balanced perspective that is capable of serving top management's needs and interests, as well as other levels of management and operations in an organization, the guideline puts forward six categories of performance indicators:

- environmental indicators, relating to such matters as use of recyclable materials, accidents and injuries resulting from products and services, etc.
- market/customer indicators, relating to such matters as market share, customer satisfaction, etc.
- competitor indicators, relating to much the same dimensions of performance as are examined for one's own business
- internal business processes indicators, relating to such matters as product development and manufacturing cycle times, sales production, etc.
- human resource indicators, relating to such matters as employee development, morale, etc.
- financial indicators, relating to such matters as revenue growth, profitability, etc.[173]

Developed for application to businesses that produce and sell a product or service, the SMAC guideline states that a performance-indicator approach such as this is also useful for not-for-profit organizations, including governments.

The need for comprehensiveness, rigour, and flexibility are given strong emphasis in the SMAC guideline. Also emphasized is the notion that "performance indicators are just that—signals of performance… They can give clues but not the answers directly." Indeed, to one extent or another, such considerations are mirrored in the discussion of all the above initiatives.

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153 Benjamin Disraeli, *Vivian Grey*, bk. vi, ch. 7.

154 Crown corporations received a lot of attention in the early eighties. In 1980, the auditor general of Canada issued the report: *Comprehensive Auditing in Crown Corporations: A Briefing Paper Prepared for the Standing Committee on Public Accounts by the Auditor General of Canada*, July 10, 1980. Later, the Canadian Comprehensive Auditing Foundation released four publications successively: *Auditing in Federal Crown Corporations: A Director's Introduction to the Audit and Special Examination Provisions of the Financial Administration Act (as amended by Bill C-24)*, 1984, 42 pp.; *Preparing for Special Examinations of Federal Crown Corporations: A Status Report—September 1985*, 30 pp.; *Special Examinations in Federal Crown Corporations: A New Dimension to Reliance on Internal Auditing in Canada*, 1986, 60 pp.; *Special Examinations, Internal Audits and Reliance: A Practitioner's Guide*, 1987, 221 pp.

155 *Act to Amend the Financial Administration Act in relation to Crown corporations*, s. 143(1).

156 Paul K. Brace, Robert Elkin, Daniel Robinson, and Harold Steinberg, *Reporting of Service Efforts and Accomplishments* (Stanford: Financial Accounting Standards Board, 1980).

157 *Report of the Commission to Study the Public's Expectations of Audits* (Toronto: Canadian Institute of Chartered Accountants, June 1988), Recommendation R-17, 57.

158 See Brenda Eprile and Dorothy Sanford, "Beyond the Numbers: Improving Narrative Financial Reporting in Canada," *CMA Magazine*, March 1991, 7-14.

159 Ibid., 7.

160 For instance, a relevant indicator for the manager of a typing pool may be the number of words typed in a day, week, or month. This information can be used in the deployment of resources and is usually expressed in thousands or millions of words. Such measures are usually meaningless to senior managers who are the clients of the service. The clients want to know what the expected turnaround time is for a letter, a ten-page report—one hour, two, a day, two days?

161 *The Citizen's Charter—The Facts and Figures*, A report to mark four years of the Charter programme (London: HMSO, 1995), Cm. 2970.

162 *The Citizen's Charter—Second report: 1994* (London: HMSO, 1994), Cm. 2540, 2.

163 Audit Commission, *Watching Their Figures—A guide to the Citizen's Charter indicators* (London: HMSO, 1994), 10.

164 Ibid, 13-14.

165 Governmental Accounting Standards Board, *Concepts Statement No. 2 of the Governmental Accounting Standards Board on concepts related to Service Efforts and Accomplishments Reporting* (Norwalk, Ct: Governmental Accounting Standards Board of the Financial Accounting Foundation, 1994), no. 109-A, i.

166 Governmental Accounting Standards Board, *Service Efforts and Accomplishments Reporting: Its Time Has Come*, (Norwalk, Ct: Governmental Accounting Standards Board, 1990). Several research reports, focusing on key program areas, have since been published.

167 Governmental Accounting Standards Board, *Concepts Statement No. 2*, 20-24.

168 Ibid, 28-31.

169 Oregon Progress Board, *Report to the 1995 Legislature: Oregon Benchmarks—Standards for Measuring Statewide Progress and Institutional Performance* (Salem, Oregon: Oregon Progress Board, 1994).

170 See Office of the City Auditor, *City of Portland Service Efforts and Accomplishments: 1993-94—Fourth Annual Report on City Government Performance* (Portland, Or.: Office of the City Auditor, January 1995).

171 Margaret Stockton, *Effectiveness Reporting: WA Pilot Study—A Practical Approach*, (Perth, Western Australia: Public Sector Management Office, 1994), 8.

172 Government of Alberta, *Measuring Up—First Annual Report by the Government of Alberta*, June 1995.

173 The Society of Management Accountants of Canada, "Developing Comprehensive Performance Indicators," Management Accounting Guideline 31, in *Management Accounting Practices Handbook* (Hamilton: The Society of Management Accountants of Canada, 1994), 15-19.

Chapter 9

Conceptual Issues in Performance Reporting

The central issues

The definition of *accountability* adopted in this book makes the rendering of account—reporting—its central requirement. Meaningful reporting about effectiveness or performance, however, is easier said than done. The Wilson Report, from which the definition of accountability is taken, recognizes the difficulties:

> In simple situations, full accountability implies a detailed disclosure of the way in which the responsibility has been carried out. If, however, the responsibility is a complex one, perhaps involving many expenditures for different purposes or the performance of many duties, full and detailed disclosure may actually defeat the purpose of accountability. The party who granted the responsibility may be overwhelmed with details and may be unable, without extensive and laborious analysis, to form any judgement as to whether the obligations accepted by the second party have been properly met.
>
> Thus, the basic problem of disclosure in complex situations is to find a manner of selecting and presenting information that will convey, in summary form, a fair, objective and accurate picture of whether a given responsibility is being satisfactorily discharged. To avoid misunderstanding or misinterpretation of the information provided, clear standards or conventions relating to the appropriate form of disclosure should be established and agreed upon by both parties. If this can be done, accountability can be maintained even in the most complex situations.[174]

Simply put, there are two main issues: what to report, and how to report it. This chapter explores some conceptual aspects of these issues; the following chapter offers practical advice about how to go about reporting on performance. First, a few definitional matters.

Performance and effectiveness

As noted earlier, the words *performance* and *effectiveness* both have to do with the notion of accomplishments as related to efforts, or capabilities, or intent. In the management and public administration literature, the word *performance* is often circumscribed to indicate the scope of the matters to which it is being related—administrative performance, managerial performance, program performance, and so on. Similarly, the word *effectiveness* is often modified—operational effectiveness, program effectiveness, and organizational effectiveness. Thus, in the context in which they are used, performance and effectiveness have meanings that they share. Effectiveness is the term used more frequently from here on.

A more careful examination of the concept of effectiveness follows shortly.

Value for money

Values such as prudence, due diligence, regularity (compliance to rules), probity, integrity, and equity have inspired the conduct of generations of public servants. They are often values that individuals have carried into the workplace from their private lives. Getting value for the money disbursed is a responsible objective and an eventual and tangible source of satisfaction. The term *value for money*, as a desirable characteristic of the conduct of public business, has only recently come into vogue.

Value for money is an outcome of the movement towards a public service that is more responsive to public needs and is more accountable. That movement gained momentum with the stress on responsibility and responsiveness in the Royal Commission on Government Organization (Glassco Commission) report in 1962. It was given shape by the Auditor General of Canada Act in 1977, and it was reinforced by the Royal Commission on Financial Management & Accountability (Lambert Commission) report in 1979, which placed emphasis on linking accountability to financial management.

In contemporary usage, *value for money* summarizes three separate but interrelated values: economy, efficiency, and effectiveness, often referred to as the 3 Es. Taken together, these values include the traditional values of prudence, due diligence, regularity, probity, integrity, and equity. Some observers like to add a fourth and a fifth E—equity and ethics—as being peculiar to government and thus deserving of specific mention. Commonly, however, both equity and ethics are generally understood to be part of the third E, effectiveness.

The third E, effectiveness, is often thought to contain the essence of the other two—economy and efficiency—even though much of the Canadian writing on the subject of measuring performance deals with each of the three Es separately, such distinctions having been largely inspired by the legislated mandate of audit offices. The reason for this is that each of the three values has some-

The Expression *Value for Money*

While the expression *value for money* may have been heard before in Canada, the *Report of the Independent Review Committee on the Office of the Auditor General of Canada* (Wilson Report) noted that it was used in 1961. It tells about Watson Sellar, auditor general of Canada in the 1950s, instructing his staff to be alert to expenditures associated with the cancellation of an agreement before the purpose was fully implemented. Mr. Sellar first called them "nugatory payments." In 1958, he began reporting such items as "nonproductive payments." His successor, Maxwell Henderson, in discussions at a meeting of the Standing Committee on the Public Accounts, was concerned about the definitional problem associated with such payments. He raised the possibility that a decision to cancel a project after some preliminary expenditures had been incurred might be wise, after all. Are preliminary expenses of this kind really nonproductive, and should they be reported as such? The committee agreed on the need for the auditor general to use his judgment, and Mr. Henderson, discussing nonproductive payments, stated: "It is not an easy problem… it boils down to a question of value for money."[175]

The Wilson Report also underlined the use of the expression *value for money* in its discussion on extending the scope of audit: "[T]he concept appears to have developed in Britain that the Government obtains appropriations from Parliament in trust and that the trust extends beyond mere technical compliance with the wording of appropriations to the prudent expenditure of funds. More recently, the Comptroller and Auditor General has been concerned with establishing whether *value for money* has been obtained through the spending process. This concept includes, but goes beyond, that of mere waste. Thus, over the years, the Comptroller and Auditor General has questioned and drawn to the attention of Parliament transactions that reflect on many aspects of the administration of programs, and his comments go well beyond a consideration of mere technical regularity."[176]

thing at its core that distinguishes it from the other two. The following definitions have gained general acceptance, even though they may not be quite definitive. In very simple terms, people concerned with assessing value for money ask the following questions respecting the three Es:

Economy: Are we getting the right inputs at the best cost (getting a good deal)?
Efficiency: Are we getting the most output from our inputs (getting a lot for the efforts)?
Effectiveness: Are the outputs getting the results we want (doing the right things)?[177]

Economy is essentially a resource-acquisition concept with a least-cost notion and is concerned with the acquisition of resources of appropriate quality and quantity at the lowest reasonable cost (buying resources at the right time, at a favourable price, in the right quantity and quality).

Efficiency is essentially a resource-usage concept, also with a least-cost notion, that is concerned with the maximization of outputs at minimal cost or the use of minimum-input resources (as evidenced by high productivity, on-time performance, and so on).

Effectiveness has been defined as an ends-oriented concept that measures the degree to which predetermined goals and objectives for a particular activity or program are achieved (the attainment of the right results from usage of resources and organizational operations).[178]

The 3 Es: Their Role in Decision Making and As Measures of Performance

The following excerpt identifies the three elements of value for money not only as an accountability framework but also as a way to gather information for decision-making purposes:

"To facilitate the process of decision making in the context of the public administration system and budgetary cycle, ideally a governmental entity should establish and communicate clear, relevant goals and objectives; set measurable targets for accomplishment; and develop and report indicators that measure its progress in achieving those goals and objectives (measures of performance). For example, for governmental entities to have appropriate information for making decisions and assessing accountability, information needs to be provided about results achieved (service accomplishments or performance) through the use of the resources provided (service efforts) and how those results compare with what was planned. The terms *economy, efficiency,* and *effectiveness* often are used in this context to describe the categories of performance information needed.

This need for comprehensive performance information is highlighted by a guideline on economy, efficiency and effectiveness supporting a British Chartered Institute of Public Finance and Accountancy (CIPFA) standard in 1982. The guideline states: "Economy and efficiency in the execution of programmes is of small consequence if those programmes are not meeting the authority's objectives, and no assessment of value for money is complete without regard to effectiveness. In order to assess effectiveness, it is necessary first, to determine and specify the objectives and second, to assess (measure) performance against those objectives so that appropriate adjustment or remedial action can be taken."[179]

More elaborate definitions of the 3 Es have been written. There is no universally agreed-upon wording of these definitions, nor need there be. The formulations in the literature all convey the same basic meaning. The differences in wording are influenced largely by circumstances or particular legislative or institutional requirements, which in some cases affect the boundaries between the three values.[180] Many of these formulations are paraphrases of one another, albeit with a useful contextual twist. The following detailed definitions are found in the *Comprehensive Auditing Manual* of the Office of the Auditor General of Canada:

> *Economy.* This refers to the terms and conditions under which an organization acquires financial, human, physical, and information resources. Economy means getting the right amount of the right resource, at the right level of quality, at the right time, in the right place, at the right cost. Lack of economy in acquiring resources could result in a higher than necessary cost of products or services, or products or services of inappropriate quality, quantity, or timeliness.
>
> *Efficiency.* This refers to the relationship between the quantity and quality of the goods and services produced (output) and the cost of resources used to produce them at a required service level to achieve program results. An efficient operation either produces the maximum quantity of output of a given quality for any given resource inputs, or uses minimum inputs to produce a given quantity and quality of output.
>
> *Effectiveness.* Program effectiveness is the extent to which program objectives or intended consequences are achieved. Where unintended negative effects occur, effectiveness must be judged on the balance of positive and negative consequences.

The above gives an impression of neatness in the abstract separation of three seemingly different values, but the reality is not so clear. In practice, it can be very difficult to deal with one value while ignoring the other two. Sometimes, what appears as effectiveness at one operating level may well be viewed as efficiency at the next level. Moreover, the effectiveness of public programs is often thought to be at the core of value for money. Effectiveness, or the attainment of program goals, outranks issues of economy and efficiency because although there may be some merit in doing the right things poorly, there is no redeeming value in doing the wrong things well.[181]

One senior academic wondered if:

… the bureaucratic values of economy, efficiency, and effectiveness [could] be melded with the political values of representation and responsibility, yet still retain their salutary influence on the work-a-day world of bureaucracy.[182]

There is no doubt that for measurement purposes, distinguishing each of the 3 Es is useful. The problem is not at that level. It is when one attempts to form an overall opinion or report on the performance of a program that it is not possible, nor useful, for that matter, to proceed as if the concepts were independent of one another.

In its March 1988 report, the Standing Committee on National Finance subscribed to the view that effectiveness should be broadly defined to reach beyond the attainment of program goals and should focus on performance in general. Moreover, the committee recognized that effectiveness cannot be measured independently of costs and productivity. In other words, the committee thought that the intellectual separation of the 3 Es may be convenient for some purposes, but when the time comes to assess and report on performance on a value-for-money basis, there is a risk that the demarcation lines between the three concepts will produce gaps and inadequacies.

The committee demonstrated a strong preference for a seamless gradation of values. It felt that economy and efficiency were essential to a meaningful understanding of effectiveness, and that there was no point in separating resource justification and program-operational performance from effectiveness or the outcomes, the results. Broad-based effectiveness, as the committee called it, could not be limited to the extent to which a program meets its objectives. Moreover, it could not be measured and reported on independently of costs and productivity.

THE EFFECTIVENESS DILEMMA

> **THE SHEER INTELLECTUAL DIFFICULTY OF GRAPPLING WITH EFFECTIVENESS—OF WRAPPING OUR MINDS AROUND SO AMORPHOUS, SO PROTEAN A CONCEPT—HAS BEEN AMONG THE GREATEST STUMBLING BLOCKS TO A WIDER ACCEPTANCE OF EXPANDED ACCOUNTABILITY FOR MANAGEMENT…**[183]

The assessment of effectiveness is by far the most important contributor to an accountability regime and at the same time the most elusive. One reason may be that there is no single, high-level, generally agreed-upon definition of effectiveness.

In daily conversation, being effective describes the capacity or the ability to achieve results. Often, it goes beyond this capacity, and being effective means having reached one's goals, to be successful. The word may also be used to emphasize the impact of one's efforts or actions. Frequently, it merely describes that a capability is actually in use, or that a law or a rule is in force. There are other uses of the word.

In practice, when discussing organizations, the word *effectiveness* is typically modified by one of three terms: program, operational, and organizational.

- *Program* effectiveness relates to the continuing relevance of a program, the attainment of its intended objectives, its impact, and its cost-effectiveness;
- *Operational* effectiveness relates to the achievement of output targets, to the delivery systems for the goods and services produced, and to the cost-effectiveness of these systems;
- *Organizational* effectiveness relates to the overall capability of the organization and the interactions among strategic planning, management structures and processes, and human and financial resources—all in relation to the mission and goals of the organization and the external environment.

Some writers have refined the notion of effectiveness by making explicit the consideration of cost-effectiveness, which is the attainment of the objectives at the least cost, at a lesser cost, or at least at a reasonable cost in relation to the value of the outcome. Some have also included both intended and unintended results or outcomes of a program as factors in the measurement of effectiveness. Others still, particularly program evaluators, have included the assessment of the continued need for the program in their conception of effectiveness. They ask the question: Are the reasons that gave rise to the program in the first place still valid today?

How effectiveness is viewed will depend on who is looking for it. Different views may be taken by the electorate, specific constituencies, customers, governing bodies, managers, and so on. Each view has validity in its own context.

Effectiveness: Not a Simple Concept

… 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 INVOLVES WEIGHING MULTIPLE, COMPETING AND SOMETIMES CONTRADICTORY OBJECTIVES AND MEASURES… DIVERSE THOUGH PERCEPTIONS OF EFFECTIVENESS HAVE BEEN TO DATE, AND DIFFICULT THOUGH THE QUESTIONS IT RAISES ARE, THE STARK FACT IS THAT THERE ARE PRESSURES TO DEAL WITH THE ISSUE. THE GREAT CHALLENGE, OF COURSE, IS TO FIND AN APPROACH THAT WILL BUILD ON THE STRENGTHS BUT AVOID THE WEAKNESSES OF PAST MEASUREMENT, REPORTING AND AUDIT INITIATIVES AND CREATE A REGIME THAT WILL SERVE THE INTERESTS OF ALL THE PLAYERS IN THE ACCOUNTABILITY STRUCTURE.[184]

The literature on the subject provides a variety of approaches to defining effectiveness. Until recently, however, there has been no single approach that accommodates the interests and needs of all parties and suits the requirements of a wide variety of organizations. There is, nevertheless, consensus that a high-level interpretation of effectiveness will usually involve the most important elements of the notions of economy and efficiency.

Effectiveness and the Achievement of Goals

Of all the meanings attached to the word *effectiveness*, probably the most common is related to the achievement of goals. Different authors, with different value systems, have their own conceptions of effectiveness, but what brings them near one another is goal accomplishment or performance in meeting objectives. This is how legislative auditors have generally viewed effectiveness for their own work.

Although making goal accomplishment central to effectiveness gives it a clear focus, the problems and implications remain very substantial. The literature on effectiveness contains many studies that raise issues surrounding this particular perspective. Among the observations[185] on this aspect are the following:

- goals are often ill-defined, complex, changing, and contradictory;
- it is often unclear at what level or with respect to what units the attainment of goals should be measured;
- more than one technology or strategy produces the same outcome;
- goal-based perspectives usually take into consideration the preferences of managers, not all constituencies; and
- goal-based definitions have failed to clarify distinctions between organizational effectiveness, managerial effectiveness, and manager and subordinate behaviour and attitudes.

In addition, there is the semantic problem regarding the apparent interchangeability of terms such as outputs, goals, objectives, mission, purposes, results, ends, and aims. There is also the difficulty of distinguishing achievements on a continuum of purposes, from results of immediate efforts all the way to the ultimate outcomes or consequence of a policy, using terms that convey exactly what was achieved against expectations at various stages:

> A reading of the literature on organizational goals reveals that in study after study there is now general agreement that the official, formally stated goals of the organisation are of little value for judging efficiency and effectiveness. Each of these and many other studies demonstrate that official or primary goals are too vague and too general to be

> operational. For example, the primary objectives of many public bureaucracies are found in legislation, but are so general that precise targets are impossible to specify. Thus the objective of housing policy is to provide "good housing for the whole populace", whatever that might mean, or education policy is aimed at ensuring that every child receives an "adequate education." Precise definitions of what constitutes "good" or "adequate" are never set out and become the focus of debate and, in many instances, controversy. In the absence of adequately specified official goals, *operative goals* are used instead. The latter are defined as goals which designate the ends sought through the actual operating policies of the organisation; they tell us what the organisation is actually trying to do, regardless of what the official goals specify as the aims.[186]

Time is also an important consideration. A government policy or program may achieve its purpose or have practical effects for everybody concerned (every beneficiary), but not at all the same time. The impact may be immediate or deferred, ephemeral or permanent. It may still be viewed as effective:

> A goal is some future state of the world which the members of the organisation try to bring about by the application of a set of means. A time dependent means-end sequence implies, therefore, the existence of a series of intermediate states which may or may not be emphasised. To the extent that they are, they become themselves goals and might be called intermediate goals, with reference being made to some global or end state which is the primary goal of the system… Whilst the bureaucracy might be successfully achieving one of its intermediate goals and be regarded as being efficient, it might nevertheless be far from achieving its primary goal.[187]

Moreover, as mentioned above, the success of the policy or program will be viewed more or less according to expectations that are bound to be different from one set of stakeholders to another: the beneficiaries of the program, the suppliers of services, the electorate, the opposition parties, the central agencies, and so on. Official, publicly stated goals may not be accepted as satisfactory by people who have some interest in the program.

In its 1975 report, the Wilson Committee identified problems with considering effectiveness in terms of goals:

> Present problems in measuring the effectiveness of spending programs revolve around two major questions. First, how does one define in quantifiable terms what Parliament expects to achieve in enacting new legislation or by approving a new program through voting funds in an appropriation act? Many programs defy quantification. For example, how can one translate the purposes of the Department of External Affairs into quantitative terms that permit objective measurement of performance? While other programs are susceptible to some form of measurement, they may be intended to achieve a number of different objectives, some measurable (for example, the reduction of unemployment or improvement in the standard of living) and some intangible (such as, overcoming a sense of injustice). Even if some of these identification problems can be resolved, there remains a second major question: how can the results achieved be measured?[188]

One study had this to say about modern organizations, particularly in the public sector:

[T]hey are often "organized anarchy" exhibiting such characteristics as ill-defined, complex, changing and contradictory goals; unclear means/end, input/output and causal connections; and widely differing criteria of success operating simultaneously in various parts of the organization.[189]

The contradictions and paradoxes of government also contribute to the difficulty of assessing effectiveness. On the one hand, stated objectives are not always those being actually pursued, and sometimes the policy objectives of a particular program or department are not symmetrical with that of another department. In fact, objectives may be competing. On the other hand, government-wide objectives may be sacrificed, ignored, or forgotten in favour of more immediate departmental objectives that may not be in accord with more global purposes.

When you have a government department that is more like the conventional private sector model of a production process, you are more likely to find the kinds of indicators and performance measures that facilitate a more precise definition [of effectiveness]. However as you move in the area of competing objectives and shaping and influencing… which are legitimate roles of government… it becomes significantly more difficult.[190]

Public policy is very complex. It emanates from politics and involves difficult choices and often produces dilemmas; it develops broad national initiatives for society according to a vision of a better future, but it gets involved in local conflicts; negotiations are at once at the center of issues and at the margin. Public policy is frequently fashioned to reinforce power. The resulting translation of public policy into programs or activities will somehow reflect all of these pursuits, making statements of objectives an art form of a rather difficult nature.

Report of the Auditor General of Canada, 1993

The Study… makes it clear that, underlying these three constraints [political priorities, management burden of administrative and procedural tasks, and disincentives and lack of incentives for productive management] and contributing to them is the inescapable complexity of government; a complexity which not only has to do with bigness but with those diverse objectives which are inevitable in the public sector.… It must be definitively understood that this Office is not advocating that all political and social priorities should be sacrificed on some altar of a narrowly-defined productivity. Our study makes it clear that it is the nature of government to fullfil a spectrum of objectives. Value for money is one such objective and one which the mandate of my Office requires me to examine. But I recognize that value for money, in governmental terms, is not measurable in terms of any simple definition of productivity alone. Value is also achieved in social, cultural, and broad political imperatives which by a narrower measure might be accounted as detracting from productivity. I fully recognize, as does our study and all our auditing, that government by its very nature serves a multiplicity of purposes. It is within the context of achieving all those purposes that the productivity of the public service must be measured.

On a different plane, the actual impact or results of a government program or activity may be independent of original intentions. The latter may or may not have been realized. When they are not, it may be because original expectations have been modified, unforeseen problems have been met, or the necessity of the public intervention has changed. Much has to do with the dynamic, sometimes volatile, nature of the issue.[191]

Some approaches to effectiveness

In response to the public exhortation for public officials to be more forthcoming about the results they have achieved, considerable thought has been given to making the notion of effectiveness a manageable concept for the purpose of assessing and reporting on it. One approach, among others, is to classify effectiveness into such categories as those mentioned earlier: program effectiveness, managerial effectiveness, operational effectiveness, organizational effectiveness. On examination, these categories tend to bleed into one another.

By the mid-eighties, the literature of public administration had not found a concise definition for the word *effectiveness* that was evocative of the entire range of meanings attributed to it, even though the notion of goal attainment was generally accepted as central to the notion. On the contrary, social scientists tended to look at effectiveness as largely situational, of little use without an explanation of the circumstances surrounding it. The literature had not yet produced a convenient and comprehensive framework that would lead to an overall judgment on the success or effectiveness of a program or public policy. But it had succeeded in identifying a hierarchy of so-called effectiveness constructs that summarized a variety of notions, attributes, and models. One grouping provides the following perspectives on effectiveness:

- constituency/political perspectives: recognizing that many organizations and individuals have competing interests;
- goal-achievement perspectives: recognizing multiple stated or unstated goals;
- structure/system perspectives: recognizing that effectiveness is a function of internal structures, systems, and attitudes;
- resource acquisition/survival perspectives: recognizing that such attributes as resource attraction, environmental adaptation, and longevity may be ultimate indicators of effectiveness.[192]

These four perspectives constitute a fairly common set of distinctions breaking down the concept of effectiveness into useful components.

Much of the literature on effectiveness originates in the United States and is really focused on organizational effectiveness. This emphasis reflects the influence of the for-profit sector and a capacity view of effectiveness. This particular view, which has substantial empirical support, is based on the belief that the effectiveness of the organization largely results from the values, behaviour, and skills of the work force. An organization that scores high on these counts is deemed to be an effective organization and is presumed to be doing the right thing. Thus, the capacity view of effectiveness implies that if all the relevant and appropriate conditions are satisfied with respect to the input, good output will follow naturally.

Beyond this, however, by the mid-eighties the literature had not produced a model of effectiveness capable of general application. It had certainly not produced a technical, mathematically based model similar to those used in such fields as economics and science. The reason, of course, is that many of the multitude of variables involved in assessing effectiveness are not susceptible to accurate measurement, and the relationships among them are not clearly enough understood to be assigned precise values. These problems remain unresolved, although some theorists are still wrestling with them.

Rather than attempt models, some authors have found it more worthwhile to develop frameworks for assessing effectiveness. These frameworks identify the attributes that are displayed when something is effective, rather than posit a general theory of effectiveness itself.

Meaning of the Term—*Framework*

A framework is sometimes viewed pedantically by model builders as a lesser form of a model. Although a framework is a reduction, a simplification of the real world, as is a model, it has the advantage of a flexibility that a model may not offer, and it is more suited in an area not easily quantifiable. It can be expanded to suit the circumstances. It can be used with circumspection. It cannot be definitive. While causal relationships cannot be entirely ignored, they do not have to be identified or formalized in a framework. A framework does not require mechanical functioning in the sense that a malfunction would make it inoperable. Finally, a framework is less tempting for its architect and manipulators to regard it as an end in itself instead of as a tool.

Lists of Attributes of Effectiveness

The literature has noted that determinants of effectiveness have not been well defined, and, for that matter, indicators of effectiveness have not been clearly distinguished from determinants. It finds that the challenge is more about knowing what to measure than how to measure effectiveness.

Creating a list of attributes that, when applied against an entity, would define the quality of performance is most difficult.[193] Compared to identifying objects in nature that can be sorted out by physical attributes readily perceived through the senses (color, odor, shape, size, weight, consistency, and so on), looking for evidence of effectiveness is a mental exercise at a much higher level of abstraction.

Attributes have to match a general expectation arising out of the particular vision of a successful organization and be capable of identifying signs of performance that indicate how well the organization is doing. The vision is not always clear, the expectations not always well articulated, and the signs are often ambiguous, if not misleading. Frequently, the signs themselves are merely representations (numerical signs, for instance), often only approximations of the reality. Moreover, expectations and understanding change over time. For example, for decades and decades, the prime measure of the health and success of an enterprise was a static one—the balance sheet. Then, in the 1930s, attention shifted to a more dynamic rendering of account—the income statement, which could be used to appraise corporate earning power and future prospects.

Finally, even in the absence of changing expectations, the greatest challenge is the identification, from a bewildering number of possibilities, of characteristics that are sufficiently representative and dynamic to indicate the quality of performance and that, together, can be used to make an overall assessment of effectiveness.

There are, in the literature of management, in particular, several examples of lists of attributes intended to cover sufficient indicators of behaviour to gauge an organization's effectiveness.

Organizational effectiveness— J. P. Campbell

J. P. Campbell's list of attributes of organizational effectiveness is frequently cited in the literature.[194] The list contains thirty effectiveness criteria and was intended to account for "all variables that have been proposed seriously as indices of organizational effectiveness."[195] Subsequent authors have observed that Campbell's list is not exhaustive, is not relevant for all types of organization, and consists of a mix of causes and effects.

Campbell's list of attributes of effectiveness:

- overall effectiveness
- productivity
- role and norm congruence
- efficiency
- profit
- managerial tasks skills
- quality
- accidents
- evaluations by external entities
- growth
- absenteeism
- participation and shared
- influences
- turnover
- job satisfaction
- achievement emphasis
- motivation
- morale
- value of human resources
- control
- conflict/cohesion
- training and development
- flexibility/adaptation
- planning and goal setting
- managerial interpersonal skills
- goal consensus
- internalization of goals
- readiness
- utilization of environment
- stability
- information management and communication

The Quinn and Rohrbaugh reduction of Campbell's list

Robert Quinn and John Rohrbaugh reduced Campbell's thirty criteria to seventeen,[196] presumably in the belief that some criteria were subsumed by others, as their list looks similar to the one they had reduced. These two sets of criteria to assess effectiveness nevertheless constitute useful frameworks of attributes:

- morale
- evaluation by external entities
- value of human resources
- planning and goal setting
- training and development emphasis
- profits
- quality
- productivity
- conflict/cohesion
- efficiency
- flexibility/adaptation
- stability
- readiness
- control
- growth
- information management and communication
- utilization of environment

Management effectiveness—Peters and Waterman

Another branch of the literature on effectiveness has to do with attributes of management effectiveness. It looks so much like organizational effectiveness that, to many, management effectiveness is a stylistic variation of organizational effectiveness. While it is largely centered on the work force (organizational effectiveness), it concentrates on the behaviour and style of the senior cadre of management, hence the appellation. To use one example, in the early 1980s, to develop the thesis of their best-seller *In Search of Excellence*[197] Thomas Peters and Robert Waterman started by applying what was known at the time as the McKinsey 7-S framework, which they had developed earlier and which identified the following:

- strategy;
- structure;
- systems;
- style;
- staff;
- skills; and
- shared values.

These were all interconnected graphically in a web resembling the structure of an atom.

Peters and Waterman were not entirely happy with the 7-S structure, as it could not distinguish a good organization that has a certain element of inertia from an innovative one with a great capacity to adapt to rapid changes in the world and in the marketplace. They needed some distinctive marks to tell them which among all the good companies they were looking at were excellent. They decided that, generally speaking, only innovative organizations deserved to be called excellent. More precisely, continuous innovation was defined as the mark of excellent companies.[198] Their study of dozens of highly reputed companies led them to conclude that a set of eight behavioural attributes or tendencies was present in what they regard as excellent innovative companies:

- a bias for action;
- close to the customer;
- autonomy and entrepreneurship;
- productivity through people;
- hands-on, value driven;
- stick to the knitting;
- simple form, lean staff; and
- simultaneous loose-tight properties.

As a sequel to *In Search of Excellence*, Thomas Peters and Nancy Austin produced A *Passion for Excellence*,[199] which reinforced the concentration on people and management presented in the first book. Passion was defined as comprising the following elements:

- care for customers;
- constant innovation;
- leadership (MBWA–management by walking about); and
- people.

The Auditor General's List of Characteristics of Well-Performing Organizations

In his 1988 report, the Auditor General of Canada devoted a chapter to what he called "well-performing organizations."[200] In an approach with certain similarities to that of Peters-Waterman, he had invited senior civil servants to identify a number of federal government organizations that by general consensus were performing very well. He studied eight organizations so identified, trying to isolate the characteristics that made the organization perform so well. The following characteristics were common to the well-performing organizations included in the study:

Emphasis on people

- the empowering organization
- the caring organization
- the successful organization

Participative leadership

- the becoming organization
- the communicating organization

Innovative work-styles
- the learning organization
- the problem-solving organization
- the intelligent organization

Strong client orientation
- supported by owners
- close to clients
- the concretizing organization

The auditor general's study was in a sense considerably more difficult than that of Peters and Waterman because of the absence in the federal government of overall effectiveness indicators such as those available in the private sector. Because of this, much of the assessment of well-performing organizations was based on criteria largely drawn from economy and efficiency values, or organizational and managerial effectiveness.

The Baldridge Award

The Baldridge Award was established by the Malcom Baldridge National Quality Improvement Act, signed by President Ronald Reagan in 1987. It was named after the late secretary of commerce. The act called for the creation of a national award to promote quality of goods and services produced in the United States and the development of guidelines and criteria that organizations could use to evaluate their quality-improvement efforts. It was left to the National Bureau of Standards (now called the National Institute of Standards and Technology) to produce a seven-category, 1,000-point scoring system. Those performance indicators constitute a sort of effectiveness framework.

Companies submit applications of up to seventy-five pages (up to fifty pages, in the case of small business) with descriptions of their quality-improvement practices and performance in each of the following seven areas:
- leadership;
- information and analysis;
- strategic quality planning;
- human resource utilization;
- quality assurance of products and services;
- quality results; and
- customer satisfaction.

These criteria in turn are broken down into many subcategories. Recently, there were thirty-two such subcategories. The Baldridge test is administered and graded by teams of trained external examiners.

As a framework for effectiveness, the Baldridge test is not comprehensive, most probably deliberately so, as it places the emphasis on total quality management and similar thrusts, not on the entire performance or effectiveness. Where the bottom line is to serve as the indicator of overall performance, it is fair to say that profitability may not necessarily originate in superior quality management. In a study of its own in 1990, the General Accounting Office (GAO) in the United States concluded, however, "that there was a cause-and-effect relationship between the total quality management practices embodied in the Baldridge criteria, and corporate performance measured by employee relations, productivity, customer satisfaction, or profitability."[201] Although some critics say that the GAO study has limitations, it nevertheless draws highly plausible conclusions. Intercompany comparisons are the essence of the Baldridge test because it is used to determine the winners in a national award program. Thus, much of the methodology and the rigour of application is peculiar to this project.

Canada Awards of Excellence

Similar in focus and approach to the Baldridge Award with its emphasis on total quality, Canada's equivalent—the Excellence Award for Quality—is administered by the National Quality Institute.

One of three separate awards under the rubric Canada Awards for Excellence, the Quality Award is divided into seven categories that span the business, government, health care, and education sectors. The Canada Awards for Excellence program is built on its predecessor, Canada Awards for Business Excellence, which began in 1984 and had been administered by Industry Canada until management of the program was passed over to the National Quality Institute with the latter's establishment in 1992-93.

The National Quality Institute has developed a set of total-quality criteria that organizations can use as a basis for self-assessment and that serve as a basis for adjudicating the Excellence Award for Quality. These quality criteria are integrated under a general "framework for effective organizations" that focuses on six broad areas, further broken down into twenty-one subareas. The six areas are:

- leadership;
- customer focus;
- planning for improvement;
- people focus;
- process optimization; and
- supplier focus.

All the above are seen as linked factors that work together to drive key outcomes related to customer, employee, investor, and supplier satisfaction.[202]

From the foregoing, it can be seen that by the mid-eighties, despite serious attention to the subject, there was no practical and widely adaptable regime for assessing the effectiveness of the performance of public sector organizations. Substantial progress had been made in providing more and better information in several regards, but no solutions had been found to some of the conceptual problems involved in this complex subject. The tools were simply not available to permit comprehensive assessment of, and reporting on, how well organizations were doing.

Sensitivity of the Notion of Effectiveness

Assessing effectiveness is an issue of extreme sensitivity in public sector organizations at both the political and managerial levels.

For some, it is a practical matter. They think that the scrutiny of policies, programs, activities, or organizations for effectiveness is costly and time-consuming. Many of the criticisms of effectiveness reviews (but by no means all of them) are based, ironically, on the other two Es, the notions of economy and efficiency in conducting effectiveness reviews, applying the test of value for money on the method of assessing effectiveness itself. What the critics are really questioning is the worth of doing what could turn out to be effectiveness assessment which is disproportionately expensive to the value of the programs under review.

Some see effectiveness information as useful but politically inopportune. Information, once reported, is bound to be discussed publicly by various individuals—critics, media observers, politicians—all promoting their own perspectives, often with the intent of embarrassing rather than enlightening or supporting. In short, what is not known cannot be used against one.

Many failures to achieve economy and efficiency can be attributed to inattention, lack of prudence, negligence, different understanding of ethics or public morality, and so on. All that can be somewhat embarrassing under the glaring light of public scrutiny, but nevertheless explainable, relatively easily forgiven, and in many cases not traceable to individuals but rather to "the system," thus allowing a certain disassociation from the events. The failure to achieve effectiveness, however, is often attributed, rightly or wrongly, to the lack of foresight, judgment, or intellectual ability of decision makers. Negative comments on these faculties is particularly wounding to people who value intellectual ability above all else. As a result, there can be an understandable resistance to effectiveness accountability, even among decision makers who bring a highly responsible attitude to their role and to their work. Sometimes, because effectiveness studies are in reference to the past, the resistance is towards third-party assessors, who are looked upon as "second-guessers."

Characteristics of good reporting

No discussion of the conceptual issues involved in reporting on performance would be complete without a consideration of the nature of good reporting.

If it is to be truly useful, information brought forward must display certain characteristics. These characteristics are common to both information conveyed through financial statements[203] or information stated in a narrative and nonquantified fashion. They are:

- relevance;
- completeness;
- predictability;
- understandability;
- timeliness;
- comparability;
- consistency;
- verifiability;
- credibility; and
- fairness.

The following discussion briefly explains what is meant by the above characteristics.

The information reported to the governing bodies should be relevant in that it pertains directly to the interests, concerns, and expectations of the members of the governing bodies and the stakeholders they represent. Anything known to be outside their interests should be left out. Inclusions and omissions have to be handled with a good feel for what members of governing bodies and stakeholders expect.

The information must be comprehensive in that it provides a complete representation of the organization or activities under review. This includes the identification of any area deliberately left out, and the reasons for it. Incomplete information, offering only a partial view to an unsuspecting reader, may be a hindrance to understanding if the report is thought to be complete; it may even be misleading, if not deceptive.

The information must be understandable to the readers of the report. Technical matters should use terminology and reasoning that is comprehensible for any lay readers to which the report is directed. The most common problems are excessive details and technical explanations using jargon, or pedantic language. For ease of reading by the largest number of interested people, it is preferable to use plain, everyday language to achieve understandability without sacrificing the substance or the facts.

Timeliness of information is also important. Complete, relevant, reliable information is of little use if offered at some inopportune time; for example, when it cannot be considered by the recipient, or when it is too late, or too early, for the recipient to do anything about the information given. Timeliness brings its own dilemma; accuracy is a frequent problem. Often, members of governing bodies or the public will prefer early information, even though imperfect, to perfect information provided too late. Early information, however, must not be so inaccurate as to be positively misleading. The information must pertain to a period not too distant in the past; otherwise, it will be useless for decision making and will become merely a record for historical purposes.

When the information focuses on performance over a period of time, it is important to present it in a manner that enables comparison with earlier periods, as the historical record is useful in forming a view of progress, or lack of it. Sometimes, it is most important to know how well the organization is doing when compared with some external standard, such as other, similar organizations. In these cases, the information must be compiled in a manner conducive to drawing comparisons. Thus, comparability, even in the face of changes, becomes very important. Related to the notion of comparability is the necessity of indicating the sources of the changes that may affect the comparison. Changes in methods of observation will obviously alter any comparison and will have to be noted.

Any rigorous comparison requires consistency, which means that all the information used is prepared on the same basis. Where even small differences in performance are important, slight differences in the way in which information is collected can produce misleading results and lead to erroneous conclusions. Comparable information presented on a consistent basis will help recipients of periodic reports become familiar with the material, which is essential for maintaining interest and developing confidence in the information.

The information presented must be verifiable. It is important that the information be produced from sources or systems that can be traced and, if necessary, attested to by an independent third party, thus ensuring its credibility.

Reports must be fair. Fairness is usually associated with a balanced view. Sometimes, balance is interpreted as a negative view of something counterbalanced by a positive aspect of the same thing. Such an even distribution of good and bad in a report can only be achieved at the expense of objectivity. Probably the best way to be fair is to keep things in perspective and be totally objective, presenting without bias both the good and the bad in whatever proportion they present themselves. Deliberate distortion is a violation of the principle of fairness.

A difficult issue arises with presenting information that is considered to be sensitive. The concern is understandable; sometimes it is related to the competitive nature of the activity being described—revealing it would give an advantage to a competitor. Material affecting national security and individual privacy is sensitive. Another example of sensitive information and a natural reluctance to display it is when it might reveal certain weaknesses leading to adverse consequences for the organization or its leaders. This can frequently occur in a political environment. For those who are concerned about being embarrassed by weaknesses being revealed, there is no alternative but to withhold or somehow obfuscate the information. Courage and integrity—in short, feeling truly accountable—can overcome these understandable concerns. With the rise of due diligence as a concept of liability, these concerns will be overshadowed by the requirement for more forthcoming reporting.

The foregoing is but a partial list of characteristics of good information and reporting. The characteristics are interrelated, with several being a precondition for others. The explanations given are far from exhaustive and are designed merely to remind readers of something they already know: good and credible information is the product of care and integrity.

Analysts and media commentators (and opposition members in political forums) often subject public information to careful scrutiny. If the information does not meet the above conditions, it will quickly be discredited, as will the individuals who have provided it.

If members of the governing body and other stakeholders in an organization do not develop a high level of confidence in the information with which they are provided, they will not be able to intervene appropriately to correct performance, nor, for that matter, will they be able to acknowledge good performance where it has been achieved. In short, without good information they will be unable to fulfill the duties entrusted to them.

About representations

What are they?

Representations are statements claiming that something is true about something else. They are written in the form of a sentence, or series of sentences, and are designed to undergo the test of truth. A representation will achieve its main purpose if it states something that is meaningful and in fact true, and if the reader agrees that it is. Authors of representations have to assure themselves of the soundness of the facts on which their statements are based and must appreciate that readers will be seeking both confidence in the underlying information and relevance of its substance.

Representations can be powerful in describing a situation, although they do not have the convenience of handling and the appearance of verifiable mathematical exactitude offered by accounting using numbers, such as financial statements. But by obeying the rules of logic and of exposition, it is possible to construct a highly credible rendering of account with words alone.

The vocabulary of exposition[204] is abundant and contains the many criteria used daily in assessing representations made by various people in a variety of circumstances. The test of truth or falsity that can be applied to a representation is not always easy, usually for lack of solid information. Compensating for the absence of complete evidence, however, is the fortunate characteristic that representations emit telltale signs of less than full, meaningful, and truthful information. Careful analysis will succeed in ferreting out most of them.

Some common pitfalls

A representation can be grammatically correct and yet be totally meaningless. It may be couched in a way that defies verification or understanding because of lack of necessary context. In some other cases, the basis for making the representation is absolutely correct but the sentence suffers from grammatical or syntactic disorders that prevent clear understanding.

Representations can also be so vague as to prevent interpretation, particularly when the statements appear to be so unrelated to facts or experience that their truth becomes hard to assess. Vagueness is related to lack of clarity and may or may not be deliberate. Ambiguity is a different affliction altogether: ambiguous statements do have clear meanings, but more than one, and it is not possible to choose which was intended. This situation is usually more accidental than intentional, as these statements are commonly the results of bad syntax.

One professor, when asked to provide references for mediocre students seeking employment, often wrote: "You will be very lucky indeed if you can get this young man to work for you."

When a representation's relation to the facts is unclear, it is because the statements are meaningless in the first place, or vague or ambiguous. But facts can be distorted. Statements can include two (or more) segments that are absolutely clear and true but imply by their juxtaposition a causal connection between them that may not be true or could not be demonstrated; such statements are misleading. Again, this situation may or may not be intentional. Sometimes, a strong belief in one's point of view carries with it a surfeit of enthusiasm that results in slanting the facts to buttress it.

A frequent way to distort the facts, deliberately or by excess of enthusiasm, is to exaggerate, using stronger claims than reasonably justified with words like "all," "totally," and "extremely," or extravagant adjectives like "tremendous" or "extraordinary." Conversely, to understate—sometimes to diminish guilt, or not to offend, or simply as a result of excessive caution—will lead to similar misrepresentation.

An exaggerated representation describes the facts too strongly. An overgeneralization is somewhat different; it claims more factual support than it actually possesses. Similarly, an oversimplification is different from an understatement: it ignores the complexity of a situation. In a very elaborate demonstration, however, an oversimplification may be used as a convenience, a link between two important explanations. Authors who use an oversimplification for purposes of convenience often admit that they do so, which makes it perfectly legitimate.

Representations that are meaningless, vague, ambiguous, misleading, exaggerated, understated, overgeneralized, or oversimplified all suffer from improper relationships between the representations and the facts supporting them. Such perversions, when carried too far, can make the representations untrue.

Other faults often observed in representations, such as triviality, irrelevance, obliqueness, and tautology, are quite different from those described above in that they do not bear on the truthfulness of the statement; in fact, representations that have these symptoms are accurate. But they may not be useful.

A trivial statement contains descriptions so obvious (indeed, so true) as not to be worthy of mention. Irrelevant statements are easy to spot: they miss the point altogether—an indication that the author has not mastered his or her thesis.

Oblique statements are often intentional and designed to be more persuasive, or are made out of a bad habit. They rely on a particular intimacy between writer and reader for correct interpretation. Oblique statements use metaphors or irony to reinforce the message.

Tautological statements contain a segment that, in different words, merely repeats another segment. On that basis, some definitions will look to be tautological but are not. But if the repetition is intended as an explanation, it will not meet its purpose.

Self-contradiction is exactly the opposite of tautology. One segment in a representation contradicts another segment, in logic or in syntax.

The above enumeration of possible traps, pitfalls, and faults is not intended to discourage the making of representations. On the contrary, it is offered to indicate that, by respecting the rules of grammar, it is possible to use words in a manner as rigorous and credible as the numbers in financial statements that faithfully reflect the financial conditions of an organization. Such rules may appear difficult to adhere to entirely, but they are not if their authors bring into the formulation of representations a healthy attitude towards accountability, a strong desire to inform; it will be easier then to avoid most of the pitfalls discussed above.

This concludes the theoretical discussion of reporting on performance. The following chapters of Part II suggests about how an organization might go about doing such reporting. Note that what follows are suggestions only, and represent one approach only, albeit one that has been found useful in a number of situations. Anyone implementing the suggested approach should be prepared to modify it as required.

174 Wilson Committee, 9.
175 Ibid., 20.
176 Ibid., 14.
177 *Comprehensive Auditing in Canada, The Provincial Legislative Audit Perspective* (Ottawa: CCAF, 1985), 45.
178 Lee D. Parker, *Value-for-Money Auditing: Conceptual, Development, and Operational Issues* (Caulfield, Victoria: Australian Accounting Research Foundation, 1986), 13.
179 Governmental Accounting Standards Board, *Concepts Statement No. 2*, 8-9.
180 The federal and Ontario audit statutes charge the Auditor with determining whether money was spent with due regard to economy and efficiency in the acquisition and management of goods and services, and whether the effectiveness of programs is being measured and reported in all instances where such measurement is feasible and practical. (Many other provinces give their auditors similar mandates.) With such terms of reference, it is clearly necessary for them to make distinctions with respect to the 3 Es.
181 This point was made in the auditor general's *Comprehensive Auditing in Crown Corporations*, 56.
182 J. E. Hodgetts, "Values in the Administration of Public Affairs," *Canadian Public Administration* , vol. 25 (4), Winter 1982, 474, as cited by Rick Van Loon, "The Twins Are Not Identical: Management and Management Education in the Public and Private Sectors," in Benoît Bazoge and Gilles Paquet, "Administration: unity and diversity," *University of Ottawa Quarterly*, vol. 56, no. 4, October/December 1986, 74.
183 Warren Chippindale, "Solving the Case of the Enigmatic Third 'E'," *CA Magazine*, January/February 1988, 33-45.
184 *Effectiveness Reporting and Auditing in the Public Sector* (Ottawa: CCAF, 1987), 64.
185 See the "General Literature Survey Project" in *Effectiveness Reporting and Auditing in the Public Sector: Supporting Research Studies* (Ottawa: CCAF, 1988), 8.
186 P. M. Jackson, *The Political Economy of Bureaucracy* (Oxford: Philip Allan, 1982), 189-90.
187 Ibid., 189. The use of the word *efficient* in this quotation instead of *effectiveness*, a term more directly related to goal attainment, should not be construed to mean efficiency in contrast to effectiveness in our use of the 3 Es. Microeconomics is a branch of economics that deals with the economic behaviour (the way in which resources are allocated among alternative uses to satisfy human wants) of individual entities like production units, firms, consumers. (Macroeconomics deals with the behaviour of economic aggregates like gross domestic product (GDP), rates of inflation, levels of unemployment). It is because Jackson was expressing his point of view within the context of the formal analysis of the concept of efficiency, one of the important achievements of microeconomics, that he used the word *efficient*. The concept of efficiency in microeconomics encompasses effectiveness in the sense that organizations are deemed to be goal-seeking entities.
188 Wilson Committee, 34.
189 K. S. Cameron, "Critical Questions in Assessing Organizational Effectiveness," *Organizational Dynamics*, vol. 9, no. 2, 1980.
190 Andrew Macdonald, Acting Comptroller General of Canada, cited in *Report of the Standing Senate Committee on National Finance, Comprehensive Auditing*, March 1988, 8.
191 See explanation of the notion of inconsistency of time in Part I, 33.
192 "General Literature Survey," 2.
193 See Ronald E. Hoyt, "Epistemological Choices for the Development of Accounting Theory," *University of Ottawa Quarterly*, vol. 56, no. 4, p. 235 for an interesting and rare treatment of the topic on choices of attributes for accounting and, for that matter, reporting purposes.
194 J. P. Campbell, in Paul S. Goodman and Johannes S. Pennings, eds., *New Perspectives on Organizational Effectiveness* (San Francisco: Josey-Bass Publishers, 1977)
195 "General Literature Survey," 13.
196 Robert E. Quinn and John Rohrbaugh, "A Spatial Model of Effectiveness Criteria: Towards a Competing Values Approach to Organizational Analysis," *Management Science*, vol. 29, 1983; see also "General Literature Survey," 14.
197 Thomas J. Peters and Robert H. Waterman, Jr., *In Search of Excellence, Lessons from America's Best-Run Companies* (New York: Harper and Row, 1982), 11.
198 Ibid., 13-15.
199 Tom Peters and Nancy Austin, *A Passion for Excellence: the Leadership Difference* (New York: Random House, 1985).
200 *Report of the Auditor General of Canada to the House of Commons, Fiscal Year Ended 31 March 1988* (Ottawa: Minister of Supply and Services Canada, 1988).
201 See David Garvin, "How the Baldridge Award Really Works," *Harvard Business Review*, November-December 1991, vol. 69, no. 6, 84.
202 National Quality Institute, *1995 Entry Guide for the Canada Awards for Excellence: Business—Education—Government—Health Care* (National Quality Institute, 1995), 10-15.
203 Most of these characteristics were elaborated upon by the CICA, in a bulletin issued by the Public Sector Accounting and Auditing Committee titled "Public Sector Accounting Statement # 2, Objectives of Government Financial Statements," November 1984. By now, they are to be found in many publications of several review disciplines with words appropriate to the particular craft. The CICA, along with other professional accounting bodies, had been developing attributes of useful reporting many years earlier for use in the private sector.
204 Harold C. Martin and Richard M. Ohman, *The Logic and Rhetoric of Exposition* (Toronto: Holt, Rinehart and Winston, 1965), 57ff. contains a section on ways of judging assertions, which is largely the basis of this explanation of the vocabulary of exposition.

Section 2

Principles and Guidelines for Performance Reporting

CHAPTER 10

AN EFFECTIVENESS REPORTING FRAMEWORK

BACKGROUND

In late 1985, the board of governors of CCAF felt compelled to address the issue of reporting on effectiveness in public sector organizations. In part, this decision reflected the general level of interest in the subject throughout the Canadian public sector. In part, it was a response to the legislation affecting federal Crown corporations that charged their auditors with commenting on whether these corporations' systems and practices were maintained in a manner that provided reasonable assurance that (among other matters) their operations were carried out effectively. Without a better understanding of just what effectiveness means, the auditors would be unable to fulfill this obligation appropriately.

CCAF appointed the Independent Panel on Effectiveness Reporting and Auditing to undertake this project. The panel comprised a number of people holding senior positions in the public and private sectors with extensive knowledge and experience in public sector management, governance, and auditing. The panel consulted with elected representatives, senior officials in public sector management, as well as with eminent practitioners in auditing and other disciplines. More precisely, those consulted included:

- members of Parliament from all political parties;
- deputy ministers;
- chief executive officers of Crown corporations;
- leading program evaluators and other professionals engaged in the fields of performance and organizational measurement;
- representatives of provincial legislative audit offices across Canada and the Office of the Auditor General of Canada; and
- partners of prominent firms of chartered accountants and management consultants.

The consultations were supported by three major research projects: a review and synthesis of the literature on accountability and effectiveness; a review of how effectiveness is perceived by experts on organizational matters; and a review of what public sector managers have actually said about assessment of effectiveness in published documents. The results of these studies were published in a single volume.[205]

The panel decided that any proposals it made would have to pass the following tests:

- they should be useful and practical for all parties to the accountability relationship;
- they should capitalize on the considerable progress and investment that had already been made to report and audit effectiveness information;
- their orientation should be to build confidence and promote understanding and agreement between those who give responsibility to carry out policy and those who accept it;
- they should be starting points for taking action and catalysts for developing consensus, and not be viewed as prescriptive; and
- they should help the audit profession to respond to expectations that are emerging in both the public and private sectors.

The panel arrived at a number of conclusions. With respect to the reporting of performance, they might be summarized as follows:

> First, "effectiveness" is a variable concept, as evidenced in the literature and in practice. On balance, effectiveness is best conceived as a multidimensional concept incorporating and linking several facets of performance that key stakeholder groups—taken as a whole—would judge as generally responsive to their interests.
>
> Second, those who govern our public sector institutions are faced with formidable challenges, choices, and decisions. They also have a fundamental responsibility to know what is being done and accomplished by those to whom they have delegated authority and resources. To know this, these governing bodies need information that is organized and presented in a way that responds to their strategic interests. They need to be able to deal with this information in a practical sense, and to have confidence in its being reasonable to the circumstances.
>
> Third, management—as the party to whom authority and resources are delegated by their governing body—is in the best position to report on the effectiveness of their organization and major lines of business (that is, make management representations or explicit evidence-based statements about effectiveness). As the party receiving this delegation, it logically and first falls to management to demonstrate their accountability—through reporting. The panel judged that—after many years of investment and learning on management's part in relation to the theory and technology of measuring and reporting on performance—now was the time to expect management to play this fundamental role.
>
> Fourth, to expect management to play this role—and others to play their part, as well—a reasonable starting point needs to be established from which appropriate actions can be discussed, agreed to, and then taken. To this end, the panel proposed a framework of twelve attributes of effectiveness that, collectively, cover all the important aspects of a public organization's performance. By reporting on how well it is doing in respect to each of these attributes, an organization is answering all the significant questions that its governing body and other stakeholders are likely to ask.
>
> And fifth, the panel concluded that simply having management report on performance to the governing body is insufficient. The governing body needs to have confidence that this information is fair and complete. This requires an audit role that reports directly to the governing body and that provides the necessary challenge and assurance to the information provided by management.[206]

Management representations

The panel's concept of management providing representations on performance establishes a direct accountability link between management and the governing body, in keeping with the long-recognized reporting obligation. As the panel noted in its report, it "provides an opportunity for managers to explain effectiveness in a context that they and their governing bodies agree is appropriate. It helps to prevent wasted effort by ensuring that information about effectiveness focuses on important matters presented at a meaningful level. It also helps managers clarify their accountability to governing bodies and to promote better accountability within their organization."[207]

As we have seen, common practice in Canada has been for legislative auditors to assess and report on value-for-money matters, but for auditors to be constrained in commenting on the effectiveness of the organization under review. The management representations approach places the responsibility for such reporting squarely on the shoulders of management, who have both the obligation to be accountable and are in the best position to know what is going on. This approach also overcomes the need for eschewing effectiveness issues, since it is management, not some third party, that is issuing the statements. In effect, it makes reporting on effectiveness similar to preparing financial statements—a responsibility of management.

Management representations have been described in the following terms:

> A management representation is an explicit statement made by senior management to their governing body… in relation to an aspect of the organization's effectiveness or performance.
>
> It is a means by which management discharges an important aspect of their accountability, 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 the governing body to exercise its 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.[208]

The panel recognized that the preparation of management representations would be undertaken differently in different organizations. The panel knew that what is germane to one organization is not necessarily appropriate for another. "As a result, the decision to use this approach involves a commitment to a substantial amount of effort to refine the concept and make it work satisfactorily in each specific context."[209] Moreover, because of the political environment in which public sector organizations operate, the panel realized that care must be taken in deciding the nature and form of the information to be disclosed.

Attributes of effectiveness

Aware of the literature on the subject, the panel considered whether the concepts of program, organizational, and operational effectiveness could provide useful tools of analysis. It decided that this "three-way categorization commingles so much information of different types that the results are not meaningful in any practical sense. It is more useful to consider a framework at one level lower. It is expected that information organized at… [that] level… can be substantiated."[210]

The panel proposed a list or framework of twelve attributes that captures the major concepts found in the literature on effectiveness. The list was subjected to careful review and criticism by managers and measurement and audit practitioners. It does not reflect any single exclusive view of effectiveness, but is intended to respond to the wide interests of members of governing bodies. The relatively high-level understanding of effectiveness that this framework represents subsumes the most significant elements of economy and efficiency, and issues regarding these virtues are found in the attributes.

No single one of these attributes provides a full appreciation of an organization's effectiveness. But with information on all these attributes, or on all that are relevant in the circumstances, people can make informed judgments about the organization and its management. The panel decided that reporting on the basis of the framework should satisfy the needs of the diverse stakeholders (management, government, legislators, and the public) who have varied interests and perceptions and, hence, different information requirements.

Apart from providing a reporting framework, the list of attributes can be used by members of governing bodies as an agenda in their discussions with management to draw out a broader and deeper range of effectiveness information than they may have received in the past.

As mentioned above, certain of the attributes will be more significant to some organizations than to others. Some may not apply at all. Time and circumstances may affect the significance of some attributes. Common sense is to be used in the application of the framework.

The attributes that the panel thought comprehended the concept of effectiveness are:[211]

- management direction
- relevance
- appropriateness
- achievement of intended results
- acceptance
- secondary impacts
- costs and productivity
- responsiveness
- financial results
- working environment
- protection of assets
- monitoring and reporting

The following discussion explains what is meant by each of these terms and why the panel thought they are important.

Management direction

Management direction is the extent to which the objectives of an organization, its component programs or lines of business, are clear, well-integrated and understood by its employees, and appropriately reflected in the organization's plans, structure, delegations of authority, and decision-making processes. Management direction embodies both the accountability of an organization and its agenda for action. It is not enough that the agenda be developed; it must be clearly reflected in the plans and strategies of subordinate organizational units and understood by those responsible for execution. Management direction affects an organization's capacity to implement its mandate and to adjust to changing circumstances. Without clear management direction, there are no guidelines to help direct change, integrate ongoing activity, or monitor and report on performance.

Information in relation to this attribute will help assess trade-offs, balances, and linkages among the following facets of the institution:

- management style, structure, and processes that recognize the need for professional latitude but at the same time assure appropriate supervision and control over matters central to the *raison d'être* of the institution and to the continuity of its operational capacity;
- an internalized value system that is client-centered and directed towards providing the most cost-effective service achievable within the context of professional standards and codes of ethics, regulations, and available resources; and
- effective linkages among and between planning and communications processes at the corporate and operating levels of the institution.

RELEVANCE

Relevance refers to the extent to which a program or line of business continues to make sense in regard to the problems or conditions it is intended to address. It is an attribute that normally would be considered in preparing a management representation about a major program, activity, or line of business within an organization. Information about this attribute could lead to confirmation, amendment, or elimination of that program, activity, or business.

This attribute is an extremely important, complex, and potentially controversial aspect of accountability. Changes in philosophies and policies regarding the role of public institutions in society, public expectations, the network of alternative programs and services, and the status and needs of the community all influence decisions about the relevance of programs and services, as well as choices for the future. Information on these matters can be important:

- to assure the governing body that the activities of their institution are within the organization's mandate;
- to highlight any matters that do or could inhibit the performance of this mandate;
- to identify actual and potential requirements, opportunities and choices; and
- to help the governing body set policy that is responsive to current needs and emerging trends and events.

Of course, it is not for management to decide on relevance; this is a policy decision that the governing body must make. But to make this decision, the governing body needs a framework for analysis, and it needs information. It will draw on many sources to extract this information. In that management is responsible for implementing the program, it is reasonable to expect management to provide information and advice that the governing body will then use as a basis for considering the continuing need for the program and/or the program mandate.

APPROPRIATENESS

Appropriateness measures the extent to which the design of a program or its major components, and the level of effort being made to implement the program, are logical in light of the program's objectives. Design considerations may involve information about the choices (for example, regulation, financial incentives, and service delivery) available to pursue the public policy objective in question. This may also involve information about constraints, the needs of those affected by the program, and administrative strategies (such as make-or-buy, contracting-out, and decision-making practices) that influence the design of the program. Information on this attribute can help management and the governing body assess the current and possible alternative targeting, span, depth, and balance of support/services relative to needs, and to analyze the nature and consequences of any gaps.

Information on this attribute may confirm or disprove that services have the capacity to reach the clientele and that there are no major flaws in logic or design significantly inhibiting the achievement of intended results. In general, information on appropriateness might help identify opportunities to improve the internal operations or the external delivery of a program, and to assess alternative delivery vehicles.

This attribute is closely related to the attribute of relevance. The distinctions between the two are sometimes difficult to maintain and articulate since, to a degree, they draw on the same information sources. The difference between the two might be seen as follows:

- relevance is concerned with questioning the legitimacy and pertinence of the program's objectives;
- appropriateness starts with the program objective(s) as a given and is focused on an analysis of how well the design and delivery of the program suit the objective(s). Essentially, the issue is one of determining the extent to which the means are proportional to the ends.

Achievement of intended results

This attribute concerns information relating to the extent to which goals and objectives have been realized. It is important to emphasize that the issue is not one of simply reporting what has happened as a result of a program or activity, but reporting in such a way that helps governing bodies judge whether the level of achievement is satisfactory. This can be a difficult task, as many objectives are not stated in terms of explicit ends but rather in terms of continuing effort or relative achievement. Often, objectives are couched in such qualitative terms as *appropriate*, *adequate*, and *reasonable*. Additional difficulties arise where objectives for a particular program or line of business are not mutually supporting or, indeed, may be competing or conflicting.

It is important to decide what level of results is being addressed: is it the level of production or the level of intended impact? Both these levels can be useful to governing bodies. At the level of production, the concern is with the specific goods or services a program produces. Generally, information about this level of results would be generated through internal operational performance management systems. This information by itself, however, is unlikely to be sufficient for governing bodies. The *raison d'être* of most programs, after all, is not simply to produce goods or services, but to do so with some valued end or impact in mind.

If information on this attribute is focused on the institution as a whole—or on one of its major programs—it will give the governing body a more integrated perspective of overall performance than they would be able to piece together from reports on individual departments or other organizational units, which typically focus at the output level and sometimes only on pieces of a larger whole. For management, this program perspective can also be useful in directing and assessing the underlying strategies, goals, work plans, and activities of individual operating or organizational units within the institution, and in identifying and analyzing possible trade-offs.

Acceptance

This attribute concerns the extent to which constituencies to which a program or line of business is directed judge it to be satisfactory. Information on this attribute can bring an added perspective to management representations on achievement of satisfactory results.

A program may be achieving its intended results but still not be considered satisfactory by the constituency to which it is directed. Conversely, the clientele might be satisfied with a lower level of effort than is currently being expended. However, gaps between what is being achieved and the acceptance this receives may not point to a performance problem *per se*, but rather to an expectations gap that needs to be addressed through various information and educational activities.

Clients' acceptance and satisfaction may contribute significantly to the intended results (for example, if taxpayers feel they are being dealt with fairly, they are more likely to comply voluntarily). Similarly, lack of acceptance may undermine intended results. The perceptions of staff regarding the level of acceptance by clients are a valuable input but, in and of themselves, are generally an insufficient basis upon which to make credible conclusions.

If an institution has an appropriately wide range of information regarding the acceptance or satisfaction of its clientele, it may avoid the possible problem of being captured by any one constituency or interest group.

Willingness on the part of an institution to seek out views of stakeholder groups also improves the visibility of the institution and shows it to be both accessible and answerable to the public it serves. This is particularly important within the context of current "service to the public" initiatives. It is also important within the context of discussions that institutions now feel they need to have with their constituents on how best and fairly to respond to fiscal constraints.

Secondary impacts

This attribute concerns the extent to which other significant consequences, either intended or unintended and either positive or negative, have occurred. For instance, knowing the overall economic impact of a program designed to provide adequate, affordable housing to specific income groups; knowing the environmental impact of an economic development project; knowing the disincentive effect of social assistance payments. Information on this attribute can be important to decisions regarding the design and operation of a program or, more fundamentally, its continuation or termination. There are probably many secondary impacts that go beyond the ability of any organization to appreciate, measure, and, most certainly, to control.

Information on secondary impacts (both positive and unwelcome) can help senior management and the governing body identify important tradeoffs and assess the consequences of specific choices. It can also provide the means for management and the governing body to explain their choices to, and discuss alternative approaches with, a wide variety of external constituencies—such as the community at large, other institutions, and government. For example, significant negative side effects to a program might cause a reconsideration of the overall merits of having the program in the first place. Alternatively, information on such secondary impacts could lead the governing body and management to consider ways to redesign the program to eliminate or reduce unwelcome effects.

Costs and productivity

This attribute concerns the relationship of costs, inputs, and outputs. Because governing bodies are responsible for approving budgets, cost information is essential to them. Cost information can be classified and aggregated in a number of ways, such as the goods and services acquired, responsibility for incurring the costs, or the activity that is incurring the cost.

The importance of good cost information is all too easily taken for granted. Deficiencies in this regard were recognized by the Federal Government Reporting Study, jointly undertaken by the Auditor General of Canada and the Comptroller General of the United States, which proposed major reforms in the way government accounting is done, particularly in such areas as full-cost accounting.

During times of severe constraints and declining resources, it is imperative that management and the governing body be able to demonstrate that the institution is using its resources to best advantage, and that the organization is constantly looking for opportunities to free up resources so that they can be reinvested where they will do the most good.

Responsiveness

This attribute concerns how well an organization adapts to changes in such factors as markets, competition, available funding, and technology. Information on this attribute can help a governing body judge how well its organization is attuned to the publics with which it interacts, and to the various forces that are pertinent to its role, operation, and objectives. Information in this area can also protect the credibility and integrity of the institution. Moreover, it could provide a useful perspective on the capacity of an organization to maintain its responsiveness in the face of any opportunities, threats, or other changed circumstances that may occur.

Current information on this attribute can give management and the governing body both the time and the basis for redeveloping program strategies, and for shifting priorities and resources in a way that will not destabilize the operations of the institution.

Management representations respecting this attribute are typically highly individualistic, focusing on factors that are key to the ability of the organization to respond to specific circumstances or trends or on general preparedness in this area.

Financial results

This attribute concerns the accounting for revenues and costs, as well as the accounting for and valuation of assets, liabilities, and equity. This information is usually reflected in periodic financial statements demonstrating financial position and financial results of operations. Using these well-understood presentations, managers, analysts, and other users will describe or examine information in terms of trends, ratios, and comparisons with other organizations. In the public sector, a comparison with approved budget may also be important.

Since information on this attribute reflects the overall financial position of the institution and provides evidence of its continuing viability, obtaining it is of central importance to both management and governing bodies.

It may be useful to point out that representations on this attribute include discussions of information that is contained in the organization's financial statements. The ability to form judgments about the adequacy of such items as sales and profitability will depend on consideration of information from this and other attributes.

Management typically keeps governing bodies informed of financial performance as the fiscal period progresses. Monthly or quarterly reports are common. More formal reporting of performance usually accompanies the budget process, and the annual report usually contains audited information on the past year's performance.

Working environment

This attribute concerns 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.

Attention to this attribute can assure a governing body that the organization has adopted constructive ways and means to manage its personnel. It also ensures that the organization is operating in concert with any relevant public policy objectives such as affirmative action.

Staff who are motivated, well trained, and satisfied with the management practices of the institution that employs them are an important determinant of the institution's capacity to achieve its mission. Satisfied and well-trained personnel are also likely to stay with the institution, an important consideration in maintaining continuity in operations and protecting the institution's intellectual capital.

Adequate space and facilities, equipment, and safety practices are necessary to minimize danger and/or accidents to clients, staff, and visitors. Attractive and clean facilities enhance the morale of staff and help create a good public image for the institution.

Staff expect that the institution will invest in job training and career development. The training employees obtain significantly affects the quality of service they provide, their progress within the institution, and the institution's ability to retain them and to benefit from its investments.

Since human resources are such a large portion of the budget of most organizations, high rates of turnover or absenteeism and low levels of productivity caused by poor working environments can waste valuable resources.

Protection of assets

This attribute concerns the extent to which important assets are safeguarded so that the organization is protected from the danger of losses that could threaten its success, perhaps its very existence. Assets that fall into this category could include key personnel, sources of supply, valuable property, agreements, and important information.

Loss of key assets, or their impairment, without recourse to reasonable alternatives, can compromise the credibility of the institution and its capacity to operate effectively. Failure to protect such assets can lead to loss of public confidence, litigation, and other serious problems.

Governing bodies need assurance that management has identified key assets, assessed risk in terms of their loss and impairment, and have strategies in place to prevent, reduce, or counteract problems as they emerge.

Monitoring and reporting

This attribute concerns the extent to which key matters pertaining to performance and organizational strength are identified and carefully monitored. The results of that monitoring should be reported regularly and accurately. Issues that might be monitored in all organizations include, for example, the extent to which key objectives are attained, limits of authority and compliance requirements are respected, and essential systems and practices are maintained.

The emphasis here is monitoring and reporting on the areas that are crucial for accountability, for success or failure—not everything. In health care, for example, matters pertaining to the prevention, identification, and correction of potential risks and actual incidents must be monitored if a hospital's responsibilities concerning quality care and safety of patients are to be met appropriately. The trustees need to have this information to discharge their responsibilities.

This information is needed to plan, allocate resources, delegate responsibility, supervise performance, assure quality, make decisions, and maintain accountability. It also facilitates a dialogue between staff and management, among management, and between management, the governing body, and other stakeholders.

Different levels within the organization require different information at various times. For example, senior management needs information on the twelve attributes of effectiveness in order to manage corporate affairs and to discharge its accountability to the governing body through comprehensive reporting on all matters of corporate significance. Although elements of these attributes may also be relevant to others further down in the hierarchy, concerns of these individuals are likely focused on important operational matters, and they may need to have certain information on a day-to-day basis.

Guidelines for making representations on the attributes

The panel recognized that in calling for representations on the proposed attributes of effectiveness, they were asking managers to do something with which they had little or no experience. However, it had a clear idea of the sort of representations it had in mind:

> What are clearly required are representations that present sufficient but not too much information about effectiveness… they should be sufficiently detailed to allow the reader to follow the reasoning behind each statement, thus permitting an assessment of both its validity and significance. Accordingly, in applying the principle to a specific major program, for example, a management representation might contain the following types of statements:
>
> - The extent to which this program continues to be relevant is demonstrated by…
> - The following intended results have been achieved by this program…
> - This program has such important secondary impacts as…
> - The quality of the working environment in this organization is demonstrated by…
>
> While the essence of representations is information on which judgements can be based, managers may want to include their own interpretations of the significance of that information. They are completely within their rights to do this, of course, but it must be recognized that it is the information, not the interpretation, that constitutes the representation… To help users arrive at their judgements, representations may include material dealing with such matters as the degree of certainty associated with the information, important assumptions, the manner in which the information was generated, management perceptions, and risks.[212]

To assist organizations that decide to follow their proposals, the panel offered several guidelines for instituting an effectiveness reporting regime.[213]

Guideline 1

All applicable attributes of effectiveness should be considered in making management representations and an explanation should be given where any attribute, otherwise expected, is not used.

All twelve attributes should be considered as bases for making representations…. however, not all attributes will be relevant in all circumstances so that it may be inappropriate to make representations on all twelve at all times. In such instances an explanation should be given for the omission of an otherwise expected attribute.

Guideline 2

Representations should reflect the full range of information generated in their preparation and contain whatever explanations or qualifications about the information and analysis that may be necessary to allow users to make informed judgments.

It is important, too, that representations reflect the full range of information and analysis that underlie them. If, for example, they reflect only the positive aspects, they will be misleading and seen as self-serving. In addition, they should clearly indicate any assumptions that were used and any areas where the information on which they were based is either incomplete or tenuous. Certain sources of information may entail inherent bias, certain types or depth of analysis may be more authoritative than others, or the evidence taken as a whole may be equivocal. Where factors such as these might have a significant effect on the reader's understanding of the statement, such explanations should be disclosed in the representation itself. If similar representations have been made in the past on a different basis than the current representation, the change in basis should also be disclosed.

Guideline 3

Representations should be prepared in such a way as to take into account the interests of governing bodies.

Common sense dictates that management representations on effectiveness should be framed with the interests and needs of the addressees—governing bodies—in mind; in other words, they should be user-oriented. One way of ensuring this is to have the representations take into account the major objectives of the governing body to whom they are directed. Such objectives are apt to fall into one or more of the following categories:

- to ensure equity of treatment among different individuals, communities and interests
- to advocate the interests of certain individuals and communities
- to preserve or advocate certain values for which they entered public office
- to ensure the satisfactory administration of public activities
- to obtain recognition.

The objectives of the governing body will have a direct influence on the kinds of management representations that are appropriate. If the governing body places primary emphasis on advocacy or recognition, for instance, attributes of effectiveness that have a strong external focus, such as relevance, acceptance, responsiveness, achievement of intended results, and secondary impact, will be most important. Conversely, an emphasis on objectives concerned with the quality of administration and, to some extent, equity, might indicate that greater emphasis should be placed on such attributes as appropriateness, costs and productivity, management direction, working environment, protection of assets, and monitoring/reporting. It must be recognized that, especially in political environments, members of governing bodies may have quite varying interests. To the extent possible, all these interests should be accommodated in framing representations.

A user orientation also implies that the representations should reflect the governing body's perception of risk. Certain matters carry with them such a combination of probability of occurrence and severity of impact that they are considered to be high-risk issues by governing bodies, who will be looking for management representations respecting them. In applying this concept to its various programs and activities, management should consider the following types of risk:

- life and health risks, particularly in areas such as transportation, policing, health care, and enforcement of safety standards;
- economic, social and business risks, in relation to such matters as industrial and regional stability, unemployment, and income security or rate of return;
- management systems, practices and control risks, particularly in relation to care, diligence and competence needed in making decisions, supervising transactions, and protecting physical, human and financial resources.

Another consideration that management should take into account is the capacity of the governing body to decide or to exercise influence over the issue on which management representations are being drafted. If, for instance, a governing body lacks the power to introduce, terminate or alter programs, representations with respect to attributes such as relevance and some aspects of cost and productivity may not be of great use. Similarly, a capacity to make decisions on or influence the level of service provided might call for an emphasis on attributes such as achievement of results and acceptance.

Guideline 4

Representations should be made at the highest meaningful level, and to accomplish this top management must be involved in preparing them.

There is a consensus that management representations on effectiveness are best made at a high—or executive—level. This is in keeping with the level at which governing bodies can realistically expect and have the capacity to provide stewardship of public funds and at which they will receive the greatest value from the information they are provided for decision making. It is also consistent with a determination to avoid information overload, which, as is generally recognized, detracts from good accountability and good management.

In order to make representations that respond to the interests of the governing body, a hierarchical approach should be taken. The highest level is the entire organization; if meaningful, substantial information can be provided on that basis, it should be done. If this is impossible, it is then appropriate to consider the next highest components. This could be, for example, the organization's major lines of business or programs, perhaps grouped where it would be sensible to do so. If even this level is too high to allow the production of meaningful information, it will be necessary to go one step lower. The hierarchical scale should be descended only as far as necessary to allow appropriate representations to be made. In all likelihood different levels of aggregation will have to be used for different attributes of effectiveness.

Worthwhile representations are likely to be achieved only if the chief executive officer is directly involved in shaping them. It is not reasonable to expect that junior-level managers or individual measurement specialists will have the high-level perspective that is called for, and if the responsibility is delegated to them, information will tend to mushroom. As one deputy minister put it, "Effectiveness is too complex and important a subject to be left to others." It is inevitable that there will be instances where only the knowledge, judgment and authority of the chief executive can determine the most appropriate application of attributes, either in relation to the timing of representations on them or to the breadth of their application.

It is recognized that having the chief executive officer involved from the outset may be difficult to achieve. This is because it runs counter to the normal pattern of information generation and processing in most organizations, which tends to be from the bottom up. It also places more demands on the already busy executive. Without this participation, however, there is a danger that the whole exercise could run the risk of being less useful than it should be, if not entirely wasted.

Guideline 5

Each organization should establish a comprehensive strategy for reporting management representations on effectiveness over an agreed period of time.

The question of the timing of these management representations was raised frequently in the course of the panel's study. In the same way in which global representations are thought to be impractical, so too may be the notion that management could, or ever should, prepare comprehensive representations on everything all at once. There really needs to be a comprehensive strategy for bringing this information forward in an organized way. This may involve cyclical, detailed reporting with periodic updates or exception reporting of major changes since the last detailed report.

Other factors to take into account when deciding on the timing of management representations include:

- the decision-making timetable of the organization and its governing body;
- the continuing relevance of previous representations;
- the cost/benefit of preparing new representations; and
- the audit schedule, including any timing requirements for an audit examination or report.

Governing bodies usually have specific timetables to which they work. They may, for example, want to take certain decisions at specific times to fulfil commitments to the electorate. Other matters affecting timing may be routine, such as the annual review of *Estimates* or the periodic detailed review of programs. Still other decisions may be required at specific times because of sunset provisions. It is important for managers to know what this timetable is and to time the development of their representations so as to respond to it in a way that will be compatible with the organization's internal and externally imposed agendas.

A second consideration that may influence the timing of management representations is the continuing relevance of effectiveness information previously provided. Changing circumstances within or outside the organization may make recent representations quickly outdated. Where this applies, more frequent development of management representations may be called for than where relatively little change has occurred.

A third consideration is the benefits and costs inherent in producing the management representations themselves. The cost to management of preparing the information and analysis to support comprehensive representations on a major unit of business can be substantial. It will be important for both managers and governing bodies to consider these costs against the benefits that are expected to accrue in terms of being able to make better decisions or to act in a more timely manner. In general, where the cost of generating them is high and the incremental benefit to the governing body is low, management representations entailing extensive analysis should be made less frequently.

Need for external review

As was seen in chapter 9, there are a variety of ways in which representations can be faultily constructed. Many of these pitfalls can be detected by lay readers who have little or no knowledge of the technical details of the issues on which the statements are based. Simple logic and common sense can often identify flaws in presentations. Thus, members of governing bodies, as reasonable, responsible people, have an innate competence to assess at least some aspects of the validity of representations made to them by management.

However, governing bodies cannot be expected to assess the validity and completeness of the information underlying management's representations. Many public institutions are so large, it is unreasonable to expect the organization's directors to have detailed knowledge of operations.

> **THE ORGANIZATIONAL DILEMMA IS: AT THE TOP ONE WORKS ON THE RIGHT PROBLEMS BUT WITH THE WRONG INFORMATION, AND AT THE BOTTOM ONE WORKS WITH THE RIGHT INFORMATION BUT ON THE WRONG PROBLEMS...[214]**
>
> Arnold J. Meltsner

Elected politicians who head government departments are often thought of as conducting an orchestra without a score. The best that they can be expected to do is to have an impromptu rehearsal. Compared with the information held by their political masters the bureaucracy possesses much more technical information about the supply of public services. To the extent that information is power, there is a need for countervailing power to that of the bureaucracy.[215]

P. M. Jackson

It is only to be expected that managers will want their representations to reflect well on their own competence and performance. This natural bias could, either intentionally or unintentionally, distort the information they provide. No matter how good the relationship is between management and the governing body, the latter may still harbour some doubts about the completeness or the accuracy of the representations brought forward.

How can this suspicion be allayed, this distortion prevented, this potential bias neutralized? The answer is twofold. First, the process of preparing the representations should be disciplined and transparent. Sloppiness and secrecy are ideal cultures in which distortion can grow. Second, the representations should be exposed to expert, outside, independent review. That review will have two immediate benefits: it will reinforce management's commitment to a disciplined process; and it will give both management and the governing body confidence in the representations brought forward.

The panel recognized the ability of external review to lend authority to management representations and provide confidence in their accuracy, completeness, and fairness. Consequently, it was recommended that auditors provide opinions on management representations brought forward to governing bodies.

The issues involved in auditing management representations on effectiveness are discussed in Part III.

205 *Effectiveness Reporting and Auditing in the Public Sector: Supporting Research Studies* (Ottawa: CCAF, 1987).
206 W. David Moynagh, *Reporting and Auditing Effectiveness: Putting Theory into Practice*, CCAF Applied Research Series (Ottawa: CCAF, 1993), 14.
207 *Effectiveness Reporting*, 16.
208 Moynagh, *Theory into Practice*, 14, 17.
209 *Effectiveness Reporting*, 17.
210 Ibid., 21.
211 The discussion of the twelve attributes draws heavily on the panel's report and on Moynagh, *Theory into Practice*, Exhibit 10.
212 *Effectiveness Reporting*, 107-108.
213 The discussion of guidelines is taken from *Effectiveness Reporting*, 108-114.
214 Arnold J. Meltsner, *Policy Analysts in the Bureaucracy* (London: University of California Press, 1976), 289.
215 Jackson, *Political Economy* (see chap. 9, n. 34), 3.

Chapter 11

Preliminary Considerations in Reporting Effectiveness

> **Although each institution is likely, to some extent, to discover its own insights and lessons, there is much that we have learned that is transferrable.**[216]
>
> The Queen Elizabeth Hospital

Recently, a number of organizations have reported on their performance using the suggested framework of twelve attributes of effectiveness discussed in the previous chapter.[217] This chapter contains some of the lessons learned from these experiences in implementing the framework.

This summary discussion focuses on five broad issues that face any organization seriously considering using the framework in reporting effectiveness. They are:

- determining whether an organization and its management are ready to take on the challenges of the effectiveness framework;
- setting realistic expectations for an organization's first effort at effectiveness reporting;
- deciding where to focus initial effectiveness reporting efforts;
- deciding who ought to participate in the process and what roles they need to play to foster successful implementation; and
- managing the overall implementation process in terms of both general strategy formulation and people-dynamics.

This chapter reflects the thinking and advice of the individuals who were directly involved in such projects, including the senior managers who gave personal leadership to these initiatives, and the wide variety of practitioners who supported the interests of management or the governing body during the process.

Overall perspective

Experience in applying the effectiveness framework demonstrates that it entails much more than senior management just sitting down to write a performance report. Indeed, it requires that management think hard about the mandate, objectives, and priorities of the program or line of business on which the organization is focusing, to build consensus on these matters, and to consider how existing processes are related, or ought to be related. In a sense, therefore, the notion of reporting almost becomes a by-product of much broader strategic considerations and processes.

> **We learned that applying the framework can be complicated, and that full and frank disclosure may not come easily. We made mistakes, we learned some lessons, and we also did many things well. From our perspective, we confirmed the validity and value of the framework and are convinced that with increased usage, larger dividends will be realized.**[218]
>
> Government of Manitoba

The successful implementation of effectiveness reporting demands a constant series of trade-offs from the beginning of the process (when a decision is made about where to focus and why), until the end (when management reports their representations to their governing body). These trade-offs are intrinsic to the process and involve fundamental choices that will determine the amount of added value that will result from the process and product. For the most part, these trade-offs cannot be made by anyone but senior management.

Experience also indicates that, while central to the success of effectiveness reporting, senior management cannot do it on their own. Ultimately, a partnership of interests needs to be established among senior management, their governing body, and the practitioners who serve both groups. This is generally a hard-won alliance, as the parties often have to look beyond the traditional beliefs, attitudes, and behaviours that have characterized their past relationships. The perspectives and decisions of each party affect the considerations and choices of the others.

> Looking back on the process, managers realize that they have had the benefit of an external review of their key systems and practices, based on criteria that they themselves devised and had approved… their own preparation for the examination uncovered a number of deficiencies and anomalies that they were able to correct.[219]
>
> Canada Mortgage and Housing Corporation

Appropriate mechanisms for communication and consultation among these parties must be established if the project is to succeed. Equally important is the influence of the corporate culture that shapes these relationships. Ideally, it encourages openness, invites challenge, permits flexibility and learning, and is based on mutual respect. At the least, the corporate culture must not be hostile to these concepts.

Determining if the Organization is Ready to Proceed

> In selecting an organization… it should be [one] whose senior management already use or have open minds about innovative practices in accounting for their actions… [220]
>
> Guy Breton

Important factors in determining whether or not an organization is ready to take on the challenges of this process include:

- the predisposition of the organization, and in particular its management, to be self-challenging, forward-looking, and innovative in improving its accountability and performance;
- the maturity of the relationship between management and the governing body; and
- the capacity of the organization's management practices and processes to respond to the information requirements of the effectiveness framework.

Where there is a motivation to improve performance, and a relationship of mutual respect that encourages management and governance to deal with this issue in a straightforward and evenhanded manner, application of the effectiveness framework has its greatest benefit.

Organizations most likely to benefit substantially, or at least have a greater potential for using the framework successfully, are those that:

- have already expressed a desire to improve effectiveness reporting to the governing body and/or the public;
- are forward-looking and tend to pursue new approaches designed to enhance the effective-

ness of their operations;

- are involved in or increasingly thinking about long-term planning and are concerned with the linkages between this planning and the information needed to support it;
- have a history of taking initiatives to enhance governance and management processes and to foster the accountability relationship between the two parties; and
- are in or are about to begin the process of looking at enhancements or alternative approaches to improve the quality of management, governance, planning, and/or operations.

Where an organization is in a period of crisis or instability, however, or where the relationship between management and their governing body is strained, it is improbable that an attempt to use the effectiveness framework will be successful. In the first case, the urgency or uncertainty associated with the organization's situation will likely keep management from devoting the necessary attention and time to effectiveness reporting; it just won't have priority. In the second case, introducing effectiveness reporting could simply make a difficult problem worse by forcing the spotlight on issues and information about which neither party is prepared to be completely open or fair with the other. In both situations, the result is likely to be a process that is soon neglected, eventually resented, and finally abandoned. The approach organizations must take, experience shows, is to resolve these fundamental problems before trying to implement the effectiveness reporting framework.

The current state of an organization's information systems is another key factor in assessing its readiness to undertake effectiveness reporting. Those most experienced in working with the framework caution against selecting or encouraging an organization with no or minimal demonstrated information processing capacity to take on the challenge of an effectiveness reporting project. It is challenging enough, they argue, for organizations with comprehensive and reliable information systems to implement the framework; without such systems, it would be extremely difficult to produce a report in which management could have confidence. While good information systems are indeed helpful, perfection in this regard is not a prerequisite to undertaking an effectiveness reporting project.

The shift from the more traditional focus on inputs and activities, to a focus on broader notions of effectiveness is not without significant challenge. The challenge is not just a technical one relating possibly to the need to adjust internal information systems and practices. It also involves a fundamental change in mind-set both on the part of those who are preparing this information and those who are receiving it. Where the parties' thinking is in harmony, the inclination of one to move in this direction is reinforced by the appetite of the other. But this may not always be so. For example, requirements and demands that one party feels to shift to a broader orientation may need to be balanced against the expectations of others for a continued focus on inputs. Making this shift—be it technical or not—is likely to be a gradual process.

It is important that an organization invests the necessary time and effort at the front end of the process to carefully consider all the critical success factors discussed above, before a final go/no-go decision is made respecting implementation. As one practitioner put it, it only makes sense to "begin at the beginning," making sure that everyone who will be involved in the process has an understanding of the effectiveness framework and that they are committed to the value that this process can bring to the accountability relationship between them.

Setting realistic expectations

[W]e anticipate that others who persuade senior management and governing bodies to adopt the accountability framework and management representations may be discouraged by the scarcity of hard data to support the development of representations. Don't be. The first representations may not be perfect, but they will become a strong argument in support of better information systems, and ultimately better management practices.[221]

City of Gloucester

Another key to success in effectiveness reporting is setting realistic expectations for the organization's first efforts. These expectations must not only be reasonable, they must also be shared among management and with the governing body. And once set, they need to be consistently reinforced throughout the exercise, since the intensity of the process can often cause those closely involved to lose perspective or to attempt to force the reporting product beyond its practical limits.

Thinking that an initial effectiveness reporting project has to be or will be perfect places an unrealistic burden on the process, which will inevitably lead to disappointment or, worse, to a product that ignores or subverts important information not in accord with this predetermined outcome.

At the same time, all parties, particularly management, have to recognize that the process of developing management representations has to be a disciplined one, based on assessment criteria that have been discussed and agreed to as reasonable by the parties involved. And it needs to be backed up by management reporting that provides a fair and complete picture of the organization's effectiveness.

Most organizations that have worked with the effectiveness framework believe that the right balance between rigour and flexibility will be achieved only over time as management and the governing body gain further experience in working with the effectiveness framework and, through this, develop a better appreciation of each other's needs and capacities.

Most organizations applying the framework deliberately decided to base their initial management representations on existing and readily available information and data. In doing so, they knew that the resulting performance story would be incomplete, perhaps even in important respects. They calculated that they owed it to themselves to exploit their existing information and systems to their fullest potential—and to assess how they stack up to requirements—before investing further resources in developing performance information. Even acknowledging the gaps in information that this strategy left, organizations consistently report that using the framework as a basis for their initial representations has provided governing bodies with a more integrated and strategic picture of performance than they have received previously. Moreover, the initial application of the framework has helped these organizations assess their information base and needs and, from this, determine what actions are required to support more rigorous and complete management reporting in the future.

Deciding where to focus initial efforts

If you are planning to do this, choose a significant area of your business to assure return on that level of investment.[222]

Mary Ferguson-Paré

The decision as to where to focus an initial application of the effectiveness framework should be taken carefully. In the case of the Queen Elizabeth Hospital in Toronto, senior management devoted an entire executive committee meeting to this issue.

Effectiveness reporting projects undertaken to date show a wide variety in practice—ranging from a focus on the entire organization, to a major line of business, to a small program, to an administrative function.

On balance, the lesson that can be taken from these experiences is that application of the effectiveness framework is most cost-effective when focused at a reasonably high level, such as a major line of business or program that is central to the organization's mission. This is the level at which senior management makes strategic choices, and it is the level most likely to engage the interest and needs of the governing body.

The decision to focus at a high level can bring certain difficulties. For example, the institution's programs and organization structures may cut across each other. Similarly, the traditional performance measurement and reporting systems within the organization may not easily lend themselves to the desired program focus. These complications, however, have generally not deterred organizations from the decision that a program/line-of-business focus is the most appropriate one. Nonetheless, these difficulties do have a strong influence on implementation strategy, as well as on expectations about what can reasonably be accomplished in initial applications of the effectiveness framework.

Deciding who ought to participate

Of necessity, an effectiveness reporting initiative involves a number of key participants, and the success of the initiative is contingent on them recognizing and being prepared to play specific roles. This includes senior management, the governing body, and the practitioners who support both these groups.

Senior management

Much of the success of the exercise is attributed to the interest and continuing involvement of senior management throughout.[223]

Canada Mortgage and Housing Corporation

Time and again, organizations that have worked with the effectiveness framework point to the leadership and involvement of top management, particularly at the CEO level, as the single most critical success factor. When management undertake the process enthusiastically and, through their own active involvement, demonstrate the importance and commitment they attach to the goal of improved accountability, the governing body understands that this exercise deserves their attention. The converse is equally true. If senior management treat the effectiveness reporting process like a spectator sport, encouraging or allowing the primary responsibility for developing management representations to be pushed to lower levels in the organization, it is unlikely that the governing body will perceive the product as relevant to their strategic interests.

The most positive aspect of this [applied] research project was the extent to which senior management assumed ownership of the results… Senior management should be committed to the value of the process from the beginning.[224]

City of Gloucester

The degree and nature of senior management's involvement in the process requires careful thought. On the one hand, there are judgments and trade-offs involved that only management can make. In addition, senior management need to have a very good sense of the information they are using in developing their management representations. On the other hand, the identification and amassing of basic information from the wide variety of sources available to the organization can be very time-consuming. These tasks are done more cost-effectively by technical support staff, such as program evaluators or policy analysts.

In particular, CEO leadership and involvement need to be strategically focused. The nature of such leadership and involvement, however, is likely to vary with factors like the organization's size, management culture, and policy climate. For instance, in a large organization where senior corporate support is likely to be available, it is reasonable to expect that the CEO will not be directly involved in the process of amassing and analyzing data and information and the physical writing of the report. In a smaller organization, more extensive involvement on the part of the CEO may be possible or necessary.

Regardless of the circumstances of the organization, however, there are four fundamental roles for the CEO to play:

- negotiating a shared understanding with the governing body about the priorities, issues, and information that need to be addressed in the performance report;
- creating a climate conducive to such reporting, up through the organization and, as applicable, from the organization to various stakeholder groups;
- ensuring that the reporting product receives an effective challenge in terms of its fairness and completeness and the central messages it seeks to convey; and
- claiming ownership of the performance report.

Experience shows that arrangements for some manner of management support should be put in place at an early stage in the process. This helps senior management keep focused on tasks where their involvement has the greatest value added—that is, deciding what information needs to be reported and why, and how this information should be interpreted and conveyed to the governing body. Making these choices can be facilitated by input from advisers, but the decisions themselves should not be delegated to them.

Governing body

The participation and support of our Board of Governors was an important component of this exercise… At the same time, it is unrealistic to expect that a Board will enter a new process with a predetermined, fully integrated articulation of their expectations and information needs… We conclude that it is up to the hospital management to bring options and advice to the Board about the information they ought to receive. The Board can then react to this and make refinements as it judges necessary.[225]

The Queen Elizabeth Hospital

The governing body must be involved in the effectiveness reporting process. This is necessary in order to gain their perspectives on the matters that should be addressed in the report, and to foster their willingness and preparedness to deal with management reporting in an evenhanded way. For reasons mentioned in the quotation above, this is a consultation process that management needs to initiate and nurture.

Most effectiveness projects entail some manner of consultation between management and governance at one or more stages of the exercise. In each case, the governing body played a key role in giving legitimacy to, or setting expectations for, the effectiveness reporting initiative.

It is wise to engage the governing body in the process reasonably early, once management have had the opportunity to orient themselves to the effectiveness framework and have developed a general sense of the kind of representations they will be able to produce. Not seeking such engagement increases the risk that management will produce a report that the governing body will not understand, will not know how to use, will not find germane to their interests, and thus will not value. The essential purpose of the effectiveness reporting framework would, therefore, be unfulfilled.

Experience shows that the best approach is for management to establish ongoing consultation with a committee of the governing body rather than to try to engage the interest and participation of the entire governance entity at every key stage in the process. This committee may be one already set up for such a purpose (for example, the board's audit committee) or one that management would encourage the governing body to establish on an *ad hoc* basis.

Auditor

The special examiner [auditor] was involved in the process of developing representations right from the start. By ensuring that the examiner was privy to all the background thinking and work, and giving him the opportunity to comment on that work as it progressed, a useful synergism grew and problems of varying viewpoints were avoided.[226]

Canada Mortgage and Housing Corporation

In the final analysis, the involvement of audit is fundamental to the successful establishment of credible effectiveness reporting by management to their governing body. The role of the auditor in this context is to provide assurance to the governing body regarding the fairness and completeness of the effectiveness information being reported by management. The presence of the auditor and the independent assurance role he or she plays reinforce the message that it is important and expected that management report the complete performance story.

At the time of writing, there are only a limited number of examples where there has been an audit attestation component to an effectiveness reporting initiative. The one prominent lesson learned from these few cases, and from other ongoing effectiveness reporting projects where there is an audit component, relates to the value added that all parties see in having the auditor involved in the process from the beginning, and not just from the point where management is ready to table their final representations with the governing body.

From the auditor's perspective, for instance, having exposure to the thinking of management and the governing body, and to the background work that has been done, helps the auditor decide how to approach the examination work. At the same time, by taking advantage of early opportunities to explain to management—and perhaps to the governing body—the type of perspectives and range of considerations that will be applied in the course of this audit work, the auditor helps foster a disciplined approach to the process and a rigorous reporting product.

There is also a lesson to be learned from those projects where the decision was made not to have an audit attest component for the organization's first attempt at effectiveness reporting. These decisions were not motivated by a desire to evade audit scrutiny as a matter of principle, but by a concern about the wisdom of trying to wrestle with too many unknown factors at the same time. Possible sources of uncertainty could include unfamiliarity in working with the effectiveness framework itself, management feeling that they need to obtain a better understanding of and confidence in their capacity to produce substantive representations, and entering uncharted territory in terms of the focus and level of discussion between management and the governing body.

In such circumstances, an organization may decide to use the first application of the effectiveness framework as a diagnostic of their information systems, their capacity to make representations on effectiveness, and the value that such information has in supporting the accountability relationship between management and their governing body. With a better understanding of these matters, and with confidence in the capacity to move forward with these ideas, future effectiveness reporting initiatives could then incorporate a formal audit component.

Facilitator

> **Application is not easy. The managers of these organizations need help. The up-front investment to understand the framework is considerable, therefore, it is preferable to draw on resources already familiar with the concept.[227]**
>
> J. Peter Gregory

Most organizations have sought out some outside help to advise and assist them in the initial application of the effectiveness framework. These facilitators are senior professionals in private sector accounting/consulting firms, legislative audit offices, and so on, who have an in-depth knowledge of the effectiveness framework and who, over time, have developed a substantial base of experience in working with these ideas in a variety of organizational contexts. They are also knowledgeable about the organization, and comfortable and skilled in dealing with executive decision makers in a workshop-leading, problem-solving situation.

Generally speaking, organizations have sought out external facilitation for one or more of the following reasons:

- they recognize that working with the effectiveness framework is likely to require management and their technical support staff to think and operate outside traditional patterns, and that having someone with an outside perspective to assist them in these tasks will help the transition occur more smoothly;
- they do not have a ready pool of resources within the organization that can be called upon to provide management with the ongoing support required; and
- they want to use the first application of the effectiveness framework to train staff so that they will be able to support management in future reporting initiatives.

Regardless of whether it comes from outside or inside the institution, those organizations that have used the effectiveness framework report that such facilitation is an essential ingredient to success. Management cannot do it alone.

Organizations report that the facilitator has played a variety of key roles:

- introducing the effectiveness framework to senior management, helping management think through the implications of applying the framework, and, if the decision is to proceed, designing an appropriate implementation strategy;
- organizing the necessary background work and material to facilitate management's deliberations on various matters throughout the process;

- helping management keep focused on the tasks that need to be accomplished and challenging management at various points in the process;
- providing expert advice to management *vis-à-vis* the development of their representations on effectiveness;
- helping management identify points of diminishing returns from their efforts and encouraging them to move on to other issues; and
- bringing closure to the effectiveness reporting process.

Report writer

Although senior management develops the substance of the management representations, the final report cannot be written by committee. Somebody needs to be designated as responsible for writing the report. This is not a trivial task, as a balance needs to be struck in being succinct yet complete, and in achieving a common presentation format yet preserving the distinctive character of individual attributes. Whoever is assigned this responsibility needs to be a part of the process from the beginning, not just brought in at the end.

Managing the overall process

> **Proper management of the framework is required to ensure that its application neither becomes onerous due to its comprehensive nature, nor prompts the drawing of unwarranted causal conclusions about the effects and effectiveness of particular social services.**[228]
>
> Roxy Freedman

The various applications of the effectiveness framework have yielded a number of important lessons regarding the formulation and execution of project management strategy. Many of these have already been discussed and are integrated below.

First, take a measured approach to the whole process. Before a go/no-go decision is made respecting implementation, it is important that management invest the necessary time to inform themselves about the effectiveness framework and to think through the implications of using it. This is best accomplished through a process that progressively provides management with information responding to their interests, and that allows them to give it detailed consideration. Doing this takes time, but it is time that organizations report was well spent, or that, in retrospect, they wished had been invested.

Second, recognize that an array of interests and expectations will be brought to the table by the various participants. These are likely to vary between—even among—the governing body, management, and those practitioners who support the interests of both parties. Moreover, the process is likely to open up entirely new areas of dialogue among these participants. The implementation process has to be flexible enough to encourage discussion on these different perspectives and expectations, and disciplined enough to bring these matters to a resolution that all parties are prepared to support.

Third, establish specific consultation/communication networks to keep all key stakeholders informed and to encourage dialogue at strategic points throughout the process. The most important network in this regard is the one that links management and their governing body. From management's perspective, for example, they need to know what the governing body wants out of the process, that they are supportive of the general principles that underlie the process, and that the governing body is ready and able to deal with the information that they will eventually receive.

Fourth, impose a reasonable timetable on the process. Rome wasn't built in a day and neither will effectiveness reporting.

Organizations applying the effectiveness framework often comment on the need to make sure that the process is well paced to maintain the necessary momentum. At the same time, it should provide sufficient opportunities for reflection and research so that management can come back to the table with new information and fresh perspectives. Although many factors might dictate otherwise, once a go-decision has been made, a useful rule of thumb would be for management to allow themselves about nine months to complete the process of developing their representations and tabling them with the governing body.

The following chapter offers more detail on the type of step-by-step strategy that could be used and on the considerations that attend each stage of the process.

Developing management representations

The process caused everyone to look beyond their own areas of responsibility and focus on the operations of the Chronic Care Service in a holistic way… A very important lesson learned was the need to have a clear sense of the program to be examined before beginning the process… [Writing our representations] was not a linear process… Probing and challenging the links among the attributes is what makes the exercise come alive… The integration of individual management representations into a single report is a significant task… This process is one in which all senior management needs to be involved.[229]

The Queen Elizabeth Hospital

Developing management representations is a complex process that involves a high degree of multidisciplinary thinking and takes a lot of effort.

There is a high level of interconnection among some attributes (for example, relevance and appropriateness); sometimes the dilemma is where to deal with information that is relevant to each attribute. At the same time, based on the applications to date, there appears to be no compelling argument that the attributes have to be dealt with in any specific order.

Keeping the focus on the main messages can be difficult, particularly when trying to integrate a wide variety of information that, in turn, has been generated by a wide variety of sources. To a certain extent, this tension is inevitable.

Experience shows that there is no single right approach to applying the framework in an organization, nor should anyone think that the suggested framework is the only way in which to structure the performance information to be reported. Indeed, CCAF's applied research projects and other applications of the framework have demonstrated a variety of ways in which to structure the performance report. In some cases, organizations have found the twelve-attribute framework to be a reasonable structure for the performance report. Elsewhere, organizations have grouped the attributes in a way they think best projects the nature of their business or in a way intended to show key interrelationships among subsets of the attributes and relevant performance information. The framework offers sufficient flexibility to be adapted to different organizational circumstances.

As explained above, it is not a question of engaging in slavish, lockstep reporting on each of the attributes regardless of the circumstances; rather, the framework should be used as a tool that provides a set of principles in stretching and organizing one's thinking about the performance issues and information that really matter, and in applying the completeness test to the reporting that emerges from this process.

Determining where and when to report representations

The panel was convinced of the wisdom of using existing vehicles wherever possible for reporting on effectiveness, rather than creating yet another reporting mechanism.

> At the federal level, annual reports, the *Public Accounts* and *Part III Departmental Expenditure Plans* appear to have good potential as reporting vehicles for management representations on effectiveness. Typically, these documents have an introductory section where the organization as a whole and the challenges it faces are discussed, and subsequent sections dealing with the several major programs or lines of business. The former mechanisms seem suitable for management representations dealing with the effectiveness of the whole organization, while representations that are specific to individual programs could fit well in the later sections… In other jurisdictions there are similar documents that deserve consideration in choosing reporting vehicles.[230]

As noted above, most public sector organizations already have certain reporting requirements placed upon them. This usually includes some form of an annual report. It might include more frequent reporting to a governing body, focusing on performance in relation to certain critical success factors for the organization. Frequently, such reporting is supported by some form of ongoing program monitoring. It might also include cyclical reports provided to a governing body, which focus on key program areas or lines of business. Usually, these are more in-depth reports that tend to be supported by periodic study-based review processes such as program evaluation.

Implementation of the framework is not intended to push aside existing reporting processes, but to build on them. Some organizations have found that implementing the framework has given a broader, more integrated focus to their overall governance and management-information strategy and has helped identify where adjustments to individual elements might be made.

Ultimately, in what form and how often an organization can most usefully report its management representations on performance or effectiveness is something each organization can probably judge for itself. Some organizations that have worked with the framework have used their annual reports to the governing body as the vehicle by which to convey management representations.[231] Others have developed a special report to the governing body focusing on the results of a specific management representations project.[232] For still others, the intention is to operate within the context of a more global strategy for reporting management representations to the governing body over an agreed period of time, each time focusing on (a) different area(s) of their business.[233]

A wide number of interrelated factors affect how and when to report management representations. As discussed earlier, these include: the decision-making timetable of the governing body, the continuing relevance of previous representations, and the cost-benefit of preparing new representations.

Some of the information that forms part of management's representations on overall performance will be useful to shorter-term decision making (reporting on costs and productivity, achievement of shorter-term operational results, some aspects of acceptance, financial results, and so on). And, where it is useful, advantage ought to be taken of existing reporting vehicles to bring this information forward. In doing so, however, it may be important to explain to the reader that this shorter-term information, while useful, does not convey a complete picture of overall performance. In all likelihood, the full range of information that emerges from applying the twelve-attribute framework will be most powerful when it is used in connection with longer-term planning, policy, program, and resource decision making.

In the final analysis, reporting on performance, in a complete way and at a high level, will need its own cycle, possibly detached from annual appropriations-related reporting but, as noted above, intersecting with it where sensibly it should. What that cycle is, and the extent to which it is integrated with other reporting processes and vehicles, are matters that should be discussed between management and its governing body.

The philosophy which underlies the management representations approach… is an important one and bears repeating. It places upon management the responsibility, and hence the accountability, for its actions. It implies a level of trust between management and the governing bodies. And ultimately, it boils down to a set of values that requires management to internalize a sense of accountability. Without the integration of this value system, all the systems and practices in the world will not be sufficient to protect the investment of public funds.[234]

George Anderson

216 *Reporting on Effectiveness—The Experience of The Queen Elizabeth Hospital*, CCAF Applied Research Series (Ottawa: CCAF, 1991) [hereinafter *QEH*], 55.
217 The results of several of these projects have been published in CCAF's Applied Research Series.
218 *Reporting on Effectiveness—The Experience of the Government of Manitoba*, CCAF Applied Research Series (Ottawa: CCAF, 1991) [hereinafter *Manitoba*], 10.
219 *Reporting and Auditing Effectiveness—The Experience of Canada Mortgage and Housing Corporation*, CCAF Applied Research Series (Ottawa: CCAF, 1990) [hereinafter *CMHC*], 13.
220 From a presentation by Guy Breton, auditor general of Quebec, to the 1991 annual conference of legislative auditors of Canada.
221 *Reporting and Auditing Effectiveness—The Experience of the City of Gloucester*, CCAF Applied Research Series (Ottawa: CCAF, 1992) [hereinafter *Gloucester*], 23.
222 From address by Mary Ferguson-Paré, Vice-President of Nursing, the Queen Elizabeth Hospital of Toronto, to the 1991 CCAF annual conference.
223 *CMHC*, 12.
224 *Gloucester*, 21.
225 *QEH*, p. 57
226 *CMHC*, 12.
227 From address of J. Peter Gregory, Executive Principal, Office of the Auditor General of British Columbia, to the 1992 CCAF annual conference.
228 Roxy Freedman, Deputy Minister of Family Services, Government of Manitoba, as quoted in *Manitoba*, 47.
229 *QEH*, 59-61.
230 *Effectiveness Reporting*, 114.
231 See Commission des normes du travail [Québec], *Rapport annuel 1992-1993* (septembre 1993) and *Rapport annuel 1993-1994* (septembre 1994).
232 See Alberta Vocational College—Calgary, *Evaluation of Effectiveness and Efficiency* (Calgary: Alberta Vocational College, March 1994).
233 *QEH*, 61.
234 George Anderson, then-president of CMHC, as quoted in *CMHC*, ii.

Chapter 12

Implementing an Effectiveness Reporting Project

This chapter describes a step-by-step process for undertaking an effectiveness reporting project, steps that would be taken by an organization embarking on its first application of the effectiveness framework.

The suggested process is a composite of actual approaches taken by various organizations in applying the framework. It also incorporates the views of those most closely involved with these initiatives—in terms of what worked, what did not work, and what might have been done better.

These suggestions should be viewed as general guidance, not as a template or series of prescriptions to be adhered to regardless of the organization's unique circumstances. Alternative strategies and steps may be—and in some cases should be—considered. This chapter identifies some of these alternatives and discusses the considerations that may attend them.

Overview of the process

The suggested process involves seven more or less distinct phases and fourteen more or less discrete steps, from the first time the subject of effectiveness reporting is introduced, to when senior management's final report is tabled with the governing body along with the auditor's opinion, if applicable.

Usually, the initial introduction of effectiveness reporting is made to the CEO and senior management, although the process could conceivably start with a presentation to the governing body. For our purposes, however, we assume the former scenario.

Experience suggests that the core work of the first project (that is, starting after the initial engagement steps described below) can take about seven to ten calendar months. An audit component adds an additional period to cover the audit planning, examination, and reporting stages, although much of this work might be conducted concurrently.

After an organization goes through the process once, some steps should be unnecessary in subsequent effectiveness reporting exercises and, in general, the process should operate more efficiently and expeditiously. This was certainly the expectation reported by every organization participating in the CCAF's applied research program. For instance, Phase I, which provides the organization with an introduction and orientation to the effectiveness reporting framework, should not have to be repeated in subsequent exercises. In addition, there may be an opportunity to streamline the process further by dropping, combining, or shortening certain steps. An organization should be able to learn from the first application of the process and, based on this, achieve a reduction in the overall investment and time required for future reporting exercises.

The following is an overview of the major phases of an initial effectiveness reporting project:

I Initial engagement of the CEO/senior management
II Deciding where to focus and how to proceed
III Preparing for and beginning implementation
IV Refining the initial management representations
V Writing the management representations report
VI Tabling the report with the governing body
VII Audit of management's representations on effectiveness

The following pages take the reader through each of the above suggested phases. Each step in the process is described and, in several cases, further information is provided on the considerations, strategies, and tools that may be useful in the application of the effectiveness reporting framework in a specific organization.

Phase I — Initial engagement of the CEO/senior management

Step 1: CEO determines whether there is any potential interest in the effectiveness framework

Step 2: Executive presentation to senior management

Step 3: Organizational workshop for senior management

Step 1: The CEO determines whether the ideas and issues on which the effectiveness framework focuses are sufficiently important to the organization for senior management to explore in more detail.

The following Accountability Checkup is offered to assist the CEO (or another senior manager or member of the governing body) in making this determination. The CEO would probably receive the Accountability Checkup from someone who is knowledgeable about the effectiveness framework and who thinks that using it would clarify and improve the accountability relationship between management and the organization's governing body. That person might be the one who plays the role of facilitator if the decision is to proceed.

The Accountability Checkup poses three key questions:

- What questions and issues about effectiveness are important to you and those to whom your organization is accountable?
- How effective is your organization in relation to these questions and issues, and how do you know?
- Can the effectiveness framework be useful to you and your organization in identifying, discussing, and resolving such matters?

The Accountability Checkup illustrates some of the issues that might reasonably be examined in relation to each of the twelve attributes of effectiveness. The importance the CEO attaches to these matters and the CEO's level of comfort with the quality of available information in these regards will be key determinants in deciding if it would be worthwhile for management to find out more about the effectiveness framework.

Accountability Checkup

Place a number in each box signifying the extent to which each issue is important to you and your organization, using the following as guidelines:

0—Not applicable/important 1—Noteworthy importance 2—Significant importance 3—Critical importance

Management Direction

Does everyone understand what they are meant to be doing?

- ☐ whether our organization's mission and priorities are clear, and are understood and shared throughout the organization
- ☐ whether there are shared values that bind our organization together and help the diversity of professional, administrative, and cultural backgrounds work together
- ☐ whether staff have the authority and tools they need to make decisions and take action, consistent with the responsibilities assigned to them
- ☐ whether the organization's planning and communications practices foster the above

Relevance

Do our activities continue to make sense in terms of the conditions, needs, or problems to which they are intended to respond?

- ☐ knowing the nature and extent of these conditions, needs, or problems—now, and as they may have changed over time
- ☐ knowing what other organizations are doing in relation to these conditions, needs or problems
- ☐ understanding the value-added that our products or services are intended to provide in this context
- ☐ knowing whether current activities are operating within the approved mandate

Appropriateness

Are levels of effort and selected methods of pursuing objectives sensible and sufficient?

- ☐ degree to which each product or service is necessary to the accomplishment of stated objectives
- ☐ whether our products or services are designed and delivered in a manner that best responds to the nature and extent of the conditions, needs, or problems identified
- ☐ extent to which our products or services are consistent with prevailing standards of practice, ethics, etc., as may exist
- ☐ whether the overall level and distribution of effort represented by our products or services is proportional to stated objectives, identified needs, etc.

Achievement of Intended Results

How challenging are our established goals, and have they been accomplished?

- ☐ extent to which our achievements in key result areas meet expectations in terms of (as applicable):
  - the conditions, needs, or problems concerned
  - established performance targets
  - past organizational performance
  - the performance of comparable organizations or activities
- ☐ whether we are meeting our own prescribed standards of practice, i.e., we are doing the right things right?

Acceptance

Are clients and other key stakeholders satisfied with the organization and its products or services?

- ☐ knowing the expectations of our clients and other key stakeholders and understanding the basis for these expectations
- ☐ the extent to which our clients and stakeholders indicate acceptance or satisfaction with the organization and its products or services
- ☐ whether the organization and its products or services are respected within its peer network

Secondary Impacts

What are the unintended effects of our activities, be they positive or negative?

- ☐ understanding the secondary impacts (social, economic, financial, environmental, etc.) that our activities, products, or services could have on our clients, other key stakeholders, related organizations and programs, and/or the community at large
- ☐ being able to explain secondary impacts that significantly impede or work at cross-purposes to our stated objectives, or where such information might call into question the value attached to primary objectives

Costs and Productivity

Are the relationships between costs, inputs, and outputs favourable?

- ☐ whether defined product and service standards are being met at the least cost

- ❑ extent to which there is an appropriate balance between capital investments and operating expenses, overhead and operations expenses, capacity utilization of major resources, etc.
- ❑ how we compare to similar organizations with respect to the above matters

Responsiveness

How well are we anticipating and responding to change?

- ❑ whether the organization has effective networks and processes to identify and assess important events and trends in its environment
- ❑ the degree to which the organization has a history of being able to adapt or respond successfully to changing needs, circumstances, etc.
- ❑ how the practices and track record of the organization in this regard compare to similar organizations

Financial Results

How good are the financial results in terms of matching costs with revenues and appropriations, and financial assets with obligations?

- ❑ whether our books of account, records, and financial management control and information systems are in accordance with sound financial policies and procedures
- ❑ how our cost and revenue ratios compare to similar organizations
- ❑ the extent to which our organization's overall financial position is viable
- ❑ whether our organization has a history of conducting its operations within approved budgets and funding levels

Working Environment

Is it a happy, healthy, and constructive working environment where staff are motivated to work together, adapt to change, and develop?

- ❑ whether our staff's job descriptions appropriately reflect work responsibilities
- ❑ the degree to which our staff have the ability and opportunity to provide services to clients in a way that is valued by clients
- ❑ whether our staff have adequate facilities and equipment to complete their tasks
- ❑ whether we are providing a safe environment for our employees and clients
- ❑ whether our staff are performing to stated and agreed expectations, and are receiving appropriate recognition for their efforts
- ❑ whether management are aware of staff opinions in relation to their job situation, the job satisfaction they derive, and the organization's management practices
- ❑ whether our human resources management plan is integrated into the organization's culture and operating plans, thus enabling the recruitment, retention, development, and replenishment of well-qualified people

Protection of Assets

How well do we protect against surprise events or losses of key personnel, critical occupations, client information, facilities, equipment, inventories, processes, or agreements?

- ❑ understanding the risk of impairment or loss of our organization's key assets
- ❑ whether we have strategies that adequately respond to the nature and level of risk assessed
- ❑ whether these strategies and our performance comply with applicable regulations
- ❑ how these strategies and performance compare with the industry in general

Monitoring and Reporting

Do management have the information they need to support their decision making and their own accountability, and do they use it appropriately?

- ❑ whether management receive complete, credible, and fair information that satisfies their decision making and accountability requirements
- ❑ whether accountability reporting is done in a transparent manner: are the right things reported at the right time and in the appropriate level of detail or aggregation?
- ❑ the extent to which monitoring and reporting systems and processes are cost-effective

Now that you have completed the self-diagnostic, consider only those issues to which you have a score of 2 or 3; that is, those matters you regard as having significant or critical importance.

Now ask yourself the following questions:

- How well is the organization/institution doing in these areas?
- On what information do I base these judgments?
- To what extent would my management colleagues and those to whom we are accountable agree on these matters?

Obviously, it is up to you and your management team to pursue the issues that arise as a result of this diagnostic.

If the CEO, having completed the checkup, finds that the effectiveness framework raises issues of sufficient importance to warrant further exploration, Step 2 will follow.

Step 2: The CEO and senior management receive a one-hour Executive Presentation giving them an overview of the effectiveness framework.

The person who makes the presentation should be knowledgeable about effectiveness reporting and needs to have a practical sense of what is typically involved in implementing such a reporting regime. He or she should also be knowledgeable and experienced in the areas of organizational process, change, and behaviour. It stands to reason that the presenter would also be knowledgeable about the organization itself and the issues with which it must deal. In certain circumstances, these qualities may not be found in one person, in which case the presenter might be accompanied or assisted by a colleague.

The purpose of the Executive Presentation is not to make a "sale" or to have the governing body or senior management group come to a final decision to proceed with implementation of the effectiveness reporting framework. Its purpose is to provide the audience with sufficient information to determine whether it is worth additional effort on their part to find out more about these ideas. The presenter has to be very clear on this reasonable expectation if he or she wishes to convey it properly to the audience.

To assist the presenter, CCAF has compiled a kit containing detailed advice on how to prepare for the presentation and how to conduct the presentation itself. Originally introduced in 1990, the Executive Presentation kit contains a wide variety of supporting documentation and video products that have since been added to the package. It emphasizes the following points:

- the need for the presenter/facilitator to set and communicate reasonable expectations for the Executive Presentation;
- the need for management to understand that this approach is about effectiveness reporting by them to those to whom they are accountable—it is not just another form of audit to be performed by an auditor; and
- the organizational characteristics that favour the successful implementation of the effectiveness reporting framework.

The CEO plays a key role in creating an appropriate context for the Executive Presentation. By virtue of their position, CEOs have a unique perspective on the needs of their governing bodies and the strategic interests of their organizations. The Executive Presentation will likely be the first time that senior management as a whole hear about and have the opportunity to discuss these effectiveness reporting ideas, and they will likely take their cue from the insight, expectations, and enthusiasm which the CEO brings to the table.

The CEO (along with the "sponsor" inside the organization, if there is one) and presenter/facilitator should meet before the presentation to discuss expectations, the general approach to be taken, and so on. They should also establish a clear agenda for the presentation. It has been found to be very helpful for the CEO to introduce the Executive Presentation, and in doing so to:

- create a context for the presentation that focuses on the governance and policy management challenges being faced by the organization and on management's responsibilities and capacity to develop its own agenda in dealing with these challenges;
- establish the CEO's own expectations; and
- state any major questions or refer to matters that the CEO would like the presenter to cover specifically or to elaborate upon.

Sample Agenda for Executive Presentation

1. ***Introductory comments by the CEO***
2. ***Introduction of presenter***
3. ***Contextual comments by presenter regarding the purpose and development of the effectiveness reporting framework***
4. ***Video presentation introducing the effectiveness reporting framework***
5. ***Bridging comments and discussion on use of the framework elsewhere***
6. ***Strategic advice concerning implementation***
7. ***Questions and answers***

To put the presentation in context, it would be helpful if the CEO would provide his or her personal perspective of the challenges for the organization. These could include:

- changes, or signs of changing patterns, in the organization's clients' needs and/or matters relating to clients' demographics;
- alternative ways of fulfilling the above needs;
- challenges imposed by current economic circumstances;
- pressures or trends affecting the resources that the organization has available to it to fulfill its mandate;
- the impact of any recent or potential legislative changes or trends;
- changes or trends in expectations of the organization on the part of the government, clients, and other stakeholders (including the public), for example, deregulation, accountability, reporting, increased authority or flexibility;
- the organization's need for better, not merely more, information or reporting;
- the challenges of managing risk and encouraging reasonable public (and government) expectations in this regard; and
- the opportunity for the organization to demonstrate leadership within the public sector.

Experience indicates that CEOs can cover the necessary opening matters in about fifteen minutes. Doing this helps to assure the relevance of the session to the CEO and his or her management colleagues' interests. The focus of the CEO's remarks should not be on the framework itself, but rather on creating a context whereby those in attendance will be asking themselves the central question:

> *Does the effectiveness reporting framework have real potential to help the organization to meet current and real management issues and challenges?*

The presenter should be prepared to tailor comments during the presentation to respond to any major questions or specific matters that the CEO would like addressed. These might deal with any number of topics, including:

- conceptual or process-oriented matters;
- nature of executive involvement needed throughout process;
- the experience of others;
- possible next steps; and
- approaches to introducing the concept to further levels of management and key practitioners inside the organization.

After the presentation itself, participants will likely have several questions regarding the nature, purpose, scope, and characteristics of management representations. The Executive Presentation kit available from CCAF contains a handout intended to help focus discussion and to provide answers to commonly asked questions:

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 effectiveness or performance.

What is the aim of a management representation?

It is a means by which management discharges an important aspect of their accountability, 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 the governing body to exercise its 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 which may be imposed on the situation, or the aspect of performance 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 judgments 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. Therefore, 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 central factors or criteria that have been applied by management 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 an understanding and consensus between management and the governing body as to what is needed, what can be cost-effectively provided, and what strategy will be pursued in this regard.

Participants will also likely have questions about the key considerations that guide the proper application of the effectiveness reporting framework and the development of implementation strategy. Moreover, they will want to know where these ideas have already been applied and what was learned from these applications. The following, as a handout, may be useful in answering these concerns:

Effectiveness Project — General Guidelines, Implementation Advice, and Lessons Learned

Key guidelines for an organization intending to apply the CCAF effectiveness reporting framework:

- Initially consider all twelve effectiveness attributes and explain those that are not deemed useful.
- Management representations (statements) on individual attributes should reflect the full range of supporting information as well as any pertinent qualifications.
- Representations should be relevant to the interests of the governing body (i.e., the intended receiver of these management statements).
- Top management must be directly involved in preparing representations.
- A comprehensive strategy should be established for reporting management representations on effectiveness over an agreed period of time.

Some important steps and considerations in deciding on and developing an implementation strategy:

- Expose the concept to senior executives and governing bodies prior to making a final decision to proceed.
- Take a structured approach to deciding whether or not to proceed. At this stage, identify and answer major questions that affect implementation, particularly as regards to where it will be applied.
- Establish involvement of different players:
  - executives;
  - information providers (e.g., evaluators, policy researchers, planners, etc.);
  - internal audit;
  - support and facilitation consultants;
  - external auditor(s); and
  - coordinating group/task force.
- As applicable, ensure external auditor support and commitment.
- The representations process itself:
  - ensures clarity of business, mission, aims, goals, objectives;
  - relates attributes to same;
  - develops an explanation of relative importance of attributes, strategic choices, and options available under each;
  - considers what assessment factors or criteria need to be applied in order to develop a complete picture of performance with respect to each attribute;

  - brings forward/collects information in keeping with the above;
  - formulates conclusions on effectiveness in relation to each attribute;
  - refines representations on an iterative basis; and
  - establishes ongoing dialogue with the governing body, and other key stakeholders as applicable.
- Finalize representations.
- As applicable, obtain audit assurance/opinion on representations.

Some lessons learned from other applications:

- External facilitation role should be understood and should not serve to deflect ownership of product from management. However, this facilitation role is crucial.
- The 80/20 role applies—it is important to focus only on what's needed and avoid paralysis by analysis. Perfection is not the objective.
- Time and dollar costs for developing management representations depend on the nature of information already available and on the judgments that management reaches regarding the need for and cost-effectiveness of closing gaps in relation to this information. Not all gaps need necessarily be filled.
- Time and cost and, ultimately, success depend on the quality of interaction between, and the commitment of, senior executives. A strong sense of corporate cohesion and development is an important part of the process.
- Constraints should be recognized but should not become absolute determinants in applying the framework and in the organization's own decision-making processes.
- The framework demands consideration of the past, present, and future. Management must be committed to exploring all three with a necessary focus on the real world of the present.
- The decision as to where to focus the initial application of the framework is very important. This decision should be taken only after management has had an opportunity to become more familiar with the framework and the individual attributes and how they could be applied to their particular organization (this can be accomplished through the one-day Organizational Workshop—Step 3 below). For example:
  - Trying to apply the framework to the entire organization all at once is more than most organizations could handle and, even if they could, it may not be the right or most cost-effective decision.
  - Trying to focus on too small a business component of the organization reduces the cost-effectiveness of the exercise, principally by limiting the strategic management value of the result.
  - Trying to focus on an administrative support function (planning, finance, etc.) limits the strategic value of the result since the main preoccupation of the governing body and senior management is likely to be the organization's major programs or lines of business. For example, organizations do not exist to manage their human resources, they manage their human resources to support their program objectives. Besides, the framework will automatically bring in any key administrative support considerations under various attributes (human resource–management performance considerations, for example, could be brought in under a discussion of "working environment" and/or "protection of [people] assets" to the extent that these attributes are relevant to an understanding of the overall performance of a major program or line of business of an organization).
- Auditors should be committed, informed, and onside.

Soon after the presentation, the CEO and senior management should decide whether they have sufficient interest in these ideas to justify further investment of their time in learning more about how the organization might profit from their application.

Step 3: Within a month or so, senior management attend a one-day Organizational Workshop chaired and sponsored by the CEO and led by a well-informed facilitator, respected by senior management as someone able to deal with issues at a strategic level.

This workshop gives management more detail on the attributes that comprise the effectiveness framework. It also provides management with an opportunity to apply some aspects of the framework to a few of their major programs or lines of business. Applying these attributes, albeit in a general way, can provide management with a taste of the substance of the representations they might end up making, and of the challenges and tradeoffs they may encounter in this process.

By the end of the workshop, senior management will have the information and orientation necessary to make a decision about whether or not to try to apply these ideas. However, they will likely not make a final decision at the workshop itself. Instead, they will want to allocate time after the workshop to discuss the matter more thoroughly than would be possible in a short period at the end of an intense day.

At this stage in the process, both the facilitator and management should appreciate that a decision not to proceed with implementation may be a very reasonable one. Indeed, the possibility of such an outcome should be understood from the beginning. Management may decide, for instance, that the framework opens up issues that are too difficult to deal with from a policy perspective. Or they may have concluded that implementing the framework demands more time and effort than they are prepared to invest. In fact, there are instances where, after participating in the workshop, management decided not to proceed and where, under the circumstances, all parties agreed this was the right decision. The purpose of the Organizational Workshop is not to skirt such matters, but to focus on them.

Recognizing the importance of the issues discussed at these workshops, CCAF has prepared a package of material intended to assist facilitators in leading sessions to the most satisfactory conclusion. Taken from that material, Exhibit A in the appendix to this part of the book provides a suggested agenda for an Organizational Workshop and Exhibit B provides an overview of the Leader's Guide.

The facilitator should retain a record of the results of management's discussions at the Organizational Workshop for possible reference at later stages in the process (for example, at Steps 4 and 5).

Phase II — Deciding where to focus and how to proceed

Step 4: Decision to proceed, and on where to focus and why

Step 4: Within a few weeks following the one-day workshop, senior management meet to decide whether and, if so, how the organization will proceed with implementation. The CEO presides over this meeting, with the facilitator guiding the senior management group in discussion about a set of key decisions. The agenda can be relatively simple:

Sample Agenda for Senior Management Meeting

1. ***CEO's comments pursuant to organizational workshop, decision to proceed or not***
2. ***Facilitator's overview of implementation steps***
3. ***Key issues to be addressed by senior management***
4. ***Other matters***

The third agenda item will take the longest to complete. The following key issues need to be addressed after having decided to proceed and before actual implementation:

Issue 1—*Determine where to focus the first effectiveness project.*

The following principal questions and considerations may be important to a discussion of this issue:

- How do we (senior management) want to talk about the organization to our governing body and those outside the organization:
  - in terms of its mission roles (usually stated as part of the organization's formal mandate)?
  - in terms of its major programs or lines of business?
  - in terms of the different major client groups with whom the organization interacts?
  - in terms of its organizational structure?
  - in terms of some combination of the above?
- Should we be trying to apply these ideas:
  - to the whole organization all at once?
  - progressively by components of the organization?

In addressing these questions, the following considerations may apply:

- link to the interests and perspectives of those to whom the effectiveness (that is, management representations) report would be going;
- senior management's agenda regarding these interests and perspectives;
- senior management's time commitments and availability;
- importance of the selected component(s);
- capacity of the organization to maintain effective control of the exercise;
- analytical capacity within the organization and availability of outside expertise to facilitate;
- importance of the issues that would be examined;
- link to ongoing and planned initiatives within or outside the organization (for example, reorganization, resource management, or policy initiatives, and so on); and
- inherent risk of such a project versus the added value that it will bring to us and to those to whom we report or with whom we deal.

Issue 2—*Clarify expectations for the final management representations report.*

The following considerations may apply to a discussion of this issue:

- what we want the product to accomplish;
- what our assessment is of the level of common understanding, controversy, etc., associated with the area or issues being examined;
- whether there are existing expectations on the part of others with which to contend and, if so, whether these expectations are reasonable, and what is our ability to influence them;

- state of existing information, and whether to base the first project on this information and be content with identifying weaknesses, gaps, and redundancies for future rectification;
- opportunity to discover and document lessons learned as a basis for improved, future application of these ideas to other parts of the organization; and
- opportunity to contribute to the general body of knowledge *vis-à-vis* the component(s) examined.

Issue 3—*Identify who else, besides senior management, needs to be brought into the process.*

The following might be considered in deciding who should be involved when in the process, how, and to what end:

- persons or agencies to whom the effectiveness report will eventually be directed;
- lower levels of management;
- key support staff (for example, policy analysts, program evaluators, strategic planners, internal auditors);
- staff at large; and
- external facilitator, either throughout the process or at certain points in the process.

Issue 4—*Identify the potential audiences for the report, what their interests may be, and what processes are needed to ensure that they are appropriately informed.*

In designing a communications strategy, consider the following potential audiences who may have an interest in the process or product, and then consider what they will want to understand, what message you want to convey, and how and when this ought to be done:

- governing body and, as applicable, other parties to whom there is an accountability relationship;
- staff within the organization;
- other external parties (for example, clients, central agencies of government, accreditation bodies); and
- public at large.

Issue 5—*Determine the necessity and consequences of having auditor involvement and, if so, how and when the audit component could best be engaged.*

In considering whether and, if so, how to have an audit examination of the management representations, the following considerations may apply:

- the consequences of having it (or not having it) for the first project—from the perspective of management, those who will receive the report, other stakeholders, independent commentators, and so on;
- when, where, and how to involve the auditor in the process; and
- how to assure reasonable expectations on everybody's part at the beginning, throughout, and at the end of the process.

Issue 6—*Determine what the first step in the process ought to be, when this will take place, who needs to be involved, what preparatory work needs to be done, and so on.*

At this point, it is important to get consensus among senior management on these matters. Specific details can be left for later. Normally, the first step is the Implementation Workshop (Step 6 below). The following considerations may apply:

- where management want to be by the end of the Implementation Workshop;
- what documentation is needed to facilitate maximum participation by senior management at the workshop, and who will prepare it;
- who else (if anybody) besides senior management needs to be at the workshop;

- what preparation is required of participants before they attend the workshop; and
- when and where the workshop will be held.

It is very important that all these matters are discussed fully and frankly. These deliberations form the basis for decisions that will influence the entire implementation process.

There are likely to be several different and possibly competing perspectives among senior management on many of these issues. A working consensus may not come easily. The issues and dynamics of the meeting may present a significant challenge to the knowledge, experience, and interpersonal skills of the facilitator.

By the end of the meeting, management decides whether to proceed and, if so, to:

- proceed in a specific area;
- involve specific senior managers (and perhaps a few other key support staff) as a steering group;
- start implementation at a specific time; and
- take specific lead-up actions.

Following this meeting, the facilitator documents the key decisions taken and their rationale. This document becomes a general communications vehicle to those who are as yet outside the process. It also becomes a reminder to senior management themselves regarding their original expectations, thus serving as an important benchmark against which to assess progress.

At some convenient time after the senior management meeting, the CEO may want to inform the governing body of management's decision to proceed and their reasons for doing so. The governing body's future role in the exercise could also be discussed at this stage.

(For the purposes of this chapter, the presumption is that management decides to focus their initial effectiveness reporting project on one major area of the organization's business. In most effectiveness reporting projects completed to date, this has, in fact, been the decision taken.)

Phase III — Preparing for and beginning implementation

> ***Step 5: Preparation for the Implementation Workshop***
>
> ***Step 6: Implementation Workshop***
>
> ***Step 7: Briefing and securing the cooperation of the governing body***

Step 5: The facilitator has several important tasks to complete in preparing everyone for the Implementation Workshop—the first step in developing management representations. In most cases, key policy and/or review analysts within the organization would assist the facilitator in these tasks.

The timing of the Implementation Workshop is key. If the workshop is delayed a number of months, the danger is that the perspective that participants have gained to date may be lost, which would mean that valuable time would have to be spent at the beginning of the workshop reorientating participants. Conversely, scheduling the workshop too soon will not allow sufficient time for the facilitator to complete vital tasks and to develop the necessary background documentation to help participants prepare themselves for the workshop and then work efficiently once they get together. Ideally, the Implementation Workshop could take place as early as six weeks after Step 4 (decision to proceed, and on where to focus and why), which means that the facilitator would have about four weeks to complete these tasks and to get the appropriate background material into the hands of the participants about two weeks before the scheduled workshop.

The facilitator's first task is to develop a concise and thorough description of the program or line of business concerned. The information and explanations provided in this program description will be vital material in developing management representations in relation to several attributes of effectiveness.

Although there may already be an existing program description, it will likely require updating. In some cases, the program description may need to be (re)developed entirely. The outline for a program profile shown in Exhibit C (in the appendix) includes an illustration of the structure and detail for such a description.

The first part of the outline focuses on the principal elements of the program description itself. The second part identifies some of the key questions that may be useful in assessing the completeness of the program description and the adequacy with which key elements are described. The third part provides an overview of key policy, planning, and review initiatives, processes and products that may be pertinent to the program. This information will help identify issues and information pertinent to a discussion of the performance of the organization or program in relation to individual attributes of effectiveness.

The second task for the facilitator is to identify and document any key external or internal trends, initiatives and reports that may bear on the discussions to follow. These include:

- known pressures on the organization or program being addressed;
- known interests of management, governing body, government, clients, and any other key stakeholders;
- pertinent policy and planning initiatives completed, under way, or anticipated; and
- pertinent performance-related review processes, activities, and reports.

Exhibit C provides advice on how background information on these policy, planning, and review processes and initiatives might be presented.

The facilitator's third task is to distill all this into a set of preliminary ideas and suggestions specific to the program concerned. Participants can use these ideas as an initial reference point for workshop preparation and discussion. This includes suggestions as to:

- why, to whom, and how information pertinent to individual attributes of effectiveness may be important;
- what constitutes reasonable key criteria or factors for assessing performance in relation to individual attributes; and
- what possible sources of information and data are available or readily obtainable in relation to individual attributes.

At this stage, it is unlikely that all the participants will share a clear and common perception of what a management representation should look like. It will facilitate future work if this ambiguity is removed before the Implementation Workshop. To assist in this, the facilitator could distribute the Elements of a Management Representation described below.

This document describes a structure for a management representation and identifies the content and range of considerations that may be pertinent in developing its constituent parts. It is intended as a general guideline for the development of the initial drafts of management representations on individual attributes of effectiveness. It includes:

- explaining how information pertinent to a specific attribute might be important to management or the governing body in terms of their respective accountability, decision making, program improvement, or advocacy interests;
- identifying and explaining what set of key assessment factors, criteria, and indicators seem reasonable as a basis for analyzing performance in relation to the attribute;
- documenting key information and findings that explain the effectiveness of the organization or program in relation to the attribute; and
- presenting conclusions on the performance of the organization or program in relation to the attribute.

Using the Elements to think through and document the initial draft of the management representations will help bring and maintain a certain degree of rigour and discipline to the process. And management representations so drafted can serve as useful working and reference documents. It is likely, however, that the form and content of the final management representations reported to the governing body will be a condensed version of what is presented in the Elements. The state of practice in preparing management representations is still at an early stage. Examples of such early-developed representations by several organizations can be found in monographs published under CCAF's Applied Research Series. Several of these documents are identified in footnote references in chapter 11.

Elements of a Management Representation

1. Attribute

This section identifies the attribute of effectiveness that is the subject of this representation. For example, it might read: Relevance concerns the extent to which (the organization, program, or line of business) continues to make sense in regard to the problems or conditions to which it is intended to respond.

2. Importance

Here senior management explain why information in relation to this attribute is, or should be, considered important by themselves, the governing body, or others in understanding the performance of the organization/program being addressed. Such reasons might include the following (clearly, these generic reasons will need to be customized to reflect the particular circumstances, audiences, program and organization concerned):

- the information permits the governing body to provide oversight on a matter in which it has a governance responsibility or interest;
- the information demonstrates management accountability in a key area of performance;
- the information serves to identify and explain certain key decisions, choices, and challenges with which management and/or the governing body must contend;
- the information empowers the governing body and/or management to make decisions, communicate the basis for these decisions, and exercise influence; and

- the information assists an informed dialogue between the governing body and management on issues of corporate significance.

This section can be helpful in focusing management's thinking about this aspect of effectiveness. In addition, establishing why this information is important and how it could be used will, in turn, influence and facilitate subsequent discussions about the scope and depth of the assessment required and, ultimately, the conclusiveness of the information that will be needed.

3. Basis for Assessment

This section identifies and explains the central factors or criteria that are needed to deal adequately with the attribute. These could be expressed in a variety of ways, depending on the nature of the attribute:

- key subsidiary issues and questions that need to be addressed
- specific indicators to be used
- specific benchmarks/targets to be applied
- specific comparisons or other types of analysis that need to be done

There are a series of questions that management ought to ask of themselves in relation to the adequacy and sufficiency of the overall assessment approach being put forward:

Would we, those to whom we are reporting, and others who are knowledgeable, agree that:

- each of the questions/indicators identified is essential to an understanding of effectiveness in relation to this attribute?
- together, these questions/indicators are sufficient in the sense that they are capable of explaining the complete story?
- the logic that connects these questions/indicators is either self-evident or, if not, is adequately explained to the reader?
- where appropriate, it is made clear what specific benchmarks or targets are being applied, and why?

4. Information and findings

This section is the heart of a management representation.

Using the previous Basis for Assessment as a reference point, in this section senior management provide the key information and findings that can be reported at this time.

Information and findings are likely to have both qualitative and quantitative aspects.

Material provided in this respect is distinct from interpretations or summary judgments by management, which are addressed in the next section of the management representation statement.

Questions to ask regarding the appropriateness and sufficiency of the information and findings being presented are:

- Are there any central criteria or factors about which no information and findings are presented?
- Is each information item significant in the sense that its inclusion is essential to an understanding of the effectiveness of the program or organization in relation to this attribute?
- Is each information item significant in the sense that its exclusion would lead the reader to an incomplete, inaccurate, or wrong conclusion?
- Does the information presented in relation to a specific factor (i.e., subsidiary question or indicator) adequately answer/address that criterion?
- Are there any significant gaps or weaknesses in the information/findings and, if so, are these appropriately acknowledged and explained?

5. Conclusions

In this section, senior management explains the interpretations they have placed on the information and findings, and the summary judgments and conclusions they may have come to in relation to the performance of the organization/program in terms of this attribute. In some cases, management may be able to formulate a firm conclusion, in other cases, there may be caveats, and in still others, it may not be possible to formulate a conclusion.

The purpose of these conclusions is to convey to the governing body management's view of what all this means. This may facilitate the deliberations of the governing body and its subsequent interactions with management.

Management's interpretations and conclusions are just that, however; they do not preclude the need to provide the necessary key information. Without this information, the governing body will have no basis upon which to formulate its own judgments.

There may be several reasons that caveats are necessary, including:

- a question about the softness of the data or information;
- the lack of multiple lines of evidence where this would be seen as necessary or desirable;
- a real or perceived question concerning the reliability of the source of the information or the accuracy of the data;
- the lack of key information needed to be able to draw a complete picture of performance; and
- the lack of agreed benchmarks or conventions against which to analyze the information or data.

An important question to consider at this stage is the sort of information that will be used in assessing the organization or program in respect of each of the attributes. To answer that question, one has to determine the basis upon which judgments can be made. The following suggestions are intended to provide assistance:

Suggested Bases for Assessing Attributes of Effectiveness

Management direction

Several factors enter into an assessment of the effectiveness of Management Direction. These include:

- the extent to which there is harmony between the governing body and management with respect to the strategic directions and priorities they see for the organization
- the extent to which there is a clear mission statement for the institution, supported by an explicit value system that is centered on providing good service to the client, and the extent to which staff see themselves in all this, and they know what is expected of them and how this supports the overall mission of the institution

  This could be measured in a variety of ways, some more direct than others:
  - Is there an explicit statement of mission and values?
  - How successfully do management and staff communicate with each other on these matters, through supervisor/staff discussions, staff focus groups, general meetings, house organs, and so on?
  - Are there policies, procedures, and processes in place that lend support to this, and are they accessible and communicated to and understood by staff?
  - What are the views of managers and supervisors in relation to staff knowledge and understanding of these matters?
  - Does management make decisions and act in a way that is consistent with the principles underlying the mission and value system of the organization?
  - Is there systematic/anecdotal behaviour, events, and so on, to suggest the extent to which staff know and understand?
  - What are the direct views of staff on these matters?
  - How do outside stakeholders perceive the corporate philosophy and image projected by the institution?
- the extent to which staff have the authority and tools they need to make decisions and take action in accordance with their responsibilities, and the extent to which staff understand the limits of their authority and that matters that transcend these limits are referred to the appropriate person
- the extent to which program, operational, and work plans are in place, are linked, and focus on the issues most pertinent to the decision-making and accountability interests of those responsible.

Relevance

Assessing effectiveness with respect to relevance could include a consideration of the following:

- the nature and extent of the problems, conditions, demands and needs to which the program mandate is directed, and the extent to which these matters have changed since the program mandate was approved or last revalidated;
- what other organizations are doing/not doing *vis-à-vis* the above, and the extent to which this situation has changed since the program mandate was approved or last revalidated;
- how the program is linked to prevailing government policy or corporate, professional, and community philosophies (for example, hospital programs in light of philosophy that favours deinstitutionalization), and the extent to which these matters have changed since the program mandate was approved or last revalidated;
- the extent to which experience with the program, or changes that have since taken place in the program's environment, confirm or refute the assumptions, logical argument, and value-added initially associated with or used to justify the program; and
- the extent to which the program and its activities and services are operating within the approved mandate.

Appropriateness

Assessing effectiveness with respect to appropriateness could include a consideration of the following:

- the degree to which each of the program's major activities is necessary to the accomplishment of stated objectives;
- the extent to which program products or services are designed and delivered in a manner that best responds to the nature and extent of the conditions, needs, or problems identified;
- the extent to which these products or services are consistent with prevailing standards of practice, ethics, etc.; and
- whether the overall level and distribution of effort represented by the program's products or services are sufficient in relation to stated objectives and identified needs, or, for that matter, whether they exceed requirements.

Achievement of intended results

An analysis of the effectiveness of the organization or program in achieving its intended results will likely revolve around the following:

- the extent to which the institution/program achievements in key result areas meet expectations in terms of (as applicable):
  - the conditions, needs, or problems concerned
  - established performance targets
  - past organizational performance
  - the performance of comparable organizations or programs
- whether the institution/program is meeting its own prescribed standards (i.e., are we doing the right things correctly?)

Acceptance

The attribute of acceptance could be examined from several stakeholder perspectives, including:

- the intended clientele;
- the actual user (who may be different from, or just a subset of, the intended clientele);
- indirect beneficiaries (for example, the public at large);
- other related institutions or intermediaries that may form part of the overall network in which this institution or program operates;
- interest groups;
- policymakers; and
- internal staff.

Central factors or criteria that may form a basis for assessing acceptance include the following:

- the nature of the expectations of these stakeholder groups and the basis for their expectations;
- the extent to which stakeholders indicate acceptance of or satisfaction with the program or services. The following factors may be pertinent:
  - perceived adequacy of the information they receive about the program;
  - accessibility of the program/services;
  - the quality and quantity of products/services they receive;
  - the affordability of the program/services;
  - timeliness of the program in responding to client's demands;
  - satisfaction of the client with the manner in which these products or services were delivered (for example, how courteously or fairly they feel they were treated by staff);
  - their overall assessment of the efficacy or utility of the program/services in helping them achieve a satisfactory outcome.

Secondary impacts

It is difficult to identify what factors or criteria might be applied in examining secondary impacts without knowing the particular institution or program concerned. This is one area where each case will be somewhat different.

Costs and productivity

One might want to group indicators into logical sets indicating that, where it would be meaningful and possible to do so, information will be presented in time series, drawing comparisons to similar institutions and relating information to specific standards/targets—either those set by the institution itself and/or by an external body.

There are several ways to group the indicators. Here is one possibility:

- Costs
  - salary, equipment, accommodation, insurance, etc.

- overhead/operations ratio
- training and development costs

- Staff utilization and productivity
  - management/staff/client ratios
  - ratios that show how staff spend their working time (e.g., working directly with the client, doing administrative work, etc.)
  - various $/work load ratios
  - processing time
- Facilities and equipment
  - utilization ratios (for example, how much of the effective capacity of the facilities and equipment is being used)
  - $/unit ratios

Financial results

This is the financial statement of the organization. This should be accompanied with a clear identification and thorough discussion of any key underlying assumptions, caveats, and so on. Some of the factors that may be pertinent include:

- whether the books of account, records, and financial management control and information systems are in accordance with sound financial policies and procedures;
- how cost and revenue ratios compare to those of similar organizations;
- the extent to which the organization's overall financial position is viable; and
- whether the organization has a history of conducting its operations within approved budgets and funding levels.

Responsiveness

Three factors that may be at the center of an analysis of effectiveness in relation to this attribute are:

- the extent to which the institution has the networks, mechanisms, and processes in place to identify and assess possible consequences of relevant trends and events;
- the extent to which the institution has demonstrated responsiveness or its lack thereof in relation to trends and events (for example, new programs or services established, realignment of resources, etc.); and
- the extent to which the organization compares favourably with similar institutions in these respects.

Working environment

The following factors may be pertinent:

- extent to which the institution has the number, type, and mix of staff needed to deliver the program/services;

- whether staff job descriptions appropriately reflect work responsibilities;
- the degree to which staff have the ability and opportunity to provide services to clients in a way that is valued by clients;
- whether staff have adequate facilities and equipment to complete their tasks;
- whether the organization is providing a safe environment for employees and clients;
- whether staff are performing to stated and agreed expectations, and are receiving appropriate recognition for their efforts;
- extent to which the institution is making adequate investments in relation to job- and career-development requirements and the aspirations of staff and the institution;
- whether management are aware of staff opinions in relation to their job situation, the job satisfaction they derive, and the organization's management practices; and
- whether the organization's human resources management plan is integrated into the organization's culture and operating plans, thus enabling the recruitment, retention, development, and replenishment of well-qualified people.

Protection of assets

Some of the key assets and considerations that may be applicable in this regard are:

- key people—compensation packages and career development strategies may attract and retain these individuals; and, succession plans can make appropriate provision for the smooth replacement of them should they decide to leave;
- client and other information—files and computer records;
- key property—ensuring that long-term capital plans are tied into the broad corporate strategy; procedures and practices are in place to assess and maintain the value of the property and its good state of operations; and the state of the property meets external inspection standards;
- key equipment and facilities—provision of adequate space to perform work; regular performance inspections on equipment to assure their effective operation;
- inventories;
- financial position—funding received from the government, donations/revenues from the public and the like;
- agreements—insurance, supply, etc.; and
- corporate memory (some aspects may link back to key people/information)—establishment of policies, procedures, and information systems so that the knowledge base of the institution does not reside in the heads of a few key people and is compromised when they leave.

An assessment of effectiveness in relation to this attribute involves three central factors:

- the extent to which the institution has identified its key assets and assessed their risk of loss and/or impairment;
- the extent to which the institution has strategies in place that adequately respond to the nature and level of risk assessed; and

- the extent to which these strategies and their performance compare to industry practice and standards, as well as comply with external requirements (for example, legal, regulatory, accreditation, and so on).

Monitoring and reporting

The factors that might be applicable to an assessment of effectiveness in relation to this attribute include:

- the extent to which senior management and, indeed, other levels of management and key users receive complete, credible, and fair performance information that satisfies their decision-making and accountability requirements;
- whether accountability reporting within the organization, and from the organization to key outside stakeholders, is done in an appropriately transparent manner. Are the right things reported at the right time and in the appropriate level of detail and aggregation?; and
- the extent to which monitoring and reporting systems and processes are cost-effective.

On all these matters, the facilitator, assisted by whatever support staff the institution has assigned, offers ideas and suggestions. The choice of the phrase "ideas and suggestions" as opposed to "conclusions and recommendations" is important. The facilitator, analysts supporting the facilitator, and the workshop participants themselves all need to understand that it is the last who make the final determination on these matters. The purpose of the background documentation prepared by the facilitator is to help open up the issues and guide deliberations, not to constrain these discussions or to foreclose conclusions.

The facilitator's final task, most likely with input and assistance from key analysts within the organization, is to synthesize all this material into a discussion paper. This document is sent to participants at least two weeks before the Implementation Workshop to guide their thinking and preparation for the upcoming workshop. Exhibit D (in the appendix) illustrates the content of such a discussion paper. Two assumptions are made; first, management met after the Organizational Workshop to consider the range of issues noted in Step 4; second, at this meeting, management decided to focus the initial project on one major program area.

Although Exhibit D describes a single three-day Implementation Workshop, a variation of this approach may sometimes prove useful or even necessary. For example, this step in the process might take the form of two one- or two-day meetings held several weeks apart. The first of these could focus on developing the front end of the management representations (that is, why individual attributes are important, and what assessment factors, criteria, and so on, could be applied in analyzing performance). Then, a general analytical framework established, the intervening period could be used to amass the needed and available information. The results could then be distributed to workshop participants ahead of a second meeting, which would be held to complete the initial set of management representations by matching, analyzing, and integrating the information collected for individual attributes.

Whether or not the Implementation Workshop was completed in one or two meetings, the general expectations for and overall logic of the approach to this step of the process would remain the same.

Step 6: Participants convene in a three-day Implementation Workshop and begin the process of developing their management representations. The facilitator leads this workshop.

Because the tasks of the workshop will demand the full attention of those participating, it might be advisable to hold it off-site where there is likely to be a more appropriate ambience and fewer distractions. Holding a reception or dinner at the end of Day 1 can also give a sense of occasion and useful informality to the workshop. A possible agenda for this session is shown in Exhibit E (see appendix).

By Day 3, the end of the workshop, participants will have a written first draft of a management representation on each attribute in relation to the program or line of business being examined. In preparing these drafts, participants will use the material supplied by the facilitator prior to the workshop as well as the information they brought with them.

In contrast to the free-flowing atmosphere of Step 4, when decisions were made on where to focus and how to proceed, the Implementation Workshop is substantially more complex and intense. Participants are asked to accomplish a great deal within a relatively short time. They are also being drawn into discussions that they may not have had with one another previously and on issues and questions for which there are no absolute answers.

The facilitator plays a critical role in fostering an appropriate climate for workshop discussion and in helping participants keep focused on the expectations they set for themselves. Playing various roles during the workshop—planner, organizer, catalyst, challenger, integrator, and problem solver—the facilitator will need to be adept at moving from one role to another, as circumstances dictate. In the final analysis, however, it is the goodwill, enthusiasm to participate, and mutual respect among participants that will make or break the Implementation Workshop.

Step 7: As applicable, and shortly after the Implementation Workshop, the CEO briefs the governing body on the status of the project. This meeting is intended to get the board's general perspective on what management is doing and to reaffirm the board's support in this regard. This is needed to sustain management's commitment to the project, to provide a steady focus for management's deliberations, and to assure that the final product will be relevant and useful to the board.

Prior to this meeting, the CEO may want to provide members of the governing body with a memorandum to help them prepare. Exhibit F (see appendix) contains a typical briefing note.

At this point, the CEO may suggest the usefulness of establishing a small *ad hoc* committee of governing body members with whom to consult, now that management has a better sense of what they would be able to produce. If there is agreement to such a proposal, a committee representing a cross-section of the governing body could be struck. Subsequently, a joint meeting might be held between this committee and key members of the project steering group to discuss mutual expectations, progress, and potential courses of action. The CEO would lead discussion on this matter.

Phase IV—Refining the Initial Management Representations

> ***Step 8:* Refinement of initial set of representations by management in a series of meetings**
>
> ***Step 9:* Consultation/discussion with the governing body**

Step 8: The management steering group meets for two or three one-half to one-day sessions (usually four to six weeks apart) to refine their management representations. These sessions are guided by the facilitator.

The four-to-six-week period between sessions is appropriate so as not to unduly burden the schedule of the participants over too extended a time. The intervening periods also provide a reasonable opportunity for follow-up and preparation work arising from discussions and decisions taken at the previous meeting.

Refinements to the initial management representations are made based on thorough discussion—supported by appropriate documentation—as to why information on individual attributes is important, the assessment factors or criteria that ought to be applied to any judgments of effectiveness regarding each attribute, and the information available with respect to these criteria. As the steering group considers such matters, it is likely that rationales as to why an attribute is important will be modified, assessment factors and information will be added, honed, or dropped, and conclusions on performance in relation to the attribute will be adjusted.

Most of the work is accomplished in smaller working groups (possibly the same working groups as were established for the Implementation Workshop), with periodic plenary sessions held during the day to discuss progress and problems, resolve how to handle any overlap or duplication among the attributes and information, and deal with any other problems that may have arisen.

There are many questions that the group might ask of itself in relation to the individual representations they have developed. The following are some of those questions. (alternative or additional questions may be applicable in individual circumstances.)

Regarding the explanation that senior management are putting forward as to why effectiveness information in relation to this attribute is, or can be, important

Content of the explanation given

- Are there points being made here that we as senior management think are not central to our executive responsibilities:
  - to our governing body?
  - to the government?
  - to our organization?
  - to our staff?
  - to our clients?
  - to other outside stakeholders?
- Is anything important missing?
- Most particularly, will our governing body:
  - regard the points made in our explanation as important to their interests?
  - expect anything else to be included in this explanation?

Presentation style

- Does the explanation flow logically from one point to the next?
- Can some points be integrated, or should others be broken apart?
- Can we condense it?

Regarding the basis on which management are assessing effectiveness in relation to the attribute

Content of the basis for assessment

- Would we as senior management be prepared to make the following statements to our governing body?
  - Each factor or criterion that we are using in our assessment is central to understanding the effectiveness of the organization or program in relation to this attribute.
  - No major criterion or factor is missing.
- Would anything be seen as missing, biased or inappropriate by:
  - our governing body?
  - the government?
  - our staff?
  - our clients?
  - other outside stakeholders and special interest groups?
  - the public at large?
  - independent subject matter specialists or researchers?
- Are there specific benchmarks, targets, and so on that we should be applying, either ones already identified or that we ourselves feel are appropriate, or ones that industry practice or stakeholder expectations would suggest?
- Have we incorporated any such benchmarks and targets into our thinking, and have we explained adequately what we have done, and what we have not done in this regard?

Presentation style

- Does the presentation of the assessment factors and criteria flow logically?
- Where the logic flow may not be self-evident to others, have we made reasonable efforts to explain how it all fits together?
- Can we condense it?

Regarding the documentation of information and findings on effectiveness in relation to the attribute

Content of the information and findings

- Is each assessment factor or criterion that should or can be addressed actually addressed?
- Is each point of information or finding directly pertinent to its applicable factor or criterion?
- Are sources of key findings and information appropriately cited?
- Is there any reason to suspect a significant problem with the currency, accuracy, completeness, or reliability of the findings and information? If so, are appropriate caveats provided?
- Would anything said here be seen as contestable, incomplete, biased, or contradictory:
  - in relation to points made in our management representations with respect to other attributes?
  - by our governing body (for example, in relation to information they may be getting through other processes)?
  - by the government?
  - by our staff?
  - by our clients?
  - by other outside stakeholders and special interest groups?
  - by the public at large?
  - by independent subject matter specialists or researchers?

Presentation style

- Do the points flow logically?
- Can some points be integrated, or should others be broken apart?
- Can we condense it (for example, boil it down to no more than two or three key points per factor or criterion)?

Regarding conclusions management are putting forward about effectiveness in relation to the attribute

Content of the conclusions

- Is each applicable criterion or factor specifically addressed, and will this be recognized readily by the governing body?
- Is any conclusion, information, or interpretation inconsistent with the criteria and findings, or with our representations on other attributes?
- Is the level of confidence associated with each conclusion substantiated by the information and findings presented?
- Have we identified areas where there is an important information deficiency (missing, unanalyzed, unreliable), and noted what actions we have taken, are taking, or are contemplating, and explained where we intend no action?
- Will any of these conclusions be viewed as incomplete, biased, inappropriate, contradictory, or simply wrong by:
  - our governing body?
  - the government?
  - our staff?
  - our clients?
  - other outside stakeholders and special interest groups?
  - the public at large?
  - independent subject matter specialists or researchers?
- Are there any central findings not linked to a conclusion?

Presentation style

- Does the presentation of the conclusions flow logically?
- Can some points be integrated, or should others be broken apart?
- Can we condense it?

At what point the group would stop asking these questions is essentially a matter of judgment as to where diminishing returns on further effort begin to set in. The facilitator can be helpful in identifying that point.

This type of reflection can be useful in testing the validity, completeness, and logic flow of the representations, not just from the point of view of management, but also from the possible point of view of other key stakeholders or readers of the final report.

The key stakeholder to be kept in mind is, of course, the governing body. It is often easy to get caught up in the process when developing the draft representations and, perhaps, lose sight of—or gloss over—important matters. Asking the questions suggested above may be one way of assuring that the final product adequately responds to the expectations that were set for the exercise, and that, individually and as a group, the representations meet the basic test of reasonableness.

The product of this step is a second, and now more substantive, draft of the management representations for each of the attributes. Experience shows that appropriate representations can be written in two or three pages for each attribute.

Step 9: :At this juncture, the CEO could trigger a joint meeting between the *ad hoc* committee of the governing body and key members of the participating group to discuss and get a reaction to the second draft of management representations. This discussion may identify the need for management to do further fact-finding and/or to make further refinements to the representations they have developed.

Phase V — Writing the management representations report

> ***Step 10:* Development and management review of a working draft of the management representations report**
>
> ***Step 11:* Management consults with their governing body on working draft with follow-up refinements as necessary**
>
> ***Step 12:* Management tables the final draft of the effectiveness report with their governing body**

Step 10: An individual within the participating group is assigned the responsibility to consolidate and write the overall effectiveness report. The group meets for a number of half- to one-day plenary sessions (usually four to six weeks apart) to review, challenge, and refine various aspects of the overall report. The facilitator guides these deliberations. Typically, there would be three such sessions. Depending on individual circumstances, however, fewer or more sessions may be held.

The four-to-six-week period between sessions is appropriate so as not to unduly burden the schedule of busy group members. The intervening periods also permit a reasonable opportunity for follow-up and preparation work by the group members, the drafter of the report, and the facilitator, arising from discussions and decisions taken at the previous meeting.

The report is more than the sum of its twelve management representations. Up to this point, the principal focus has been on the logic and completeness of individual representations. The group now needs to stand back and look at the linkages and consistency among these representations. They need to consider the central messages these representations convey as a whole, and how these representations and the strategic context within which this initiative was taken can best be communicated to the governing body.

These steps result in an initial and complete working draft of the report. Exhibit G (see appendix) suggests a structure for the report. It is based on actual reports that have been made to governing bodies. This proposed structure can serve as a basis for discussion among the project's principal stakeholders. The final structure of a project report may vary from the illustration that follows, owing to the nature of the project, how the organization perceives its business and priorities, the main messages to be communicated, and so on.

It is useful to start the report with a thorough description of its purpose and the governance/ management context in which this approach to effectiveness reporting is being undertaken. For an initial effectiveness reporting project, it may also be useful to include a section on lessons learned, as a means of documenting and communicating a retrospective analysis of such things as: what worked well and what didn't; what benefits and costs have accrued from the project; what other insights have been gained; and what should be done differently in the future. Essentially, these matters become the basis for future discussions on whether and how to proceed with future projects.

Subsequent reports may be shorter. Apart from a brief description of the area of activity concerned, and a detailed discussion of management representations on the effectiveness of this particular line of business, it may only be necessary to remind the governing body how the current report fits within the context of past or future such reports, that is, within whatever strategy is being proposed to, or has already been established with, the governing body.

Step 11: At this juncture, the CEO could arrange a joint meeting between the *ad hoc* committee of the governing body and key members of the management group to get a reaction to the working draft of the report. This may identify the need for further fact-finding or refinement to aspects of the report.

It may be possible to accomplish this refinement through a series of bilateral discussions between the person responsible for drafting the document, the CEO, individual members of the management group, and the facilitator.

Step 12: The CEO and key members of the management group present the final draft report to the *ad hoc* committee of the governing body or, in the absence of such a committee, to the full board.

Phase VI — Tabling the report with the governing body

Step 13: Tabling the management representations report with the full governing body

Step 13: The CEO tables and discusses the report with the full governing body.

Before sending the report to all board members, the CEO will likely make a final review of it to reinforce his or her personal confidence in it and to anticipate possible reactions by the governing body. To this end, the CEO will likely want the facilitator and one or two key people from the management group to participate in a pretabling discussion. Such a discussion might focus on the following questions:

- Are there matters on which the report has not responded to previous input or feedback provided by the governing body or its committee? If so, do I know why, and am I prepared to deal with members of the governing body on these matters?
- Do the main messages in the report fairly reflect the effectiveness of the organization or program? Is the level of conviction associated with these key points appropriate, and does the report offer sufficient substantiation in this regard?
- What will the governing body's reactions to these main messages likely be? Do I have a strategy to answer or deal with these reactions?
- What implications does the report have for specific decisions or actions that may have to be taken by the governing body, myself, and my management colleagues, or others?
- What is my bottom-line assessment of the effectiveness reporting framework and process? How does this accord with initial expectations? What further potential do these ideas have for the organization? What should the next steps be?

PHASE VII—AUDIT OF REPRESENTATIONS ON EFFECTIVENESS

***Step 14:* Audit of management's representations**

Step 14: There may or may not be an audit phase to the initial project. It is sensible to expect, however, that the governing body, as well as other key stakeholders, may want to receive independent, third-party assurance regarding the reasonableness and fairness of management's representations—if not for the first exercise, then for subsequent effectiveness reporting exercises.

At Step 4, for instance, it may have been decided not to involve audit right away. Instead, the decision may have been to use the initial project to diagnose the state of the organization's performance information in relation to the requirements of the effectiveness framework. Having obtained a better understanding of or confidence in management's capacity to make substantive representations, or what intermediate actions are required to get to this point, the organization may decide that audit scrutiny could become a feature of subsequent effectiveness reporting initiatives.

If audit is involved, it should be recognized that Phase VII is not really a sequential stage in the sense that it only begins *after* management has finalized the effectiveness report. Ideally, the auditor would be involved from the beginning. It is in the interest of all parties that this occur. Such early cooperation allows management to know the kind of audit tests that will be used and to shape their representations accordingly. At the same time, it allows auditors an opportunity to understand the nuances of the process from the outset and to make better-informed decisions about their audit programs.

A discussion of what is involved in auditing management representations on effectiveness appears in Part III.

CONCLUSION

There are a number of factors that now put and will continue to put increasing pressure on accountability in both the private and public sectors. The economy lacks the buoyancy it had in the 1980s, and is unlikely to regain it in the near future. Governments and businesses, in the face of enormous financial pressures, are reorganizing, merging, restructuring, and downsizing.

To survive, organizations and their component departments and programs are going to have to fight for resources. Those that are most accountable and have processes which support and demonstrate their effectiveness will have a much better chance of survival. They will have to be able to demonstrate:

- the relevance, appropriateness, impacts, and efficiency of their programs, services and products; and
- their capacity to respond to change and to sustain effectiveness in the long term.

Informed decision making is an obligation rather than an option, particularly so when limited resources and the need to serve citizens and satisfy customers combine to introduce new and higher levels of risk than have been common in the past. It is therefore necessary for organizations to ensure that they have appropriate performance management and information systems.

ELEMENTS OF A GOOD PERFORMANCE MANAGEMENT SYSTEM

There are several elements that must be clearly defined in a good performance management and information system:

- the needs and obligations of information receivers;
- the responsibilities of those who are obliged to measure and report on performance;
- an agreed basis for measuring and reporting on performance;
- organizational arrangements, incentives, and capacity development;
- processes and mechanisms to collect, analyze, report, and use information about performance; and
- validation mechanisms.

NEEDS AND OBLIGATIONS OF INFORMATION RECEIVERS

Those who are intended to receive information in the system ought to:

- have clear responsibilities to know what constitutes reasonable information to fulfill the mandate they have accepted; they need to articulate clear objectives and set out expected performance or achievement regarding these objectives;
- be responsible to ensure that appropriate arrangements are in place to obtain the required information; and
- use the information obtained in a fair and appropriate manner that fosters trust, a positive environment, and the effectiveness of the organization.

RESPONSIBILITIES OF THOSE WHO ARE OBLIGED TO MEASURE AND REPORT

Those who are expected to collect and report performance information ought to:

- pay due regard to the specific responsibilities, interests, and needs of those to whom they are reporting, and due regard to the timeliness of the information for decision making;

- ensure that the information reported is complete enough to be a fair representation of the performance of the organization; and
- ensure that the performance information is rigorously prepared and that it contains whatever explanations or qualifications are necessary to allow the receiver to make a well-informed judgment about performance.

An agreed basis for measuring and reporting on performance

The agreed basis should be clearly understood by the providers and receivers of the information, and should:

- serve as a bridge between the needs, interests, and responsibilities of information receivers and suppliers;
- recognize that performance is a multifaceted concept and should focus on results and achievements;
- serve as a basis for both receivers and suppliers of information to judge its completeness and fairness, working from a common and predetermined set of ground rules; and
- allow flexibility, but ensure that departures from what otherwise might be expected are identified and adequately explained.

Organizational arrangements, incentives, and capacity development

The following organizational arrangements are essential for the successful implementation and operation of a good performance management and information system:

- the personal and visible support and involvement of the most senior officials in the organization (in government, this means political leaders as well as administrative heads);
- an ethos and whatever incentives and sanctions may be appropriate to encourage the production and use of broad-based performance information; issues involved may be power sharing, value systems, mind-sets—indeed, the entire organization's management culture;
- a commitment to provide the time and resources necessary to help all those involved to understand the system and play their roles effectively; and
- a commitment to persevere with the system over the long term and to continuously improve it.

Processes and mechanisms to collect, analyze, report, and use information

A good performance management and information system:

- recognizes that information must come from a variety of sources, not from a single one;
- takes maximum advantage of existing information sources, such as day-to-day statistical and operations data, financial information systems, internal audit, other review mechanisms, evaluation and strategic planning processes; and
- assembles information from these various sources into an integrated performance picture capable of meeting the tests of adequacy, completeness, and fairness.

Validation mechanisms

A suitable validation mechanism can substantially increase the confidence that decision makers have in the information provided by the system. As described in Part III, audit could be used to provide this assurance.

Elements of good performance measures

Usually, no single indicator is sufficient to provide decision makers with the understanding of the performance of an organization or program they need. Different indicators are commonly required to afford insight into the various aspects of performance. Besides being reliable and timely, information should:

- explain what choices were made and why, and what the consequences were or are expected to be: the information should contain supporting data and include explanations of its significance, limitations, reliability, and relevance to the issues at hand;
- compare actual performance with intended performance and outcomes, using predetermined targets or goals;
- contribute to determining how performance can be sustained or improved in the future;
- reflect the actual performance for the time frame in question;
- balance the need for understanding and simplicity with the complexity of the programs, services, or organizations in question; and
- vary to accommodate the responsibilities, needs, and interests of people at different levels of the organization.

Appendix

Exhibits

The following exhibits are provided purely for demonstration purposes. They reflect what has been done in some applications of the effectiveness reporting framework, and it is hoped they will be of interest to people who are considering taking such an initiative. Readers are asked to keep in mind that all these matters can and should be adapted to the particular circumstances of the organization concerned and the interests, skills, and preferences of the people involved.

Exhibit A

Suggested Agenda for Organizational Workshop

Subject	Duration
Introduction	20 minutes
Key challenges	25 minutes
Overview of the effectiveness framework	30 minutes
The effectiveness attributes	2 hours
Introduction to group exercise	10 minutes
Group exercise	50 minutes
Report out by groups	50 minutes
Application of the framework	45 minutes
Helping the organization to make a decision	30 minutes

Exhibit B

Overview of Leader's Guide

Organizational Workshop Package

Nature of the Organizational Workshop

This is a one-day workshop.

The purpose of the workshop is to give executive decision makers more information on the framework of twelve attributes of effectiveness and to give them the opportunity to apply the attributes to certain of their major programs or lines of business. Applying these attributes—albeit, in a very preliminary way—can provide management with a foretaste of the substance of the management representations they might end up making, and of the challenges and trade-offs they may encounter in this process. Doing this provides management with the orientation they need to be able to determine whether these ideas are applicable to their interests. They will also be able to gauge the potential consequences that implementation of these ideas may have for their organization.

Possible outcomes of the workshop are:

- the organization feels that there is merit to these ideas and would like to hold another, more detailed workshop to explore further the ins and outs of implementation;
- the organization is ready to begin implementation and is ready to commit the resources and effort necessary to do so;
- the organization is not prepared to pursue the topic further at this time.

Participants in the workshop are primarily members of the executive management group. Possibly, one or two key members of the governing body might participate, as well. Also, a few key practitioners who would be involved in supporting management in such a process might also be invited to attend. The workshop is led by a facilitator.

It is important to keep the focus on the senior-level decision makers, as they are in the best position to understand where these ideas can or should fit into the strategic agenda of the organization. Middle-level managers are understandably more focused on operational issues—which are not the focus of this framework.

It is best to keep the size of the group to no more than twenty—the ideal size would be closer to the 10-12 range.

Key parties

Typically, there are three key parties.

The workshop leader/facilitator

The role of this person is to lead the participants through a process that will orient them to the effectiveness framework, have them apply these ideas to their organization, and bring them to a point where they can make a decision to proceed with implementation, or not. To accomplish this, the individual must be thoroughly familiar with the framework, knowledgeable about the organization, and comfortable in leading workshops with senior-level decision makers.

In certain cases, the facilitator may be familiar with the framework but not have the necessary depth of knowledge about the organization. In these circumstances, the workshop leader/facilitator may be accompanied and assisted by another individual, perhaps a colleague or someone from within the organization.

The sponsor

The involvement of a sponsor from within the organization is critical to the success of the workshop. This may be the CEO or some other senior and influential member of the executive management group. This person is someone who believes in the merit of the message being conveyed and who is prepared to advocate the framework to his or her peers. The sponsor plays several important roles:

- working with the workshop leader/facilitator in planning the workshop, providing information, and assisting in logistical arrangements;
- ensuring that the right people are at the workshop;
- introducing the workshop leader/facilitator and setting the stage for the event in terms of situating these ideas within the context of the interests and strategic agenda of the organization; and
- assisting in achieving closure, that is, helping to bring discussion to a point where a decision can be made to proceed, or not.

If there is no senior-level individual inside the organization who is prepared to play this role, this may present a reason to question the viability of an effectiveness reporting initiative. Ultimately, this process cannot be sustained without the direct leadership and involvement of management and without a strong sense of personal ownership on their part to the eventual effectiveness report.

The participants

Those attending the workshop must come prepared to participate actively in the discussion. The success of the workshop is also highly dependent on who these individuals are. The best candidates are people who are responsible for forming and directing the affairs of the organization. If few of these individuals are prepared to participate in the workshop, leaving this role to lower-level managers or functionaries, this may present another reason to question the viability of an effectiveness reporting initiative.

Purpose of the Leader's Guide

The Leader's Guide provides the facilitator with the advice and information necessary to plan and then lead the workshop. It comprises nine modules that are linked to a typical agenda for the one-day workshop. A participant's package also comes as part of the overall Organizational Workshop kit.

Of course, as was the case for the Executive Presentation, the workshop Leader's Guide cannot anticipate every possible type of audience or circumstance. The guide is designed in a way that recognizes there will need to be some flexibility and adaptation in the planning and conduct of the workshop to suit the specific circumstances.

Setting and communicating realistic expectations

The purpose of the Organizational Workshop is to bring the members of the executive management group to a point where they can make an informed decision to proceed, or not, with implementation of the effectiveness framework.

One of the most important understandings that MUST emerge from the workshop is that executive management appreciate that—"This is something that cannot be done for us. We must do it ourselves!"

While it might be possible to come to a "go/no-go decision" at the end of the day, this decision carries with it yet a further set of considerations: when and where to start, who to involve, precisely what to expect, and so on. It is unlikely that by the end of the day, there will be sufficient time or willingness to engage this further set of considerations.

Thus, at the end of the workshop, the CEO/sponsor should indicate that time will be set aside in the near future for the executive management group to discuss and resolve these matters. The CEO/sponsor should encourage his or her colleagues to think about these considerations in the interim.

Administrative issues

The Organizational Workshop is an intensive exercise for everyone involved. The group dynamics of the workshop require that participants be as comfortable as possible within their environment, with the arrangements, and with one another. Therefore, administrative arrangements should facilitate open dialogue, ease, and comfort. They should represent a strong commitment to the process and be of the highest possible quality.

Special care should be given to determining the location for the workshop. Ideally, the meeting location should be outside of the business premises. There are several reasons for this. It helps to direct participants' undivided attention and energies to the workshop without the constant reminder of the organization's day-to-day business going on just outside the meeting door.

Usually, the best venue for the workshop is a hotel. It will have the necessary space for the main meeting room, and separate, smaller rooms for the group syndicate sessions that are part of the workshop. The hotel can also easily provide other necessary items such as coffee, meals, and audiovisual equipment, as required.

As indicated above, it is important to establish a pleasant and congenial working relationship among all participants in the workshop and the workshop leader. A good way to achieve this is to hold a dinner the evening before the workshop, preferably at the same hotel in which the workshop will be held. The occasion can also be used to jog the participants' memories on their discussions at the Executive Presentation and to go over the next day's agenda.

Exhibit C

Outline for a Program Profile

Key elements of the program description

Mandate

- State the current mandate for the program and identify the source of its authority
- Explain the underlying rationale for this mandate in terms of:
  - the conditions, needs, or problems that the program is trying to resolve
  - what other programs—inside or outside the organization—may be doing or are empowered to do

Objectives and goals

- Identify the stated objectives and goals of the program or line of business

Intended clientele/population affected

- Describe who the beneficiaries, intended clients, and actual users are, distinguishing each class, as appropriate
- Describe their characteristics
- Explain how these may have changed over time

Program design and delivery

- Identify the principal activities or functions of the program and, as applicable, explain their interrelationships
- Explain how decisions are made and implemented in relation to who is eligible for what manner and level of program support
- Explain how program activities are delivered (for example, centralized versus decentralized operations, direct contact with client or through intermediaries, and so on)

Organization and resources

- Describe the organizational structure of the program
- Identify the physical, financial, and human resources that are allocated to the program

Key questions regarding the completeness and adequacy of the program description

General

- Are there any important discrepancies in perception of the program or aspects of it on the part of various key stakeholders? If so, what are the implications of this?

Mandate

- Does the description adequately explain the original circumstances and reasoning upon which the current program mandate and objectives have been justified?

Objectives and goals

- Are the program's objectives stated in results-oriented terms? If not, do we nonetheless know what key results are intended in relation to the objectives? And, if we do, have these key intended results been appropriately identified?
- Are there specific expectations or targets as to the level of performance to be attained in key result areas? If not, do we nonetheless have a general sense of what these levels of performance ought to be? And, if we do, have these performance expectations or targets been appropriately identified?
- Is there any competition or conflict among the stated objectives that ought to be explained?

Intended clientele/population affected

- Have we appropriately described all the pertinent characteristics (social, economic, demographic) of our beneficiaries, intended clients, and actual users?
- Are we making an appropriate distinction between the concepts of beneficiary, intended client, and actual user?

Program design and delivery

- Is there anything that needs to be explained in terms of the intended balance or order of precedence among the major activities or functions of the program?
- Is there anything more that needs to be explained in terms of the key criteria and processes used to establish, for example, who is eligible for what manner and level of program support?

Policy, planning, review, and reporting initiatives and processes

Developing an overview of past, existing, or anticipated initiatives and processes that are pertinent to the program will help ensure best use of existing systems and practices. It will also provide a common starting point for the facilitator and Implementation Workshop participants in their own preparation and information gathering leading up to the workshop.

Regular policy, planning, and review processes

- Identify and describe each major external and internal process in terms of:
  - the focus of the process
  - who conducts the process
  - what is reported
  - to whom
  - how often
  - how report is used

Specific past and current policy, planning, and review initiatives

- Identify and describe specific major external and internal initiatives or events in terms of:
  - the focus of the initiative
  - the time frame for the initiative
  - who conducted/conducts the initiative
  - as applicable, the findings of the initiative, to whom they were reported, and how they were used

Exhibit D

Implementation Workshop Discussion Paper

Table of Contents

Implementation Workshop Discussion Paper

1. Introduction

Objective of workshop

The objective of the Implementation Workshop is to have participants develop a first cut of their management representations in relation to [name of program]. This step in the process builds on the results of the Organizational Workshop, and on decisions taken at a follow-up management meeting on where and how to focus initial efforts.

As explained later, participants will accomplish this task through an iterative process of plenary and syndicate discussion sessions over the three-day period.

Expected output

It is reasonable to expect that workshop participants will produce the following outputs over the three days:

- a description of the strategic context for this initiative, i.e., why undertaken, who can benefit, and how?;
- a written preliminary set of management representations in relation to key attributes that management think are important to communicating and understanding the performance of [name of program]; and
- a broad outline of a strategy for further development of these representations to a point where senior management would be comfortable presenting them to the board (governing body).

Follow-up activities to the Implementation Workshop

Follow-up activity and meetings will be needed to refine the representations, undertake necessary consultations with key stakeholders, draft and refine the management representations report, and develop the strategy for bringing this report to the board.

Purpose of this discussion paper

The purpose of this discussion paper is to provide participants with an overview of the agenda and activities of the Implementation Workshop.

It is important that participants read this paper *before* coming to the workshop and that each participant brings available documentation, information, and data that will be used as a basis for developing representations on the twelve attributes of effectiveness. More detail on the nature of the required documentation, information, and data is provided below.

2. Background

On [date], senior management participated in a one-day Organizational Workshop. The broad objective of this workshop was to introduce the concepts and framework behind effectiveness reporting and auditing and to provide participants with an opportunity to begin to work with some of these ideas in relation to [name of organization]. This was intended to help senior management make an informed decision as to whether and how to proceed in implementing this approach within the organization.

Following the Organizational Workshop, senior management decided to proceed with implementation, which, in turn, led to a series of more detailed considerations as to where to focus initial efforts, who to involve, and how to proceed. These matters were discussed at a senior management meeting on [date]. At that time, senior management decided to begin with a focus on [name of program].

At that time, management also decided that the next step in the process would be a three-day Implementation Workshop, delivered by [name of facilitator] and involving the same management group (and, perhaps, a few key analysts who will be expected to support management).

3. Description of key roles

Workshop leader

The workshop leader is [name of facilitator]. Broadly stated, the facilitator's role is to establish the context for participant deliberations, help focus discussion and provide advice, and maintain an appropriate pace in the workshop. [Specify whether facilitator will be assisted by anyone else].

Workshop participants

The participants are the senior management of the [name of organization] (and, perhaps, a few of the key analysts whom management expects to call upon for support throughout the exercise). The work and discussions of the participants will be the key to a successful workshop.

Participants are expected to bring to the workshop various documentation, information, and data available to them that they will then be using as a basis for developing management representations on the twelve attributes of effectiveness. Annex 1[235] of this discussion paper provides an initial overview of key policy, planning, review and reporting initiatives and processes that may be pertinent to the program. Participants can use this overview as a starting point in their preparation for the workshop.

4. Structure of the Implementation Workshop

Attached as Annex 2 is the agenda for the workshop.

Flexible Schedule

The timing of activities identified on the agenda may be speeded up or slowed down depending on circumstances. For instance, at the Organizational Workshop and follow-up management meeting, some thought has already been given to those matters scheduled for the first morning. Therefore, it may well be possible to resolve these issues fairly quickly. If so, this would allow more time for the development of the management representations, which would be welcome, as the time proposed for this activity is expected to be very tight.

Morning of Day 1

After a few brief opening remarks from [CEO name], [facilitator name] will set the stage for the three days and review the agenda and related logistics with participants. It will be very important at this time to identify and establish agreement on the general expectations and specific outputs for the workshop, and to acknowledge what still will likely need to be done as further follow-up.

After these introductory remarks and discussion, the first task will be for participants to recap/write down what they see as the broad strategic context for this initiative. This includes consideration of several questions, including the following:

- What factors, initiatives, events, constraints, trends, etc., in the organization's internal and external environment are at play or could emerge that are significant to this initiative?
- What challenges, decisions, and choices do the board and senior management face in today's or the foreseeable climate, and what benefits can be derived from this initiative in this regard?
- Do staff, clients, the general community, and other key stakeholders also derive specific benefits from such an approach as this?

Participants will recall that several of these issues were discussed at the Organizational Workshop and again at the follow-up management meeting. Annex 3 lists some of the issues and considerations discussed at these earlier meetings. *[Note: The facilitator should have kept a summary record of these discussions and prepared this Annex from those notes.]*

The second task for the morning is to recap/write down the rationale for choosing [name of program] as the focus of this first application of management representations. We should review, and if necessary amend, the program profile that has been prepared and is enclosed as Annex 4.[236] We should also identify the relative importance of individual attributes to this activity. Any attributes that participants judge to be of little or no importance will be put aside. However, it will be important to have a specific rationale for any such exclusions in order that it can be brought back into the discussion of the overall management representations in the morning of Day 3.

The issues surrounding the choice of [name of program] and the general applicability of the attributes to this area were also discussed previously. Annex 3 outlines these matters, as well. *[Note: The facilitator should have kept a summary record of these discussions.]*

Depending on the participants' level of satisfaction with the results of past discussions on these matters and the adequacy of relevant documentation appended to this discussion paper, this aspect of the workshop might proceed quite quickly.

Afternoon of Day 1 and All of Day 2

This time will be devoted to the main task of the workshop—development of management representations in relation to individual attributes.

Participants will be divided into two groups. Each group will be responsible for discussing and then writing out draft management representations on two different attributes at a time. Each group will bring its written statements back to plenary for further discussion and, as necessary, revision. This process of shifting back and forth from syndicate groups to plenary session will continue until all the attributes identified as being important have been addressed. Annex 2—the workshop agenda—outlines provisional blocks of time for syndicate and plenary group discussion, respectively. We may want to alter this time allocation as we proceed.

General guidelines and a structure for the development of individual management representations is provided in Annex 5.[237] The commonality of structure will assure that all key aspects of a management representation are addressed in each instance or, at least, to the limits of current thinking and information. This commonality will also help us to identify gaps, overlaps, and so on, among the individual representations (in the morning of Day 3).

At the end of Day 2, the intent is to be able to give each participant a set of all the individual representations developed over the previous day and a half.

During this one and a half days, it will be important for us to keep our expectations in mind and to maintain perspective in relation to what we can reasonably accomplish at this stage in the process. This may not always be easy. We should push ourselves to be as complete and forthright as we can, but still recognize that we will not have a full level of comfort with the assessment criteria and information we can bring to bear. However, if we can marshall effectively the criteria and information we currently have, and then identify what further steps we need to take after the Implementation Workshop, we will have accomplished a lot.

Morning of Day 3

Beginning in the morning of Day 3, participants will again break into their syndicate working groups. Each group will be asked to review and critique the overall set of representations developed, looking for gaps, redundancies, conflicts, opportunities to make links among these statements, and opportunities for greater precision and better explanation. The working groups will bring the results of their deliberations back to the plenary in the latter half of the morning for further discussion and adjustment, as required.

Afternoon of Day 3

In the early afternoon, and time and stamina permitting, each syndicate group will be asked to consider several questions related to a strategy for further development of the management representations. The results of this will be discussed in plenary session later in the afternoon. If we are pressed for time, and we may well be, an alternative might be to delay detailed consideration of these questions to a subsequent management meeting in much the same fashion as we did following the Organizational Workshop.

Some of these questions/issues include the following:

- What needs to be done to the draft representations in the short term (that is, over the next few months) to bring them to a point where senior management would be reasonably comfortable in presenting them to the board?
- Who should do what and by when in this regard?
- What now needs to be done to begin to engage key members of the board?
- As applicable, how will audit be engaged? Has our experience over the last few days given us any cause to reconsider the merit or consequences of decisions made earlier on this matter?
- What needs to be done to engage or keep informed other key stakeholders; for example, staff, clients, other organizations?

5. Pre-workshop preparation by participants

In preparing for this workshop, participants should read this discussion paper carefully; this will appropriately prepare them to approach their tasks and to appreciate the intended linkages among these activities.

Most important is the pre-workshop preparation of participants in amassing the documentation, information, and data that they will bring to the workshop and then use as a basis for discussing, developing, and reviewing management representations in relation to individual attributes.

This material could involve the following:

- measurement criteria or factors to be used in assessing various aspects of performance or effectiveness;
- performance benchmarks, targets, or goals that have been set for various aspects of the program;
- available performance information on operations, administration, financial and human resources, health and safety, costs, outputs and outcomes, and comparisons with other programs or organizations;
- reports and reviews such as those related to audit, evaluation, organizational development, health and safety;
- policy and planning documents developed within or outside the organization and which would bear on the program and its related activities;
- survey or other such reports pertaining to needs and views of staff, clients, and the community at large;
- special studies and reports such as those produced in journals, by the media, and so on, that have a bearing on the program in whole or in part; and
- annual reports.

As noted previously, Annex 1 of this discussion paper provides a preliminary overview of some of the major policy, planning, review and reporting initiatives and processes. Participants may find this useful as a starting point to their preparation. Also, Annex 5 provides guidance and a structure for developing draft management representations. This may serve as a further guideline in identifying and thinking about the range of assessment factors and information that may be pertinent to a particular attribute. Finally, Annex 6 provides a series of general ideas and suggestions in relation to individual attributes, based on a preliminary analysis of all the documentation gathered thus far. No doubt, over the course of their preparation and workshop discussion, workshop participants will find reason to reject, add to, and refine these initial notions.

6. Documentation of workshop discussion and outputs

[Describe mechanics of how documentation produced by individual syndicate groups and discussed/refined in plenary sessions will get processed during the three days]. *[Note: The facilitator will need to make arrangements to be able to produce this documentation, possibly using hotel resources, or faxing the material back to the organization's offices to have someone type and/or copy this material before sending it back to the workshop site.]*

Annexes

Annex 1: An Overview of Pertinent Policy, Planning, Review and Reporting Initiatives and Processes
Annex 2: Implementation Workshop Agenda
Annex 3: The Strategic Context for this Initiative—Results of Previous Meetings and Discussions
Annex 4: Program Profile
Annex 5: Elements of a Management Representation
Annex 6: Drafting the Initial Set of Management Representations—Preliminary Ideas and Suggestions for Consideration

EXHIBIT E

IMPLEMENTATION WORKSHOP AGENDA[238]

SESSION		DURATION
	DAY 1	
Introductory remarks to set the stage for the workshop *(CEO and then facilitator)*		45 minutes
Plenary discussion	Why is the organization interested in pursuing a management representations approach? Who can benefit and how?	1 hour
Plenary discussion	Why has the organization chosen to start with a focus on this program? Are we satisfied with how the program is currently described? What level of importance can be attached to individual attributes in relation to this program area?	1.5 hours
Syndicate group work	Development of draft management representations on specific attributes	1.75 hours
Plenary discussion	Discussion of draft management representations on these specific attributes	1.5 hours
	DAY 2	
Syndicate group work	Development of draft management representations on specific attributes	1.75 hours
Plenary discussion	Discussion of draft management representations on these specific attributes	1.5 hours
Syndicate group work	Development of draft management representations on specific attributes	1.75 hours
Plenary discussion	Discussion of draft management representations on these specific attributes	1.5 hours
	DAY 3	
Syndicate group work	Review of consolidated set of draft management representations	1.75 hours
Plenary discussion	Discussion of the results of syndicate groups' deliberations	1.5 hours
Syndicate group work	Strategy for further refinement of management representations	1.75 hours
Plenary discussion	Discussion of syndicate groups' deliberations	1 hour
Plenary	Concluding remarks	

Exhibit F

Typical CEO Briefing Note to the Governing Body

To: Members of the Board of Directors

From: CEO

Subject: **Project Concerning the Development of Management Representations on Effectiveness**

As a follow-up to our previous discussions, and as background to our upcoming meeting, this briefing note has been prepared to explain:

- the nature and purpose of this project;
- the current status of the project and the plan for its completion;
- the importance I attach to having your advice and input at this juncture in the project; and
- the nature of the advice and input I am seeking.

Nature and Purpose of this Project

Over the last number of months, we have been involved in a project whose purpose is to apply a comprehensive "effectiveness reporting framework" and set of guidelines developed by the CCAF to one of our main lines of business. I should emphasize that this is a senior management–led, not analyst or audit–led, process.

For your reference, the attached brochure provides an overview of the effectiveness reporting framework we are using, identifying the twelve attributes of effectiveness that comprise the framework and the range of questions that are involved.[239]

This framework is designed to help a CEO report to the governing body and account for the organization's performance in a broader, yet more focused and meaningful manner than has generally been common practice. CCAF's background research indicated that, in most cases, governing bodies across the public sector were receiving only piecemeal data, lacking in strategic context, and of limited value to their decision making and ability to hold management to account in an adequate manner.

As noted below, this work is ongoing; however, ideas are beginning to coalesce and a reporting structure and content are beginning to emerge. As I explain later, I think it would be very timely to have your perspective and advice at this juncture.

I would like to elaborate briefly on why we are engaged in this project.

First, both you as board members and I and my management colleagues are faced with complex, challenging, and controversial issues. Demands for services are increasing, the resource environment is constrained, and the public policy context within which we operate is, to say the least, fluid. This situation will undoubtedly continue. It requires of us thoughtful and difficult choices. To make these choices, good information is needed, and this information needs to be developed at a level that will help to identify and analyze trade-offs and explain these decisions credibly and forthrightly to a variety of stakeholders. Such information will also help us to exert influence on these stakeholders.

Second, more comprehensive reporting will provide a basis for continuing dialogue between management and the board, at a level that we both judge to be of direct interest. I see this project as an opportunity to introduce a high-level, program-oriented basis for discussion as well as a way of providing you with a better picture of how underlying activities interact in pursuit of the main objectives of the organization. We have chosen one of our larger programs as the first candidate for reporting. If the project is successful, we will, over time, focus on our other major programs.

Third, the project supports the interests and capability of senior management in developing and establishing consensus on priorities, connecting the professional and administrative cultures of the organization, directing its operations, and providing a focus for important management initiatives. To a person, senior management is convinced that the process has already yielded benefits along these lines.

Fourth, the project provides the organization with the opportunity to demonstrate leadership within the broader community of institutions of which it is a part.

Current Status and Plans for Completion

Senior management has already met on a number of occasions—usually in the form of workshops—to focus on this matter. The purpose of these workshops was to develop an understanding of these ideas about effectiveness, to assess their feasibility in our organization, to decide on where to focus initial efforts, and to begin the process of developing management representations; that is, the report on effectiveness.

Subsequently, we have met to develop and refine our management representations on individual attributes of effectiveness. This process continues and we expect that an initial draft of the report will be developed in the relatively near future.

What this initial report will do is capture and integrate existing information, as well as data readily attainable, against the reporting framework. I expect that there will be several gaps in our information the first time around, given that certain aspects of the framework involve new thinking and directions. The initial report will assess the importance of these gaps and, where deemed necessary and cost-effective, will outline strategies to fill them.

Over time, the report will become increasingly more complete, as will reports on other major programs as they are addressed. I visualize the overall picture as one with in-depth reports to the board on different individual major programs each year, and with general performance information on each program being reported on a more frequent basis, as required; for example, annually, quarterly, and so on.

Importance of Your Advice and Input

As I have noted above, senior management have already devoted considerable time and effort to this project. This has begun to yield a concrete picture of the nature and content of the kind of report we should be able to produce. I expect to speak to this matter in more detail at our meeting.

We are now at a juncture where your perspective on the project and on the results it could or should yield *vis-à-vis* your needs is required. Your general views on these matters will help us give further focus and shape to our work and to the report under development. Without this perspective, the ultimate objective—-providing you as board members with information that will facilitate your decision-making and governance responsibilities—-will not be achieved.

Assurance as to your interest in the project and its objectives and, ultimately, your preparedness to engage the product of this process is also of vital importance to sustaining management and staff commitment and effort to improve the quality of reporting on performance. Your support will also be a key factor in the credibility attached to this project by the government, by other boards, and by other organizations and stakeholders within the broader community.

Nature of Advice and Input Being Sought

I regard this upcoming meeting as the beginning of a process of substantive dialogue with you in relation to this project and the results I expect it will produce. I anticipate that there will be further occasions for discussion over the next few months as this project continues.

At this point, your general advice and assurance of interest is being sought. Only when you have had an opportunity to review the draft report would it be reasonable to ask you for more specific reactions.

My hope is that this briefing note, supplemented with the comments I will be making at our meeting, will provide a reasonable basis for our initial discussion.

Exhibit G

Final Report Structure for an Initial Effectiveness Reporting Project —An Illustration

Executive Summary

- explanation of what the report is and the context within which it should be viewed;
- summary description of the organization, activity, line of business or program;
- highlights of management's representations; and
- significance of management's representations in terms of the interests of the governing body, actions to be taken by management, future such reporting on this or other lines of business.

Main Report

Section 1—Introduction and Background

- Explanation of what the report is and the rationale for it, for example:
  - linkage to specific external events or initiatives or to a specific aspect of the organization's strategic agenda
  - motivation to provide the governing body with better and more comprehensive performance information and so facilitate their oversight and decision-making roles
  - motivation to demonstrate management accountability
  - motivation to provide a focal point for discussion between management and the governing body regarding expectations for and understanding of performance
  - motivation to provide a focal point for similar discussions among management and down through the organization
- Explanation of how the report should be viewed, for example:
  - as a pilot project aimed at learning more about the effectiveness framework and assessing its applicability
  - as providing an initial basis for discussion with the governing body about their needs for information and their understanding of the overall performance of the organization, activity, line of business or program
  - as the first (or a subsequent) step in a broader and longer-term strategy already discussed and agreed to between the governing body and management

- Explanation of approach taken to developing the report:
  - general process followed
  - major players and their roles
  - nature and level of contributions made by these people

Section 2—Description of the Organization, Activity, Line of Business, or Program on which the Report Focuses

- Statement and explanation of the mandate
- Statement of the objectives
- Description of the structure and interrelationship of activities
- Profile of the beneficiaries, intended clientele, and actual users
- Description of key aspects of the program design (for example, eligibility criteria) and delivery process (for example, centralized or decentralized, direct or through intermediaries)
- Profile of physical, financial, and human resources, as applicable

Section 3—Management Representations on Performance

- Introductory subsection that explains and puts in perspective the following or other matters, as applicable:
  - any choices made, such as to exclude certain attributes, to combine or split certain attributes, to give priority to certain attributes over others, to group the attributes or present them in a certain order
  - the overall message and balance that the management representations, taken as a whole, are intended to convey
  - the initial report is likely to be based on existing data and information rather than involve extensive measures to capture and analyze a lot of new information, and as a result it is likely to have gaps—some perhaps quite important—that future reports might be expected to fill
- Explanation of the following with respect to each pertinent attribute:
  - what the attribute means and why management thinks information in relation to the attribute is important to itself, the governing body, and other key stakeholders
  - a summary discussion of the key assessment factors, criteria, and indicators that management actually applied in analyzing performance in relation to the attribute
  - key data, information, or evidence in relation to the above
  - the overall conclusion that management has reached with respect to performance (in some cases, particularly in the initial report, there may be caveats because of lack of appropriate benchmarks, insufficient or contradictory information, and so on)

Section 4—Lessons Learned

- Discussion of the following or other matters, as applicable:
  - overall relevance and value-added of the process and the resulting product
  - roles played in the process by management, governing body, and those who support them
  - managing expectations regarding the process and resulting product
  - management of the process itself
  - nature and level of resources needed compared to what was available to do work such as this

- areas where improvements could be made to adjust the focus of such reports to a higher or lower level, clarify expectations, reinforce or streamline roles played by key players, make the process more efficient

Appendices, such as:

- Organization chart
- List of the key assessment factors, criteria, and indicators that were used as the basis for analyzing performance with respect to each attribute
- Tables related to key data and information cited in Section 3 of the Main Report

235 This document could be derived from the work the facilitator has done in Step 5. See the last portion of Exhibit C, *Outline of a Program Profile*, for further suggestions in this regard.
236 This document is prepared by the facilitator. See Exhibit C, *Outline of a Program Profile*, for suggested structure and content
237 See outline and discussion in *Elements of a Management Representation*, which can be found on pages 159-161 of Part II
238 As noted in the text, in some circumstances it may be preferable to hold the Workshop in two parts rather than in one three-day session.
239 Copies of this brochure, *Reporting on Effectiveness*, can be obtained from CCAF.

Part III

Comprehensive Audit

Introduction

The condition upon which God hath given liberty to man is eternal vigilance . . .[240]

John Philpot Curran

Parts I and II of this book focused on the nature and importance of accountability in the public sector and the means by which management discharges its accountability responsibilities through reporting to the governing body. Part III deals with audit, in particular the role that audit plays in assuring the governing body of the quality of an organization's performance. It demonstrates how audit effectively closes the accountability loop by providing an independent, objective and professional opinion in which the governing body can have confidence.

The emphasis in Part III is on audit that serves the governing body, the level in an organization that delegates responsibility for administering policy to top management. Many of the issues and principles discussed are also relevant to other auditing activities, such as internal audit, which also serve an accountability relationship. Sometimes that relationship is between management and the governing body, although it is more frequently between executive management and other levels. As long as such a relationship exists, the principles examined here apply.

All auditing requires discipline and rigour. This applies as much to audits concerning performance as it does to the audit of financial statements. Although our focus is on audits that concern performance in respect of economy, efficiency and effectiveness—on what is called comprehensive auditing—it is important to understand certain principles of audit generally; chapter 13 is devoted to that subject.

To provide a historical context, chapter 14 outlines the development of comprehensive auditing. The three different approaches to comprehensive auditing are described in chapter 15, as well as the factors that determine which approach is taken.

Chapters 16 and 17 describe the comprehensive audit process; some general considerations, and the conduct of the audit itself. Chapter 16 explains what differentiates this kind of auditing from financial statement auditing and the factors that drive the audit itself and the resulting report. As with any professional discipline, a number of decisions must be made in the course of conducting a comprehensive audit. These choices and their implications are explored, as are the major practice issues that must be dealt with in this type of auditing. Particular attention is given to the role that internal auditors play and the way that external comprehensive auditors can rely on their work and on other studies that are undertaken with respect to the audited organization.

Chapter 19 explains the standards that comprehensive auditing must adhere to and the manner in which practitioners strive to ensure the highest professional quality of their examinations. Audits are, of course, conducted by people. The demands placed on comprehensive auditors are discussed, as are the skills auditors must bring to their assignments; the role of the clients and the areas in which they can and should influence audits is explained here.

Comprehensive auditing is a dynamic concept, one that has grown and changed through experience. It most certainly will evolve even further in the future. While it is not a panacea for good accountability, management and governance, it can contribute substantially to those ends. Part III is intended to give readers a clear understanding of how the concept originated, grew and is practised at the time of writing.

It is important to recognize that the concept of comprehensive auditing is sufficiently flexible to allow different interpretations and approaches in differing circumstances. In some cases, Part III reflects comprehensive audit practice that is currently being uniformly applied. In other cases, it reflects only what some practitioners are doing. In still other cases, it encourages practitioners to experiment with new ideas and approaches. Variety is a hallmark of this kind of auditing. What is common to all, however, is the disciplined, objective professionalism that is brought to the work.

240 John Philpot Curran, Speech on the Right of Election of Lord Mayor of Dublin, 10 July 1790.

Section 1

Background

Chapter 13

Understanding Audit

The Origin of Audit

The need for financial accountability has existed ever since it became necessary for one individual to entrust the care of his possessions or business to another. In primitive societies, when a man found he could not personally control his herds, crops and other possessions, he began to delegate responsibility for his affairs to others and to require an accounting from them. Advances beyond a rural economy to trade and early forms of industry made it necessary for proprietors to exact an accounting from their servants through intermediaries. As many of these servants were illiterate, their accounting was necessarily oral and the intermediaries who heard the accounts became known as auditors. In addition to hearing and transcribing the accounts, auditors checked their accuracy by verifying the quantity of money, cattle or goods that should be on hand at a given moment.

As the world of commerce developed and the level of literacy rose, servants acquired the ability to report directly, and auditors were no longer required to hear reports and transcribe them for their masters. Auditors did not, however, disappear from the scene. Instead they moved into a role that resembled their modern one: they concentrated upon verifying the accuracy of the information provided by others.[241]

Relationship to accounting

Historically, the word *audit* has been primarily associated with, though not a part of, financial accounting. The greater significance of corporations and government in society has created a need for more and increasingly meaningful financial accounting in both the private and public sectors. In the business sector, for example, the growing diffusion of corporate ownership into hundreds and thousands of unrelated shareholders (including institutional investors who may have large holdings but tend to keep their distance from management) has created important groups of interested people totally unconnected to the management of these corporations or to market and other regulators. Effective communication between these groups and management is essential to the proper functioning of the economic system. Financial accounting provides this communication. Without it, much commercial activity would be impossible. Lenders, for example, demand reliable financial statements as a prerequisite to granting credit. In a user-oriented definition that stresses this communication role, R. J. Anderson defines accounting as "the process of identifying, measuring, and communicating information to permit informed judgements and decisions by users of the information."[242]

The conventional understanding of the relationship between accounting and auditing is based on the following three presumptions:

- management, not the auditor, should prepare accountability reports;
- there are generally accepted bases for preparing such reports (in Canada, Generally Accepted Accounting Principles—GAAP); and
- the auditor's job is to add credibility to these reports, using generally accepted auditing standards to examine them, and thus provide the client with assurance whether they have been presented fairly (this has been called *attest auditing*).

Anderson explains the need for attestation in a manner that really defines and justifies the role of auditing in society:

> To be effective, accounting information must be both accurately prepared by the sender and believed and acted upon by the receiver. To believe and act upon the information received, the receiver or user must be satisfied with its quality. Four conditions preclude many users of accounting information from achieving this satisfaction directly and therefore create the need for an objective audit and attestation.
>
> The most obvious condition is *remoteness*… the remoteness may be geographical… or it may be legal: under corporation acts, shareholders have no right of access to the books of account… or it may be economic: although the government has a statutory right of access to company's records to validate tax information, in many cases it will choose to avoid the cost of exercising its right if objective attestation of the information is available.
>
> A second condition is *conflict of interest*. Preparers of financial accounting information will frequently have interests at variance with those of many users.… Wherever users of financial accounting information perceive actual or potential conflicts of interest, they will have a natural reluctance to accept the information without some objective attestation of its quality by an auditor.
>
> A third factor is *complexity*. Increasing complexity of the information systems and the preparation of data for financial reports increases the probability of error. At the same time, user satisfaction as to the quality of the information, even given access to all underlying records, is diminished substantially. In such cases, users require someone else, acting on their behalf, to employ an appropriate level of expertise in assessing and attesting to the quality of the information.
>
> A final factor is the *consequence of error*. If users act upon the information received, imprudent actions based upon poor quality information may have direct financial consequences. The greater the potential consequence, the greater the need for satisfaction, through attestation, as to the quality of the information received.
>
> The role of auditing is therefore to add credibility to financial statements and thus to enhance the effectiveness of accounting communication needed by our economic system.[243]

Accounting is primarily constructive and is the work of management, whereas auditing is fundamentally analytical and is carried out independently of management in order to judge management's performance.[244]

Definitions of audit

Over the years, writers have devised a number of definitions of audit, usually with some specific context or purpose in mind. The Wilson Committee, for example, produced the following:

> 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.[245]

Other definitions—focusing on the audit of financial statements—are as follows:

> Auditing can be defined as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.[246]
>
> Auditing is defined as an exploratory, critical review by a public accountant of the underlying internal controls and accounting records of a business enterprise or other economic unit, precedent to the expression by him of an opinion of the propriety of its financial statements.[247]
>
> Auditing is the systematic examination and verification of the accounting records, vouchers, and other financial and legal records and documents of a private or business organization. The audit is performed in order to ascertain the accuracy, integrity, and authenticity of those records and documents. It is made with the intention of presenting fairly the financial condition at a given date and the results of operations for a period ending on that date, on the basis of consistency and conformity with accepted accounting principles.[248]
>
> Auditing involves a critical analysis and examination of the transactions and records of a concern, the interpretation of the results, and normally an expression of opinion concerning the records and financial statements of the client. This work is done by a person or by persons independent of management and is intended to determine the reliability of management's representations.[249]
>
> Auditing [is] the objective examination of records accompanied by the expression of a competent opinion concerning the financial condition and operating results of a client's business.[250]

While all of these definitions apply in the context of auditing financial statements, they are too narrow in focus where the performance information involved goes beyond matching revenues and costs or valuing assets and liabilities. From an examination of the nature of audit, a somewhat broader definition can be derived, as is shown in the following chapter.

Characteristics of audit

The above definitions of audit, while differing in particulars, are all based on a common understanding of the fundamental characteristics of audit.

The first prerequisite of audit is that it serves an accountability relationship. That must be the primary purpose of an audit engagement. While other purposes may be served by an audit, they are essentially of secondary importance. If serving an accountability relationship is not the prime purpose, the engagement is not truly an audit, no matter that it uses audit methodologies and even though there may be some strategic or tactical benefits to be gained from calling such a service an audit.

Other characteristics of audit arise from the need to ensure that people who delegate responsibility receive an authoritative audit report. 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 must be gathered in an orderly and systematic way;
- auditors have the responsibility and freedom to determine the scope and depth of work necessary to support their opinions; and
- auditors have an obligation to carry through an audit engagement to the point of reporting their opinions: 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 the 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 opinions that a third party would judge to be objective, and the resulting reports could be considered biased or highly subjective.

Finally, an audit must be conducted in accordance with rigorous, established standards. For financial audits in Canada, those standards are the CICA's Generally Accepted Auditing Standards (GAAS). The purpose of GAAS is to ensure that a stringent discipline is both applied by the auditor and expected by the client and that the resulting audit report is reliable. Auditing is a profession, and audits must be conducted by professionals.

241 Wilson, 10.
242 R. J. Anderson, *The External Audit*, 2nd ed. (Copp Clark Pitman Ltd., 1984) 3.
243 Ibid., p. 5. The four conditions identified as creating the need for an objective audit or attestation were those discussed in *A Statement of Basic Auditing Concepts* (ASOBAC) (American Accounting Association, 1972) See Anderson's footnote 5 in chapter 1.
244 Arthur W. Holmes, *Auditing, Principles and Procedures*. (Homewood, Ill.: Richard D. Irwin, Inc. 1952) 1.
245 Wilson, 9.
246 *A Statement of Basic Accounting Concepts* (ASOBAC), American Accounting Association, 1972, as cited by R. J. Anderson in *The External Audit*, 2.
247 Eric L. Kohler, *A Dictionary for Accountants*, (New York: Prentice-Hall, Inc. 1957) 44-45.
248 Holmes, 1.
249 Ibid.
250 Ibid., 2.

Chapter 14

Understanding Comprehensive Audit

> There must be a realization by auditors that all levels of government are accountable to the people for the efficient and effective delivery of services. There has been a realization that strictly financial data is not sufficient to inform government managers and decision-makers… as well as the public… about achievements and failures in carrying out government programs.[251]
>
> The Honourable Elmer B. Staats
> Comptroller General of the United States (1966-81)

Historical development

Comprehensive auditing was developed primarily as a response to client demand for better accountability information. 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 could choose to 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.

Frustrated by the apparent unwillingness or inability of management to properly report on performance, many legislatures asked their auditors to supply broader accountability information. Thus was comprehensive auditing born, based on two important principles of management in the public sector.

The first principle is that public business should be conducted in a way that makes best possible use of public funds. Officials responsible for spending public funds must ensure that their decisions result in economical, efficient and effective public services. The second principle is that people who conduct public business should be accountable for the prudent and effective management of the resources entrusted to them. This onus of accountability permeates the public sector, from elected representatives accountable to the public, to the officials accountable to their elected or public service superiors.

The first Canadian legislature to give its auditor a broader mandate was the Parliament of Canada. Following the 1975 report of the Wilson Committee, Parliament enacted the Auditor General Act in 1977. Among its several provisions, the act enabled the auditor general to report whether money was spent with due regard to economy and efficiency in the acquisition and management of goods and services, and whether the effectiveness of programs is being measured and reported in all instances where such measurement is feasible and practical.

James J. Macdonell was the auditor to whom this mandate was given. Even before the enactment of the legislation, Macdonell had been working to develop the concept of more comprehensive auditing. To this end, he enlisted the participation of some of the brightest and best of the auditing and consulting professions from across Canada. Under the guidance of a high-level advisory committee, seasoned professionals from public accounting and management consulting firms worked on secondment with staff of the Office of the Auditor General of Canada to lay the foundation for discharging this new responsibility.

THE HARD FACT IS THAT A NEW DIMENSION IS BEING FORGED IN TERMS OF VALUE-FOR-MONEY ACCOUNTABILITY FOR BOTH MANAGERS AND AUDITORS IN THE PUBLIC SECTOR, AND THE SOONER WE RECOGNIZE IT AND ADAPT TO IT WITH VIGOUR AND ENTHUSIASM, THE BETTER SATISFIED WILL BE THE SHAREHOLDERS (THE TAXPAYERS) AND THEIR REPRESENTATIVES (THE LEGISLATORS). IT IS A GREAT OCCASION FOR PROFESSIONAL PEOPLE TO FEEL IN THEIR HEARTS THAT THEY ARE DOING SOMETHING SIGNIFICANT TO EXPAND THE HORIZONS AND THE COMMON BODY OF KNOWLEDGE OF THEIR OWN PROFESSION.[252]

JAMES J. MACDONELL
AUDITOR GENERAL OF CANADA (1973-80)

The result of this background work was unveiled in December 1978 at the centennial conference of the Office of the Auditor General of Canada. The new approach was called *comprehensive auditing*. The term was chosen to indicate that audit examinations would take into account not only the traditional matters of financial records, the safeguarding of valuables and compliance with authorities, but also issues of nonfinancial performance.

Not long after the federal initiative, several of the provinces also provided their auditors with similar mandates.

An important landmark in the development of comprehensive auditing was the 1980 establishment of the Canadian Comprehensive Auditing Foundation (CCAF) as a cooperative, nonprofit organization devoted to research and education in the field of comprehensive auditing. CCAF, as it is known today, is supported by Canada's leading firms of accountants and management consultants, together with the federal and all provincial governments through their legislative auditors. The foundation is, in essence, a pooling of interests and resources of these parties. Its main purpose is to build knowledge for meaningful accountability and effective governance, management and audit. Accordingly, its focus is on the interests of the three principal parties to accountability relationships—members of governing bodies, management and auditors. CCAF is interested in the whole issue of accountability for public sector organizations—ranging from the federal and provincial governments, to health and educational institutions, social service providers, municipalities and, of course, state-owned enterprises. Increasingly, private sector businesses are benefitting from the work of the foundation. These include regulated industries such as banks and trust companies, as well as publicly traded corporations in the manufacturing and service sectors.

When CCAF was established, professional bodies such as the Canadian Institute of Chartered Accountants, the Certified General Accountants of Canada and the Society of Management Accountants of Canada quickly became involved.

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 recognized that the first duty to report lies with management, not auditors, and that there are certain areas in which they did not want auditors to become involved. For example, legislated and voluntary regimes of comprehensive auditing seldom explicitly mandate auditors to report effectiveness information where management does not do so. Moreover, they often restrict auditors from commenting on the merits of policy.

Comprehensive auditing is now practised 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-size municipalities have adopted the concept, as have a number of health care, educational and social service institutions. Many of the auditors for these institutions are in private practice. Federal Crown corporations are by law required to conduct periodic "special examinations" that invoke all of the principal elements of comprehensive auditing.

Canada is not alone in adopting broad-scope audits. Internationally, audits that go beyond traditional financial statement auditing are 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 performance issues. These audits, while not always referred to as such, usually cover the same types of matters having to do with economy, efficiency and effectiveness as do comprehensive audits. There have been two international conferences on the subject—1992, in Mexico City, and 1995 in Buenos Aires—and many other international conferences deal with it regularly.

The comprehensive audit concept

What is meant by *comprehensive audit?* An examination of the term will help clarify it.

Comprehensive

The first word in the term—*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 an organization has complied with pertinent statutory authorities and regulations. A comprehensive audit looks at how carefully an organization has given attention to economy, efficiency and effectiveness as the terms are explained in Part II.

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; and
- the economical, efficient and effective management of public funds and resources.

When originally devised, the term *comprehensive audit* referred to the entire range of the mandate for broad-scope audits.

> **Note**
>
> **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 that deals with broader performance issues. This book adopts that usage. The use of the terms *comprehensive audit* and *comprehensive audit reports* and comments about them should not be interpreted as extending to the financial and compliance elements of the broader comprehensive audit concept.**

Audit

The second half of the term—*audit*—distinguishes the concept from all other review processes. It emphasizes the need for professional standards and discipline. In this context, it may be instructive to examine how contemporary comprehensive audit practice corresponds to the description of audit in the previous chapter.

First, it is useful to sketch how a comprehensive audit works.

Process

In general terms, a comprehensive audit is conducted in the same way as all audits. The process starts with the audit engagement. This may be the result of a legislated mandate, as with legislative auditors, or may arise from a contractual arrangement. The work begins with the planning phase.

Planning phase

During the planning phase, the decisions are taken about what is to be audited and how the audit will be conducted. A great number of issues must be addressed at this time, including:

Audit approach: There are three broad approaches to comprehensive auditing, although in practice these approaches may not always be mutually exclusive.

The first approach focuses on the quality of management systems and practices. These systems and practices are examined with the view to using them as an indicator of the extent to which the organization pays due regard to economy, efficiency and effectiveness. This is the most common form of practice to date.

The second approach entails the comprehensive audit concentrating on delivering an opinion of the completeness and integrity of management's representations (reporting) to their governing body or stakeholders on the performance (effectiveness) of the organization. Such representations include sufficient information to allow readers to draw conclusions and for the auditors to substantiate.

The third approach involves the comprehensive audit itself undertaking to measure and report on the organization's performance. While auditors have frequently looked at individual aspects of performance (for example, economy and efficiency issues), there are few examples of their using the attributes of effectiveness discussed in Part II or other similar frameworks. Typically, this approach is appropriate where the governing body wants assurance about the organization's performance but management does not have the capacity or is unprepared to make the representations that satisfy this need.

Understanding the organization: A good understanding of the organization to be audited is essential if the right things are to be examined and appropriate conclusions are to be drawn. In some instances, the auditors are already familiar with the organization, as they have served the client for some time. In other cases, however, the auditors may know little about the organization and must gain a sufficient understanding of it in order to plan an effective audit.

Audit objective: The audit objective is a cornerstone element of the audit. It flows from the audit mandate and concerns the nature of the audit information that the auditor intends to report to the client. It influences the audit process throughout—from planning to reporting.

Scope: An important decision to be taken at the outset is the scope of the projected audit. Scope determines what the audit will cover: will it be the whole organization, one or more of its divisions or branches, or perhaps one or more or its functions, such as personnel, purchasing, and so on? Unlike financial audits, where the scope is nearly invariably the entire organization's financial statements, there is usually no fixed scope for comprehensive audits. Determining scope is, therefore, an important issue and has a direct bearing on the ultimate cost of the audit.

Intended level of audit assurance: In financial audits, there is a generally understood degree of certainty that readers may derive from an auditor's opinion. Not so with comprehensive audits. The degree of assurance that auditors have regarding their opinions varies with such matters as the intensity with which the examination is made and with the nature of the issues examined. However, this does not mean that it is an unlimited concept that is absolute at either the high or low end of the scale. In planning the audit, auditors have to decide how confident they will want to be about the opinions they form and the depth of the examination that will be required to achieve this confidence level.

Significance: A third variable that distinguishes comprehensive audits from financial audits is the level of significance[253] that will be used. This means how important a problem has to be to warrant being mentioned in the audit opinion. Like the level of audit assurance, the decisions about significance affect not only the amount of work that will have to be undertaken—and hence cost—but also the proper interpretation of the report.

Criteria: Criteria are the yardsticks against which auditors assess actual performance. They are objective benchmarks that help auditors decide whether something is acceptable or whether it should be identified as a deficiency. They may be either quantitative or qualitative and are usually process-oriented, such as best practices or generally accepted norms. Depending on the subject, criteria may be drawn from many sources: accepted good industry practice, relevant literature, the organization's own accepted standards, and so on.

Evidence collection: Decisions must be made about what evidence to collect, and how to gather, analyze and manage it. When this has been done, a plan for the examination, in which the required evidence is actually gathered, can be made.

Administrative matters: Once all these decisions have been taken, the auditors can decide on who will do what, how they will go about it, how long it should take and how much it should cost.

That done, the planning phase is complete.

Conduct and reporting phases

During the conduct phase, auditors collect the evidence they need to support their opinions. Frequently, adjustments have to be made to the original plan drawn up in the planning phase. This doesn't mean that the planning was necessarily inadequate, but rather that new information or insights are gained, or unexpected problems or opportunities are encountered either in the operation of the organization or in the collection of evidence.

Once sufficient evidence is gathered, auditors compare it to the criteria and formulate opinions. These audit opinions, and the evidence supporting them, are discussed with management to ensure their reasonableness.

The last phase is the preparation and presentation of the final audit report. Although reporting seems a distinct phase, it is in fact not usually so isolated. If good communication is maintained throughout the audit, reporting of one kind or another will happen regularly. The final report and its discussion with the governing body is usually the last, culminating step.

Is it true audit?

With the description of comprehensive auditing above, we may examine whether it is a true form of audit as we have come to understand the term. We can ask: To what extent do the three presumptions about the relationship of accounting to auditing mentioned in the previous chapter apply to comprehensive auditing?

Regarding the first presumption (management's responsibility to report), in the environment in which comprehensive audit is performed there are still few cases of management producing full and rigorous reports to the governing body on key aspects of the organization's performance: there is no legally imposed obligation on management to do so. Does this mean that no true audit can be done on performance issues in such an environment? Clearly not. This set of presumptions never envisaged an environment in which an auditor is engaged to perform an audit but management is not required to report.

The Wilson Committee faced the dilemma produced by this environment. In looking at the audit of effectiveness, the committee concluded that the primary role of the auditor is to audit the reports of management on their effectiveness. In saying this and in reflecting this notion in its definition, the committee made two vital caveats. First, it noted that although the systematic evaluation of program results presents problems, these should not be taken as an excuse to question the auditor general's right of reporting on obvious cases of ineffectiveness uncovered during the course of his or her examination of the accounts. Second, the committee noted that it was important "that the new legislation be broad enough to ensure that the Auditor General has the right to report on such studies and even make his or her own evaluation of program results if there is no other satisfactory way of obtaining this."[254]

As a result of the incongruity between the premise of management reporting and the environment in which comprehensive auditing is practised, it is not appropriate to apply all the conventional presumptions to differentiate between audit and nonaudit services.

There is, however, some evidence to suggest that these presumptions could become relevant. In its 1987 report, CCAF's Independent Panel on Effectiveness Reporting and Auditing in the Public Sector strongly recommended that managers provide information on effectiveness (which they defined as including the most important elements of economy and efficiency) in the form of representations to help governing bodies judge performance. The panel also recommended that auditors provide attestation audit opinions on these representations, in effect saying that this is a desirable target for comprehensive auditing. Since then, there has been a growing number of cases in various parts of the public sector where management has produced accountability reports, although it is too early to determine if this will become a common practice.

The second presumption in the conventional understanding of audit—the existence of generally acceptable bases for the preparation of performance reports by management—cannot now fully apply to comprehensive auditing. Substantial progress has been made in developing appropriate reporting models for use by management in a manner analogous to GAAP. There nevertheless remains a significant challenge to adapt these principles to different parts of the public sector. In the meantime, agreed criteria—even though they are determined on a case-specific basis and usually pertain to management processes as distinct from performance results—are used as a basis for carrying out and reporting on comprehensive audits. That is, in each situation there is an agreed basis for reporting: agreed standards that management, and its systems and practices, can reasonably be expected to meet. Such criteria have been developed and used for years.

The third presumption—of adding credibility to information and providing assurance on the fairness of the reporting—is an implicit facet of current practice. Clearly, in the absence of a management report, the manner in which the auditor meets this presumption will be different, but it is merely another way of achieving the same purpose. As is described in a subsequent chapter, the principal question is how to communicate the intended degree of audit assurance.

This assessment takes into account the view, held particularly in the legislative audit community, that even if management does report on performance in a complete and fair way, attestation to these reports by auditors will likely have to be supplemented by additional reporting to fulfill their responsibilities completely. For example, legislative auditors believe that additional reporting will still be needed to inform legislators about issues that transcend organizational lines and for which a number of ministries share responsibility. Individual accountability reports may need to be augmented by additional information to help governing bodies examine issues in a broader context than might otherwise be afforded.

Although not all the traditional presumptions of audit may apply to present comprehensive audit practice, the two key aspects of audit are clearly present.

The first is that the engagement is superimposed on an accountability relationship. It is a question of fact whether an accountability relationship exists and if the party who has engaged the auditor is also the party who allocates the responsibility. If so, and if the auditor's report addresses the manner in which the undertaking of the responsibility has been discharged, then the engagement meets the test of serving an accountability relationship. That it is the auditor, not management, who is reporting does not mean that the accountability relationship is not being served. This form of reporting is simply a practical means of accomplishing the same purpose.

The second aspect is whether comprehensive audit is done in compliance with objective standards. In 1988, the CICA's Public Sector Accounting and Auditing Committee issued its *Value-for-Money Auditing Standards*, dealing with the professional qualities of auditors, the conduct of their audit examinations and the content of their audit reports. It is to these standards that comprehensive auditors must conform.

From the foregoing analysis, and understanding current practice, the following definition of audit has been adopted in the comprehensive audit context:

> 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's systems and practices, against criteria, reported to a governing body or others with similar responsibilities.[255]

Nonaudit forms of practice

Many practitioners provide their clients with consulting services in the value-for-money area; indeed, from time to time, members of the legislative audit community undertake research that relates to performance in addition to their regular audit duties. These services are valuable, and it is entirely appropriate for practitioners to provide them when they can be of assistance to their clients.

Such services, however, are sometimes rendered under an audit label. This is troublesome as it may create unjustified expectations and can confuse the client and management communities. Therefore, it is in the best interests of comprehensive auditing to use the term *audit* only when an audit, as described in the preceding chapter, has been conducted.

Beyond offering the above working definition of audit, it is not the intention here to propose an exhaustive list of value-for-money services that should or should not be considered to be audit. Nevertheless, any engagements that are not designed to serve an accountability relationship, and/or that do not meet all the criteria identified above 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 (for example, restricted to matters not pertinent to or perhaps operating well beneath that accountability relationship) 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 does not fit the working definition of audit, 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.

Comprehensive audit practitioners have been, and will no doubt continue to be, called upon by their clients to help develop effectiveness or performance reporting frameworks, approaches or systems. They may also help implement such approaches or systems, or participate in activities that are intended to demonstrate such approaches with a view to educating management. In some cases, practitioners may be asked to do this with the knowledge that they will also be engaged subsequently to conduct additional work that more closely fits the working definition of audit that is adopted in this book.

Where any of the above is the case, the message for practitioners is simple: they should ensure that these services and the reports resulting from them are properly labelled to indicate that they are not comprehensive audits or comprehensive auditing reports.

It would be helpful if the client and management communities take into account the definition presented here when requesting practitioners to provide services respecting their organization's performance.

To Avoid Confusion and Unrealistic Expectations

- **Value-for-money engagements that do not serve an accountability relationship or that do not exhibit the other characteristics of audit should not be called comprehensive audits.**
- **Where audit reports contain the results of research or other material that do not meet the test of true audit, such material should be clearly labelled to distinguish it from comprehensive audit or comprehensive audit opinion.**
- **Practitioners should make special efforts on suitable occasions to discuss with their clients or potential clients (and their managements) the fundamental differences between auditing and the various types of services described above.**

251 Elmer B. Staats, *Centennial Conference Proceedings* (Office of the Auditor General of Canada, Ottawa, 1978).
252 James J. Macdonnel, ibid.
253 Readers will notice that the term *significance* is used throughout Part III and may wonder why the more conventional audit term *materiality* has been avoided. Some practitioners think that the terms are not synonymous, noting that in comprehensive auditing more emphasis is placed on qualitative matters than on the monetarily quantifiable matters that preoccupy financial audits. They believe that the term *significance* connotes this greater emphasis on qualitative matters and that this term is more all-encompassing and therefore more fitting to the breadth of matters that fall under the purview of comprehensive auditing than is the term *materiality*. In fact, those who take this view often look at materiality as a subset of significance. Others interpret materiality as broad enough to encompass all that needs to be included. Is one term preferable? Some maintain that the use of two terms to connote a single concept is confusing. It is even worse to use one term to mean two different things. In this book, the term *significance* has been used because it is the term most often used in comprehensive auditing.
254 Wilson, 35.
255 *Comprehensive Audit Reporting: Concepts, Issues, Practice* (Ottawa: CCAF, 1991) 32.

Chapter 15

Three Approaches to Comprehensive Audit

An evolving concept

The genesis of comprehensive auditing occurred 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[256] to the 3Es—economy, efficiency and effectiveness—in the administration of public funds. Typically, their reports contained examples of opinions about such matters as costs and productivity and the use of equipment and resources.

The prime characteristics of reporting 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; and
- there were no predetermined criteria to help assess what would or would not merit audit reporting.

Reports that primarily comprise *instances* are today a much less prevalent product of comprehensive auditing. Where such instances do appear in recent audit reports, they are usually provided as specific examples to support broader comprehensive audit opinions. In any event, the reporting of instances of poor performance provided a strong precedent for a more rigorous approach to this issue.

A systematic approach

In the mid-1970s, the enactment of comprehensive audit legislation called for more systematic approaches. The new mandates focused the auditor's attention on finding performance deficiencies and on the systems that were, or should have been, in place to ensure that there was due regard for economy, efficiency and effectiveness. 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 affecting performance and to prepare reports.

Over time, the approach has become further sophisticated. Today, the approach most widely used by both legislative auditors and private firms who do comprehensive auditing can best be characterized as providing opinions based on reasonable criteria (usually agreed upon with the client's management) of whether due regard to the 3Es has been demonstrated in the administration of resources. This approach recognizes that it is not always the case that auditors are looking only for deficiencies to report.

The key factor is the availability of sufficient, appropriate audit 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 the *Value-For-Money Auditing Standards*, issued by the Canadian Institute of Chartered Accountants, recommend that the criteria used in specific examinations be identified in value-for-money audit reports.

The majority of criteria used in comprehensive audits have to do with management systems and practices established to ensure due regard to the 3Es. By examining the design of these management systems and practices and how they are followed and work in practice, auditors can focus on the factors that may have a significant influence on an organization's performance. Although these systems tend to be designed to meet the individual circumstances of each organization, they frequently have many characteristics in common with systems used elsewhere for the same purpose. This provides substantial help in devising, and getting agreement on, the audit criteria. Other criteria may be quite specific to the organization under review.

One of the important results of using this methodology is that the audit reports emphasize opinions on whether or not due regard to the 3Es was evident. To the extent that specific deficiencies are reported, they are reported in support of, or as exceptions to, the opinions expressed in the report.

The nature of what gets reported from this systematic, criteria-based process, however, can vary across a spectrum ranging from exception reporting of deficiencies in management systems and practices, to providing an overall opinion on performance, both the good and the bad. What is important is that auditors make their intentions clear in their reports so that the reader understands the context of these reports and does not misconstrue what is said or what can reasonably be concluded or inferred.

Many practitioners recognize that if they focus their reports solely on negative observations and opinions without indicating corrective actions, they would not be contributing as much as they could to the future quality of public administration. Thus, the auditor's 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. Often, comments are included to recognize what is working well in the organization, as well as what is deficient.

This kind of reporting recognizes that many governing bodies are looking for more than lists of problems—it is a step towards the expression of broader opinions on the state of management in audited organizations. It also provides recommendations that can help the organization become more efficient and to manage its resources more effectively.

Such reporting, however, does not in all cases overcome the possibility of negativity in the resulting opinions. If an organization does not in large measure meet the established criteria, the auditor's opinion will say so. But when an organization does some or most key things well, the auditor will report a generally favourable opinion that creates a positive context for mentioning any specific deficiencies found and audit recommendations for improvement. This results in a report that more accurately reflects the organization's true performance. This, in turn, is more useful to the governing body in its decision-making and stewardship responsibilities.

Three approaches have evolved

Comprehensive auditing has evolved considerably in the last two decades. 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 performance in 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. A second approach is for the audit to concentrate on providing audit assurance on the reports by management to a governing body or stakeholders on the organization's performance. A third approach is for the audit report itself to provide performance information where the organization's management has not reported adequately to the governing body.

These approaches differ in focus and degree, but they are not mutually exclusive. In examining management systems and practices, for example, the issue is not simply one of noting a deficiency in the system or practice, but may also extend to consideration of the causes and consequences of this deficiency. Similarly, in looking at the performance of the organization directly, consideration must be given to the strength and reliability of underlying management systems and practices.

The approach which is right for an organization depends on a number of factors. These 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 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 is informed about key aspects of the performance of the organization, the methods by which it is informed and the way it uses the information it has been given.

This following sections describe each of these three different approaches to comprehensive auditing.

Audit 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 economy, efficiency and effectiveness.

This approach is currently the most prevalent form of comprehensive audit practice. It is 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.

Legislative auditors often call this a form of direct reporting, distinguishing it from attest auditing. This form of reporting does more than summarize an auditor's opinions. It also contains important information, prepared by the auditor, and reported directly to the governing body.

The systems-and-practices approach has limitations. This kind of auditing is only a proxy for auditing that can tell the governing body the extent to which the organization is doing its job effectively. It focuses on management systems and practices, not directly on the organization's performance. It is one thing for an audit report to say that management has or has not followed certain reasonable criteria in terms of a management system; it is a more difficult matter to know what such a finding really means in terms of the bottom-line performance of the organization.

Where this approach is used

This approach is used—though not exclusively—by virtually all legislative auditors with comprehensive audit mandates. They typically allot a certain portion of their annual budgets to comprehensive audits, choosing areas for examination after assessing such matters as risk, importance, time elapsed since the last examination, and so on. And the comprehensive auditing they do usually concentrates on key systems and practices established to ensure due regard to the 3Es.

This approach has also been used extensively by auditors for public sector organizations that have indicated they want the sort of assurance about their management systems and practices that a comprehensive audit can bring. Where a comprehensive audit mandate is not legislated, the undertaking of such an audit requires careful negotiation to ensure that the client understands the nature of the assignment and has no false expectations about the eventual outcome. It may be, for example, that a more sharply focused consulting assignment may better serve the client's needs. As mentioned earlier, to avoid confusion and a debasing of the coinage of the term, it is important that assignments that do not meet the essential characteristics of audit are not called comprehensive audits, no matter how expedient it may be to label them as such.

This approach to comprehensive audit assignments is typically undertaken where the client organization has established systems and practices to achieve good performance but does not make substantiated statements about its achievements in this regard. As noted in the previous chapter, audit reporting using this approach may also continue to be needed where management representations on performance do not cover the entire organization. This could happen, for instance, in a government where representations are made by departments but do not cover such government-wide functions as personnel management.

Audit attestation to management representations on performance

A relatively new approach

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 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 twelve attributes of effectiveness, as described in Part II, 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 rigour 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. It is important to note 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.

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.

The underlying approach to the audit of management representations on effectiveness has traditional roots—like the previously described approach, it examines systems and practices. Here, however, auditors are called on to present an opinion on what management has to say about how well those systems are working. In other words, the auditors 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 include all relevant information in order to result in meaningful disclosure.

Early auditor involvement

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

Probably more than in financial attest auditing, comprehensive auditors need to be involved from the beginning in management's approach to making representations on performance. The preparation of financial statements is governed by standard rules (GAAP) that are as well known to the organization's accountants as they are to its auditors. Usually, there is little need to consult with auditors in drawing up these statements. Nevertheless, in valuing certain assets or liabilities, or in taking a new approach to handling items, accountants will often consult their financial auditors. With representations on performance, where there are not yet established criteria or standards for reporting, early consultation with the auditors is of great help. Particularly in early experiments with making management representations that are to be audited, the auditors should be involved from the very beginning.

Management need this involvement in order to understand what the auditors' approach will be: the type of audit tests that will ultimately be applied, what factors will be considered important, and so on. The auditors need this early involvement in order to have a good sense of what management have done, how it has been done and what considerations have been applied. This helps the auditors to decide how to approach the examination work, what level of confidence they can attribute to underlying management processes and systems, and so on. The governing body usually wants to see this involvement in order to have greater confidence in both management's report and the auditors' opinion on that report.

Early on, the auditors would have sought to:

- achieve a clear understanding of the steps that have been taken in the development of the representations and the underlying rationale;
- communicate to management and the governing body the auditors' perspectives on the overall audit role and process, and the general considerations that will apply in the course of the audit and, ultimately, as a basis for the attestation opinion; and
- provide comment on the work of the organization as it progresses *vis-à-vis* the development of management representations.

The nature of their involvement presents a challenge to auditors. They need to be able to maintain a careful balance between preserving professional independence on the one hand, and being isolated from the whole process of developing representations on the other. This, however, is something with which they are familiar. After all, the great majority of disclosure and financial reporting problems are discussed with auditors as accountants are preparing financial statements.

Audit approach

As mentioned above, the approach that auditors take to management representations on effectiveness is, to all intents and purposes, the same as that taken to financial statements, which involves reliance on systems, practices and controls that surround the collection, consolidation, consideration and reporting of information.

The application of this approach to management representations should not create conceptual problems. As with financial auditing, auditors must understand, document and test the processes used to gather and organize information. The techniques that auditors have developed to achieve this are well known and are readily adaptable to the new environment. And it is worth remembering that there is already substantial experience—gained through comprehensive auditing—in auditing systems to measure and report on many aspects of performance. That experience is germane to auditing management representations on performance, although the end product—assurance about representations rather than opinions on management systems and practices—may be different.

There are, nonetheless, some technical challenges for auditors working in this environment. Probably more than ever before, they will be dealing with lower levels of audit assurance and the attendant reporting and communication issues. They will also have to increase their knowledge and expertise in relation to the much broader range of concepts involved and the methodologies needed to measure and analyze them.

Regardless of whether the auditors are involved from the beginning, or whether their first contact with the process is only after management have prepared their representations, the auditors need to ascertain at the outset of the assignment what the organization's expectations are for the management representations process and product, whether these expectations seem reasonable under the circumstances, and whether these expectations are understood by the parties involved. Where their initial appraisal of the situation indicates a problem in this area, auditors ought to go back to the client to address these issues rather than going forward and doing more audit work. This is an important matter in which auditors must exercise professional judgment.

Once the management representations are developed, the auditors would then begin an examination to:

- establish, by means of an initial review, the basic reliability of the data/information, and the appropriateness of the assessment factors or criteria being applied. In determining whether the assessment criteria are appropriate, the auditors would be guided by:
  - the discussions and agreements that may have taken place between the governing body and management on this specific matter
  - the general state of thinking and practice in this specific area
  - the logical arguments put forward in support of these factors/criteria
  - the auditors' own professional judgment
- assess significance and risk and, from this, determine the nature, extent and timing of the examination of management systems and

practices that need to be done;
- conduct the examination accordingly and then form an opinion on management systems and practices;
- review the information contained in the management representations and form an opinion on its reasonableness and completeness; and
- communicate these opinions to the governing body in the form of an audit report.

Audit evidence and levels of assurance

As has been pointed out, management representations on effectiveness vary in many ways, and these variations have implications for the level of audit assurance that it is possible to obtain.

In some instances, full and reliable supporting information may be readily available or can be provided in a timely fashion at reasonable cost. In other cases, it may be possible only to make estimates. Sometimes the amount of information substantiation will be determined by the state of measurement technology with respect to the attribute in question. For example, currently it is easier to account for costs and productivity than it is for organizational responsiveness.

All management representations involve a degree of uncertainty, and managers have to deal with this appropriately when framing and communicating them to ensure that they are meaningful to the users. Auditors face somewhat different problems, as the following questions indicate:
- How can a valid representation be recognized?
- How much audit evidence is needed to support an opinion on representations?
- How can one ascertain if a representation is misleading?
- How far should one look for evidence that is contrary to the representation?
- How can one distinguish representations that can only be disproved through some distant future event?

The above questions bear on the issue of evidence and significance from the perspective of the auditors. In general terms, the following factors will have to be weighed in determining what constitutes sufficient, appropriate evidence:
- the extent of assurance desired by the client;
- the extent to which the representation can be substantiated;
- the cost of obtaining audit evidence; and
- the significance level considered appropriate by the auditors.

Most financial statement attest audits are designed to provide relatively high levels of assurance, despite inherent imprecisions embedded in some of the figures reported. The level of assurance such audits convey is generally well understood, and techniques have been developed to collect a sufficient amount of appropriate evidence cost-effectively. Auditors do not give different levels of assurance on different types of assets, liabilities, revenues and costs. They have developed their craft to the point where they obtain relatively uniform levels of assurance on the global assertion of management that the financial statements present fairly the financial position and results of operations.

To date, auditors have been unable consistently to give the same level of assurance respecting all management representations on effectiveness; a somewhat different approach is warranted, at least in the short term. In large part this is because auditors have not provided such assurance in the past. It is an area where experimentation and negotiation are necessary. This factor, along with the varying degrees of uncertainty that accompany the different attributes, ensures that there will be varying levels of assurance provided by auditors respecting management representations on effectiveness. This subject is discussed further in chapter 18.

In some cases, traditional positive assurance may be possible. That is the type of assurance that is provided when auditors declare that in their opinion the representation "presents fairly"—thus leaving little or no uncertainty in the reader's mind about the reliability of the information provided, within the bounds of whatever reservations management may have declared. Assurance of this nature may be provided where it is vital to do so, or where sufficient, reliable, appropriate evidence can be obtained at a reasonable cost. It may, in certain circumstances, be appropriate to provide a lower level of assurance than is allowed to financial statement auditors—a negative assurance that would inform readers of the audit report that, based on the work done, nothing leads the auditors to believe that the representations are not fairly presented.

There are no definitive answers about the level of assurance that either can or should be achieved. Auditors and their clients and management will have to work together to adopt the most appropriate patterns. Once sufficient concrete experience is gained, however, suitable conventions are almost certain to emerge. What is important is for auditors to be flexible, to be practical and to consider the options presented above. To help ensure that the results of the audit are clear for users, auditors should also describe the criteria they have employed to determine what is significant. This issue, too, is discussed at some length in chapter 18.

Audit opinions on representations

Comprehensive audit reports that attest to management representations on effectiveness may be either highly summarized (similar to the audit opinions that auditors usually give on financial statements), or they may be longer in form and narrative. The short-form report for financial statements evolved over the years as management accepted responsibility for preparing the statements and the accompanying notes that explain the accounting practices adopted, valuations and other matters. In either long- or short-form reports, the focus of the audit opinion is on the information reported by management and not on the details of systems and managerial practices.

Interestingly, it was a federal Crown corporation that was the first organization to prepare management representations on its performance, based on the framework of effectiveness attributes. An audit opinion was issued on the resulting management report on the corporation's effectiveness:

> [I]n 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.[257]

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

Audit reporting on performance

Members of governing bodies often find themselves in a situation where they need the type of performance information anticipated in the framework of effectiveness attributes 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 focusing on management systems and practices, such as those described above, may be insufficient to meet the due diligence needs of the governing body.

In such a situation, members of governing bodies may consider a third model of comprehensive auditing, one that goes further than looking at systems. In this approach, in the absence of management information on performance, the auditors obtain and report results-oriented information to the governing body. This information might be based on the effectiveness reporting framework.

To a certain extent, this approach has frequently been taken by Canadian legislative auditors. They have often included in their reports and opinions information in respect of economy and efficiency. Moreover, of late, some legislative audit offices have moved towards what is termed "results-based auditing," in which emphasis is placed on identifying the critical results or products to be achieved by a program or process. These results may take the form of outputs produced in relation to those intended, products delivered or immediate goals that must be achieved for the program or process to be a success. This approach has several implications. For example, the auditor may need to spend extra time with management of the audit entity to obtain a common understanding of the key results and what constitutes reasonable performance in these regards. Indeed, those moving in this direction view the approach as significantly changing the starting point of the audit.[258]

In the United States, the General Accounting Office regularly reports information on the economy, efficiency and effectiveness of the organizations they have reviewed. This approach also has strong roots in financial auditing. It was not that many years ago that auditors prepared long-form audit reports that included financial information that might otherwise not have been included in financial statements. It is common practice for financial statement attest auditors to provide information, even in their "short-form" audit opinions, where such information is deemed essential to a meaningful understanding of the financial position or results, and where such information has either been omitted or improperly reported in the financial statements.

It is unnecessary to elaborate on this approach, since the sort of considerations outlined in the discussion of the first model—opinions on management systems and practices—apply here. Moreover, the kinds of issues and considerations with which auditors need to deal in accounting for performance are discussed in Part II.

It is important to mention, however, that in providing the performance information that would otherwise have been reported by management, the auditor is not attempting to form or communicate an overall judgment about the performance of the organization or the merits of its policies. Rather, the auditor is providing the governing body with information it needs to form such aggregate or summary judgments.

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256 *Due regard* refers to adherence to sound management practices and systems that are intended to foster the economic, efficient and effective operation of the organization. It should be recognized that adherence to such systems and practices is not a proxy for substantive information about actual performance.

257 *Reporting and Auditing Effectiveness, The Experience of Canada Morgage & Housing Corporation* (CCAF, 1990) 23.

258 Wm. F. Radburn and Maria Barrados, *Results-Based Auditing*, Discussion Paper Series, Discussion Paper No. 68 (Ottawa: Office of the Auditor General of Canada, August 1994).

Section 2

General Considerations

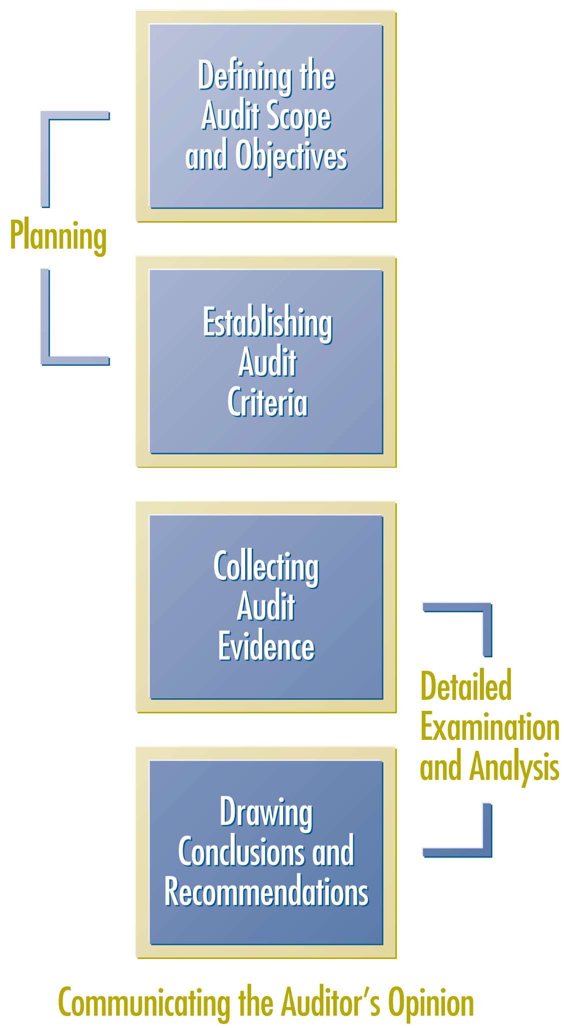
CHAPTER 16

COMPREHENSIVE AUDIT—GENERAL CONSIDERATIONS[259]

Because circumstances vary so significantly from case to case, no two comprehensive audits will likely be the same. The way in which the decision about the assignment is made, the actual subject matter and conduct of the work are always determined by the particular characteristics of the organization and the people involved. Thus, it is not appropriate to try to identify a single model or a series of completely discrete steps that apply to all comprehensive audits. For purposes of presentation in this chapter, however, it is convenient to discuss the process under headings that should be thought of as interrelated phases of the audit. The process described here is essentially that used when auditors want to satisfy themselves on management systems and practices or to support their opinions on management representations on effectiveness.

For many processes, including financial audit, it is common to identify three steps: planning; detailed examination and analysis (or conduct); and communicating the auditors' opinion. Although this triad can be used to describe a comprehensive audit, it is important not to let it obscure a feature of this type of work that must be kept in mind: *the whole process is the audit.* Gaining and exchanging information at the planning stage is just as much a part of conducting the audit as the detailed collection of data and the formal reporting. Impressions and insights gained in the preliminary interviews are often as critical influences on audit opinions and recommendations as the analysis of detailed evidence. Indeed, much of the detailed work may serve only to test the validity of hypotheses developed at a very early stage. The audit starts even before the first interview. Figure 3.1 illustrates the interrelationships of the different parts of the audit process.

FIGURE 3.1: INTERRELATIONSHIPS BETWEEN DIFFERENT PARTS OF THE AUDIT



It is with these reservations in mind, therefore, that the following chapter is organized to create notional, but artificial, divisions in what is in reality a single continuous process. Issues discussed with respect to reporting, for example, should be an integral part of the auditor's thinking in planning and conducting the audit.

Before discussing the actual detailed conduct of an audit, however, it is useful to indicate the types of examinations that can be undertaken, the way in which decisions are made about what to audit and the variables on which decisions must be made and which distinguish comprehensive audit from other forms of practice.

Three key variables

Three closely linked concepts influence, in large measure, how auditors conduct their work and how they report their opinions: scope, intended degree of audit assurance and significance. These concepts are intrinsic to any form of auditing. They flow from basic notions of audit and the generally accepted auditing principles that attend them. Briefly:

- *Scope* refers to the breadth and depth of the audit.
- *Intended degree of audit assurance* refers to the confidence that auditors have in the accuracy of the opinions expressed in their reports.
- *Significance* determines what auditors decide to report and what not to report.

Decisions made with respect to any one of these factors will ultimately affect the other two and the audit report itself, particularly since audit resources are finite. For example, an audit designed to provide an opinion on the entire spectrum of a government's or an organization's activities is by nature very broad in scope. Given constraints of time and resources, such an audit could not examine the organization in the same degree of detail that would be possible, using the same resources, if the scope were limited to only a part of the organization or its activities. As a result, the auditors may not have the same degree of confidence in their findings and consequent opinions as they would if they had undertaken a more restricted audit. In such cases, auditors would not want to have the readers of their reports take the same level of comfort from them as they would had more detailed examinations been done. Acknowledging that the intended degree of audit assurance is variable, however, should not be interpreted as meaning that it is an unlimited concept that is absolute at either the high or low end of the scale. Its aim is to provide confidence, being the product of a disciplined process, based on the application of suitable criteria and tied to notions of relevant, competent, sufficient and appropriate evidence. It may be, however, that in certain circumstances the intended degree of audit assurance is medium to relatively low. Where this may be the case, the practitioner needs to exercise professional judgment, thinking carefully about the appropriateness of using the word *audit* as a descriptor of the opinion being expressed.

Similarly, an auditor's consideration of significance in a wide-scope audit will differ from that of a more narrowly scoped one. Simply stated, what is important to report in a detailed examination of a single activity may well lose its importance in an audit of the full spectrum of the client's operations or a large portion of them.

In addition, significance factors such as a program or component's financial size, sensitivity and impact normally figure into decisions as to what is chosen to audit.

Comprehensive audits have covered virtually the full spectrum of potential scope—from opinions on entire organizations to opinions on programs or activities and, in some cases, on only portions of activities or functions. All practitioners recognize that, as a practical matter, audit resources are limited. Auditors and their clients therefore have choices to make in trading off between breadth of scope, intended degree of audit assurance and the significance thresholds they use. They can, and regularly do, make diverse choices in practice. These trade-offs in turn significantly influence audits and the opinions they produce.

It is worth noting that the range of choices regarding each of the three key variables is broader in comprehensive auditing than in traditional financial attest auditing. How these variables are treated in practice also tends to vary more from one audit to another in comprehensive auditing than in financial statement attest audits.

Almost universally, the minimum scope for financial attest audits is not a matter of choice for either the auditor or the client. The scope is normally fixed by legislation and well-articulated professional standards: it pertains to the entire organization. In that context, auditors cannot simply audit and render an opinion on one or even several lines of a client's business or activity. They may choose to do little or no audit work with respect to certain aspects of a client's transactions or affairs, but only on the basis that any problems that might be found in these areas would not affect their audit opinion with respect to the organization as a whole.

Comprehensive auditing is practised differently. As a rule, legislation does not specify the overall scope for such audits.[260] Comprehensive auditors, therefore, have to make choices about the breadth of these audits and, as mentioned, practice to date has revealed a wide diversity in the choices that are made.

The concept of assurance is central to accountability and audit. The term *intended degree of audit assurance* refers to the confidence that auditors have in the accuracy of the opinions expressed in their reports. Generally, when auditors are associated with information, readers place more reliance on it than if no auditor had been involved. Clearly, the extent to which auditors accept a risk of error in their opinions will have a bearing on their reports' potential value to their clients and the decisions that are eventually based on them. Careful professional judgment is needed, since there is no universally right or wrong level of audit assurance.

The use of the term *assurance* is not without its critics. Some believe that it connotes a guarantee, something that is certainly not intended by an audit. The critics argue that the term is not generally used in public sector auditing and, hence, should be avoided. Others view it as an accepted part of auditing terminology and do not equate it with guarantee, but with the notion of a declaration intended to give confidence. It is this latter understanding that is adopted here. It is congruent with the bulk of accepted audit theory, summarized in the following definition drawn from the literature of financial statement auditing:

> Audit assurance may be defined in terms of the degree to which an audit effort increases the credibility of specified representations of others—or, alternatively, the extent that it reduces the risk of material errors in the representations.[261]

So, is assurance a valid concept in comprehensive auditing? Of course it is. Unless readers can draw accurate inferences from comprehensive audit reports, those reports, however accurate and insightful, would be without value. It is obvious, therefore, that assurance is a key concept for comprehensive auditing.

As with scope, there is a contrast between financial statement auditing and comprehensive auditing in connection with the concept of intended degree of audit assurance. Legislation and regulations do not fix a universal degree of intended audit assurance for financial statement attest audits. Practice is mature, however, and auditors, their clients and knowledgeable users of audit opinions recognize that the intended degree of audit assurance is generally consistent and set at a high level. Financial statement audit opinions do not mention the intended degree of audit assurance partly because of the generally understood norms that have evolved.

Because their scopes vary, the degree of intended audit assurance associated with comprehensive audit opinions is bound to vary from one audit to another. The intended degree of audit assurance is a true variable, and its range can be quite wide.

In the case of significance, the same considerations apply as those with intended degree of audit assurance. That which is important to report is a derivative of the scope for the audit and the intended degree of audit assurance. In financial statement attest auditing, scope and intended degree of audit assurance are reasonably predictable. As a result, significance thresholds also tend to be common and consistent over a wide range of audits. To the extent that scope and intended degree of audit assurance are variable in comprehensive auditing, so will significance thresholds vary from audit to audit. Again, no convenient rules of thumb are available for either auditors or their clients to apply in this regard.

With three interdependent variables at play, the question arises as to whether one variable should take precedence over the other two. Is there a hierarchy of importance? Again, in both a theoretical and practical sense, there are no convenient rules of thumb, and practice does vary. Some practitioners, for example, place primary emphasis on the degree of intended audit assurance. Their audit policies are structured such that the audit result will always conform to a certain degree of intended audit assurance, and they will not compromise on this. In turn, their trade-offs relate more to scope and significance thresholds. In other words, they have anchored one of the variables and only the other two actually vary. In other cases, scope is anchored. There is no single approach that is right in all circumstances, but it should be recognized that in practice certain practitioners will pick one of the three variables and tend to keep it relatively constant, while introducing true variability to only the other two.

Decisions about these variables are crucial in determining the nature and eventual usefulness of comprehensive audits. It is essential, therefore, that for each audit these decisions be made both carefully and consciously with the assistance, where appropriate, of relevant specialists. Moreover, close consultation with the client on these issues will help prevent any undue expectations and misinterpretation of the eventual audit report.

Focus of examinations

Comprehensive audits may examine a number of different facets of an organization. Audits are regularly conducted on:

- organizational units (such as departments or parts thereof) that deliver programs or services (sometimes called vertical studies)
- key management functions (such as personnel or purchasing) that affect all parts of an organization and the management of specific types of expenditures that are made in several or all of the program or service areas

There are no hard-and-fast rules that dictate the choice of the type of audit to be undertaken. It is important, however, to consider each possible approach and candidate program or function in light of the significance of the area, perceived difficulties and potential benefits. Each has implications in terms of the cost of the audit, its makeup, its report and the nature of its findings.

Examples of Potential Comprehensive Audits

Specific Units or Programs	Organization-wide Functions
Highway construction	Financial management
Old-age homes	Electronic data processing (EDP)
Special schools	Human resource management
Military reserve	Legal services
Fire department	Purchasing
Chronic-care service	Travel costs

Specific units or programs

Audits of this type:

- concentrate on information about results and operations and the systems and practices that generate such information;
- may require auditors to examine, at the level of the specific unit, those aspects of organization-wide functions that have a significant impact on the operation of the program or activity under review; and
- usually produce recommendations that are specific to the particular program or unit under review and point to improvements in program design, organization and service-delivery systems and techniques and to opportunities for cost savings.

Organization-wide functions or expenditures

Audits of this type:

- concentrate on one or more key managerial processes that affect all programs;
- may require auditors to examine issues pertaining to the function in several program areas in order to gather sufficient evidence and to draw broad conclusions; and
- may produce observations and recommendations that point to potential cost savings, but are more likely to deal with questions of the adequacy of the systems and procedures.

Deciding the subject for audit

There are many possible subjects for audit in an organization of any size. Several criteria are usually considered in deciding what will be examined.

Significance

No auditor will willingly undertake a comprehensive audit of a part of an organization's operations that he or she does not regard as significant. Several factors may be considered under this head.

One is financial size. Small programs, even if they might be improved dramatically as a result of an audit, are usually given a low priority. This is not to say that programs should be ranked solely on their budgets, but rather that auditors tend to want to address areas where substantial resources are involved. As more and more subjects within an organization have been covered by comprehensive audits, it may be that this criterion (almost one of financial materiality) will become less important.

A second factor may be a consideration of the sensitivity of the potential subject. This involves the subject's impact on the well-being of the public. While some programs, such as environmental protection and ambulance services, may be relatively small in terms of overall expenditure, they may have a significant social impact and thereby warrant attention by the auditors.

Potential results/risks

Auditors try to assess the significance of the potential results that may accrue from a comprehensive audit, and this involves an assessment of the risks inherent in an operation of its kind. Although this is in part a function of the size of the operations involved, it is also in part a result of the nature of the program or function.

Under this head could come an evaluation of the risks of fraud, abuse and financial error. The potential for lack of economy and efficiency can also be assessed. The relative need for superior management and control systems can be gauged by looking at the complexity of operations, the variety of programs or functions subsumed in the subject and the degree to which operations are decentralized. It is generally assumed that the greater the complexity and decentralization, the greater the likelihood that control systems will require attention. Often, knowledge of experience in similar operations elsewhere helps in assessing these matters.

Another factor for consideration is the adequacy of the information that is made public or provided to the governing body. An assessment of this information can help auditors judge whether the client—the governing body— is properly equipped with the information it needs to fulfill its own control responsibilities in respect to a particular potential subject for audit.

Suitability for audit

One factor that must be considered here is the availability of appropriate methodology to deal with the subject. It is not uncommon to consider a potential subject that has not yet been examined by practitioners. What must be determined is whether there are particular characteristics of the subject that are both of central importance and of too great difficulty to audit. If the important features of the subject can be audited, there should be no problem, but if some essential part of the subject is so specialized that it would require the development of new techniques for audit, a decision will have to be made about the feasibility and cost of developing the required methodology. Clearly, a good knowledge of what has been done in other jurisdictions will help in assessing this factor.

Another consideration is the availability of staff qualified to conduct the proposed audit. If particular skills are required that are either unavailable or are committed elsewhere, this must be taken into account. Such a deficiency might be overcome by obtaining the necessary skills from outside the audit organization, but this option is not always available nor, depending on the sort of skill involved, is it always appropriate.

Although sometimes considered as a separate criterion, the attitude of management of the candidate subject is seen by some to influence whether or not a meaningful audit can be undertaken. The impact and efficiency of a comprehensive audit largely depends on the cooperation of those being audited. While there are bound to be instances where audits must be done in spite of a suspicious or even hostile management, a cooperative environment is much preferred. Experience has shown that as more and more audits with positive impacts are completed, there is a growing understanding and acceptance of the concept throughout an organization. Other considerations permitting, it is better, particularly in the early days of the introduction of a comprehensive audit regime, to go where management will contribute to, rather than hinder, the audit.

A somewhat related factor is the condition of the potential subject for audit. If the organization or function is relatively stable, this does not create a problem. But if a major reorganization is under way, or has only recently been completed, or if important new systems have just been introduced, it may be useful to consider if an audit would assist or exacerbate a difficult situation. Audits are apt to be at least marginally disruptive to the routines of some of the audited staff, and it is best to avoid placing extra burdens on already pressed personnel.

Audit cycle

Many auditors have established a long-term audit cycle for comprehensive audits. In these cases, the potential subjects will be dealt with more or less in the order set down in the predetermined cycle, although the other criteria listed above may affect the actual order ranking. Where there is no established cycle for this kind of work, auditors still usually consider the time that has elapsed since a thorough audit was made of the candidate subject—even if the scope was confined to financial audit. In any event, unless the previous comprehensive audit disclosed some particularly compelling reason to do otherwise, such as a high risk of recurring weaknesses, auditors will not choose to conduct a second audit in the same subject area while other important subjects are left unexamined.

In considering the subject for audit, it is important to ensure that management and the client are kept informed of the auditors' thinking. Without consultation, auditors may not recognize potential difficulties or opportunities. Such consultation also helps ensure the cooperation of management, which is so important for a successful audit.

259 A portion of the material in this and subsequent chapters is derived from publications of CCAF, CICA, the Office of the Auditor General of Canada, and the U.S. General Accounting Office (GAO). In some instances, this material is paraphrased to make it better fit the context. Wherever possible, direct quotes from CICA, the OAG of Canada and GAO publications are given specific attribution.

260 An exception is the special examinations of federal Crown corporations prescribed by the Financial Administration Act, which deal with the entire corporation and subsidiaries.

261 J. Alex Milburn, Ph.D., C.A., *Limited Audit Engagements and the Expression of Negative Assurance* (CICA, 1980).

Section 3

Comprehensive Audit Practice

Chapter 17

Conducting Comprehensive Audits

Planning the audit

Once the general subject for the audit has been chosen, the detailed planning can begin. Responsibility for this work must be assigned to qualified staff, and it is usually best to have it supervised by the person who will have overall responsibility for the detailed work of the whole project. Some auditors find it helpful to use a peer review process for these audits, sometimes called an advisory committee and sometimes including professionals from outside the office. This technique has helped to ensure the appropriateness of the audit objectives and methodology. If such a process is to be used, it should be engaged from the start. In addition, it is helpful for the client to identify a contact person at the outset to act as principal spokesperson for the client on all matters that concern the audit.

The main objectives of the planning phase of the audit are:

- **the development of an understanding of the audit entity and its environment;**
- **the selection of the lines of audit enquiry;**
- **the preparation of the survey plan;**
- **the identification of the audit issues and the criteria by which they will be assessed; and**
- **the preparation of the survey report and audit plan.**

Given the size and complexity of most subjects for comprehensive audits, it is usually impossible for the auditors to provide a complete, detailed comprehensive audit of the entire organization or function. This means that the scope of the audit must be narrowed to those key areas or issues that are essential to good performance. Accomplishing this requires a sound, broad knowledge of the organization or function. Gaining this knowledge is a primary objective of the first part of the planning phase, usually referred to as the overview stage.

The overview stage

The prime activity in the overview stage is to gather information about the organization. With that information, the auditors prepare a report that is essentially a plan for the second stage of the planning phase, the survey.

Understanding the audit entity

To develop a basic understanding of the organization, the auditors should gather the following information.

The mandate of the audit entity

The entity might be an entire organization, department, or part thereof. It might be a program or an operation. It could be a major responsibility centre or a function. It could be within a central, provincial or local government or within an institution such as a hospital or university. The entity could be a Crown corporation or just a part of it.

Whatever the entity, the first thing the auditors should do is determine its mandate—its *raison d'être*. If the organization is part of a larger whole, then the overall mandate should be established, as well as the links, accountability and otherwise, between them. Unless this is done, the organization might well be examined out of context.

The programs and activities of the audit entity

The auditors should next identify the programs operated by the organization, the clients it serves, the program objectives and the general nature of the operations: inspections, advice, maintenance, and so on. It may be that the organization and the program are one and the same. This is more likely to occur where the entity is small or is part of a larger program, department, operation or function.

At this stage, a good understanding of the auditee's objectives and the strategies adopted to achieve them is important. Several audits have found, well into the detailed examination, that the key issue was in reality not operating-and-control procedures but the faulty working of the overall planning mechanism that had failed to identify truly appropriate objectives and the strategies to achieve them. Often, becoming satisfied on these issues at the outset can save a great deal of time and expense and help ensure a better and more productive audit.

How the audit entity is organized

The auditors should then identify the major responsibility centres within the organization and the manner in which they relate to the activities identified. In other words, "Who's in charge of what?"

Larger entities will also operate certain distinct support activities, such as financial management, materiel management, computer operations and human resource management, among others. In some cases, the program under audit will be very dependent on these support activities. For example, in entities requiring highly skilled staff, the staff training and recruitment functions are critical to achieving good performance. A clear understanding of the importance of such support services will ensure that they are given appropriate attention in the audit.

Resources

Next, the auditors should determine what principal resources (capital, materiel, information, people) are used by the organization and their distribution within it. The auditors should also determine what resources are unique to the organization (for example, scientists, laboratory equipment in a research environment) and account for the budget by both program and responsibility centre to ensure that none is missed.

Management climate

The auditors should then determine the management climate in the organization. Is good management encouraged and what evidence is there to indicate that?

Some indicators of a good management climate

- Effective internal audit
- The use of performance measurement techniques
- Recent productivity improvements
- Clear setting of objectives, goals and targets
- Program analysis and evaluation

The auditors must become acquainted with the key management processes, especially planning, control and evaluation. It is important for auditors to understand the structure and process for both long-term and operational planning.

Other influencing factors

The term *environment* is used to describe a variety of conditions that can influence the operation of a program or activity, and to which auditors must be attuned in performing their work.

Some Environmental Factors Affecting Performance

- ***Economic factors:*** **periods of restraint that may hamper service delivery, or unchecked expansion that can produce waste**
- ***Social factors:*** **high unemployment, technological change, climatic or demographic factors such as isolation often lead to decisions that are not based on considerations of economy, efficiency and effectiveness**
- ***Central agency requirements:*** **rules and regulations regarding personnel management, signing authorities and approval for certain expenditures are often cited as constraints to efficient and effective management**
- ***Presence of other players:*** **shared or joint responsibilities, complementary activities and the need for coordination often produce confusion and delay**
- ***Political intervention:*** **for example, an active involvement of members of the governing body that may not be consistent with good performance**
- ***Internal politics:*** **power struggles or frequent reorganizations that can have detrimental effects on people and results**
- ***Public interest or concern:*** **vocal and effective lobby groups or attention by the media that can influence decisions at the political and bureaucratic levels**

Prudent auditors recognize these issues early in the audit and take them into account in selecting areas for detailed examination, in assessing performance and eventually in forming their opinions.

The amount of information that auditors have available or can gather in the overview stage is often limited, especially if the organization to be audited is located some distance from the auditors' office. In such a situation, the auditors may initially rely on easily available documentation to gain a preliminary understanding of the organization. The auditors' understanding can be verified when the audit entity is actually visited in the survey stage.

Line of audit enquiry

Using the information they have gathered, auditors then make one of the first important decisions of the audit: they establish the breadth of the survey. The term used to describe the key components for examination in the survey is *lines of audit enquiry*. Lines of audit enquiry are the matters or areas selected for preliminary examination in the survey stage. They define the survey parameters. Possible lines of audit enquiry may include, but are not limited to:

- organizational activities or programs
- key support functions (such as finance, human resources)
- generic issues such as compliance with regulations or safeguarding of assets
- measurement of performance and results
- resource acquisition and utilization

Lines of audit enquiry will vary from audit to audit and that there is no single best way to develop them.

Factors To Be Considered In Identifying Lines of Audit Enquiry

- **Nature and relative importance of the activity**
- **Money and people involved**
- **Impact of the activity on the public or product**
- **Audit and management priorities**
- **Known problem areas**
- **Recent audits and reports**

Overall, the lines of audit enquiry should provide the desired coverage of the organization. Choices may have to be made at this stage, depending on the size and nature of the audit entity and the audit resources available. The difficult part is that these choices are often made with sketchy information. The selected lines of audit enquiry will establish the tone for the work to follow, as set out in the survey plan.

Survey plan contents

The overview report/survey plan should include a brief description of the organization, including its key operational characteristics and a description of the environment in which the organization operates. The broad areas of examination to be pursued—the lines of audit enquiry—should be included in the survey plan, with reasons for selecting them. The plan identifies individual survey projects. Usually, there will be one project for each of the lines of audit enquiry. In certain circumstances, however, it is possible to combine two or more lines of audit enquiry in one project. Survey project plans include the objectives of each project, key tasks, proposed resources and expertise needed and time budgets for each project to be pursued during the survey stage.

The survey plan should also identify the sources of the criteria that will be used in making a preliminary assessment of the organization under review (chapter 19 deals with audit criteria).

The survey plan serves as a useful tool to identify what areas will be examined, to control the examination of those areas and to communicate to an audit advisory committee (if there is one)—and ultimately to the audited organization—the intended plan of action.

The survey stage

The ultimate purpose of the survey stage is to develop a detailed plan for the conduct, control and reporting of an audit. During this stage, auditors make an analysis and preliminary review of the subject to design a manageable audit that deals with significant issues and fulfills the audit mandate. It is in this stage that decisions are taken about what is useful and practical to audit, and how that audit will be done.

Gathering information is crucial in both the planning and conduct phases of an audit. In the overview phase, the information needed is of a relatively general nature and may be found with relative ease. Indeed, if the auditors have had previous engagements with the organization, the information may already be present in the audit files. More specific information is needed as the audit progresses. It is useful to consider the techniques that auditors employ to gather the information they need.

Gathering information

Among the techniques applied to improve the auditors' understanding of how an organization functions, either in the planning or examination phases, the following are the most common:

- meetings and interviews with the personnel of the audited organization
- physical observation and inspection
- review and analysis of documentation (reports, manuals, and so on)
- modelling

Each of these techniques is briefly discussed below. The manner in which the information gathered is treated is examined in chapter 20.

Meetings and interviews

- Initial meetings should be held to establish contact and to inform officials of the nature and purpose of the audit.
- Individual interviews with senior staff can enhance the auditors' understanding of the organization and help identify and explain issues of interest and importance to the audit. These issues can be used for developing questionnaires to ensure completeness and consistency in the subsequent detailed interview process.

During the survey stage it may be necessary—and in the conduct phase it is almost inescapable—to interview people who are involved in the detailed delivery or administration of the program or function. Significant differences in understanding between these officials and their seniors can indicate a problem that warrants further examination. Good or poor morale may indicate the extent of regard for economy, efficiency and effectiveness.

Clients of the program or users of the services or goods produced often provide a useful perspective, as suppliers to the organization in certain circumstances. Consistent complaints, if deemed to be reasonable, may indicate areas needing examination. The client, of course, should be informed about such meetings and, indeed, may be helpful in identifying useful contacts.

Officials in other organizations with similar activities often help identify areas for detailed examination, broaden the auditors' understanding of the organization and suggest possible audit criteria. In some audits, it is important to obtain the perspective of officials in relevant central agencies. In other audits, this may be unnecessary.

Auditors of other, similar organizations can often share their experience and point to areas where significant problems or weaknesses may be found. They may also suggest, or help refine, appropriate audit criteria and approaches.

Outside experts in the subject matter being examined can offer insights and identify areas that deserve particular attention. They may also explain issues that puzzle the auditors and confirm or amend impressions about industry practices. This expertise is often so helpful that many comprehensive audits include experts from outside the office on multidisciplinary audit teams. Bringing this capability to the team can be important at all stages of the audit process, including: validating audit objectives and audit criteria; discussing the steps of the audit program; gathering and analyzing evidence; and developing the audit report. Choosing these resources, melding them into the team and providing appropriate supervision of their work is no simple task.

Attending special meetings and conferences that pertain to the specialized areas under scrutiny is also a practical strategy. As well as the information that practitioners can glean from such events, this is also a good opportunity to identify experts or specialists who, as noted above, can play a key role in the audit process.

Physical observation and inspection

Visits to the site(s) of actual operations furnish vital information, provided auditors are observant and know what to look for. Physical inspections allow auditors to acquire an understanding of physical processes, equipment utilization procedures, accounting operations, and so on. Personal observation can identify lack of regard for value for money if there is evidence of:

- a significant backlog of work;
- idle equipment and staff;
- outdated methods;
- poor working conditions;
- poor equipment condition.

Review and analysis of documentation

Management reports

Management reports provide a wealth of information to auditors. An assessment should be made about whether all the appropriate reports are produced. Existing reports should be analyzed in respect of the following:

- frequency and timeliness;
- financial results relative to the budget;
- output results relative to targets;
- efficiency and unit cost trends;
- attainment of, or contribution to, objectives; and
- distribution.

Internal audit and evaluation reports

Internal audit and program evaluation reports are invaluable for the auditors. These reports often identify potential areas of overlap in scope and scheduling of the audit. Past problems discussed in the reports may or may not require further attention. In addition, they can provide valuable insights into the working of the audited organization. Chapter 22 deals with the reliance that auditors give to these and similar reports.

Literature search

A careful review of the relevant literature gives the auditors an understanding of the historical developments of the organization and the general area in which it operates as well as of characteristic management control issues. The literature may also suggest relevant criteria that can be used in the audit.

Policy and procedure manuals

Auditors should review important manuals for clarity of instructions, delineation of responsibilities, levels of financial authority, and so on. These documents may also point to audit issues that should be examined and to audit criteria that can be used.

Other sources and documentation

In addition to the above, it is often be useful for auditors to peruse *Hansard* (the record of proceedings in the legislature) and any work that has been done by other auditors on similar organizations of activities.

Modelling

A useful way of documenting and understanding the organization is to use models or charts. Charts depict in graphic form processes and relationships that might be difficult to describe in writing. In addition to helping the auditors develop a better understanding of the organization, models are a useful tool for communicating the understanding and findings to managers and the audience for the audit. Three types of models are commonly used:

- program structure model
- key activity or program delivery model
- environmental model

Program structure model

Figure 3.2 shows the program structure of a national highway safety program. Note that the level below Program Components identifies the program outputs. Below Outputs is the hierarchy of objectives and intended effects. The diagram shows that the accomplishment of immediate objectives is expected to lead to the accomplishment of intermediate and ultimate objectives/effects.

Purpose of Program Structure Model

- TO PROVIDE AN UNDERSTANDING OF THE ORGANIZATION FROM THE PERSPECTIVE OF THE PROGRAM MANAGER
- TO DEPICT PROGRAM ACCOUNTABILITY RELATIONSHIPS
- TO FACILITATE UNDERSTANDING THE PROGRAM
- TO FLAG OTHER POTENTIAL AREAS FOR DETAILED EXAMINATION

The program structure model attempts to provide an understanding of the audited organization from the perspective of the program manager. It shows the program accountability relationships, including which objectives various program components can be held accountable to achieve. The primary purpose for preparing such models is to facilitate understanding the program and to identify related performance indicators of interest to management and the legislature or other governing body. Questions to pursue in relation to the elements contained in the model include: Are program components well defined? Are objectives/effects sufficiently precise? Are causal linkages plausible?

Finally, the model helps flag other potential audit issues such as potential problems for planning when objectives are vague.

FIGURE 3.2: PROGRAM STRUCTURE MODEL - HIGHWAY SAFETY PROGRAM

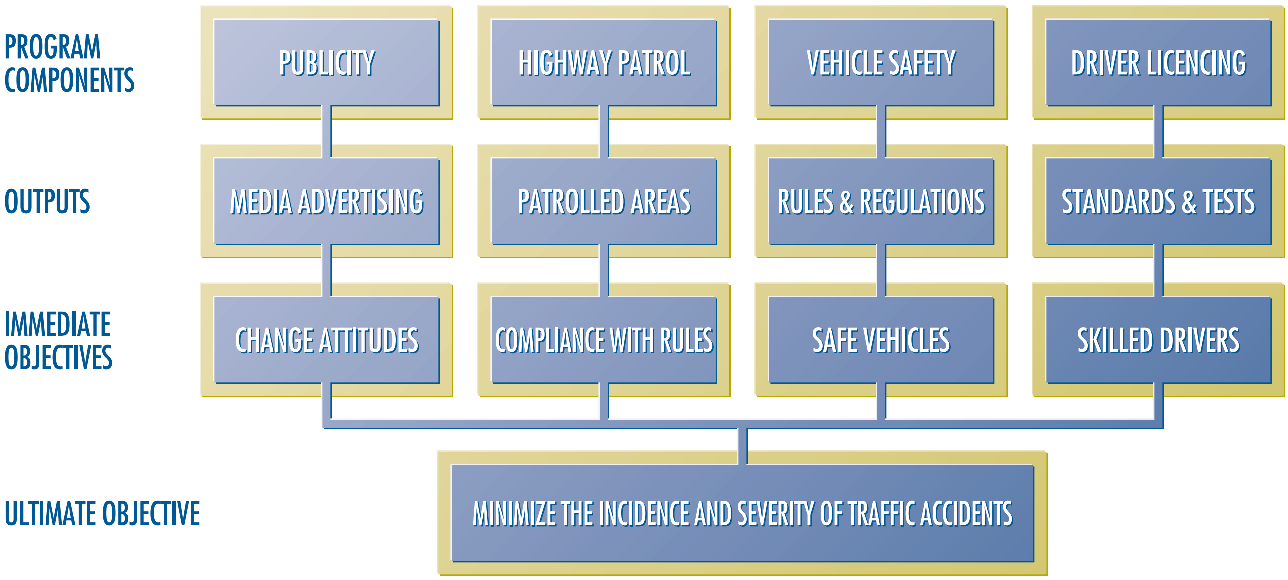
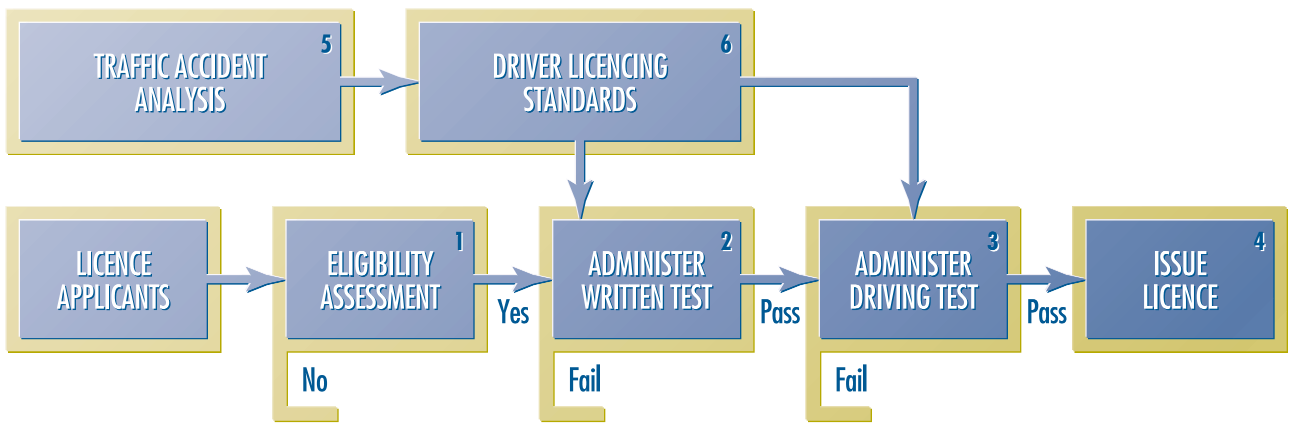


FIGURE 3.3: PROGRAM DELIVERY MODEL - DRIVER LICENCING



1. CLERICAL STAFF: DATA CHECK, INCLUDING COMPUTER
2. CLERICAL STAFF: COMPUTER ASSISTED
3. DRIVER EXAMINERS
4. CLERICAL STAFF
5. COMPUTER ANALYSIS OF ACCIDENT REPORTS
6. RESEARCH STAFF: PERIODIC PROPOSALS TO REVISE STANDARDS

Program delivery model

The second type of model that auditors can prepare depicts the manner in which the program is carried out in pursuit of the program objective. The main purpose of this model is to identify the key activities of an organization so that a later assessment can be made of the control exercised over them by management.

The flowchart (figure 3.3) illustrates the process for obtaining a driver's licence in a Canadian province. It depicts the major activities or decision points in graphic form and in the sequence in which they would normally occur, and makes it easier to understand the process and to communicate it to others.

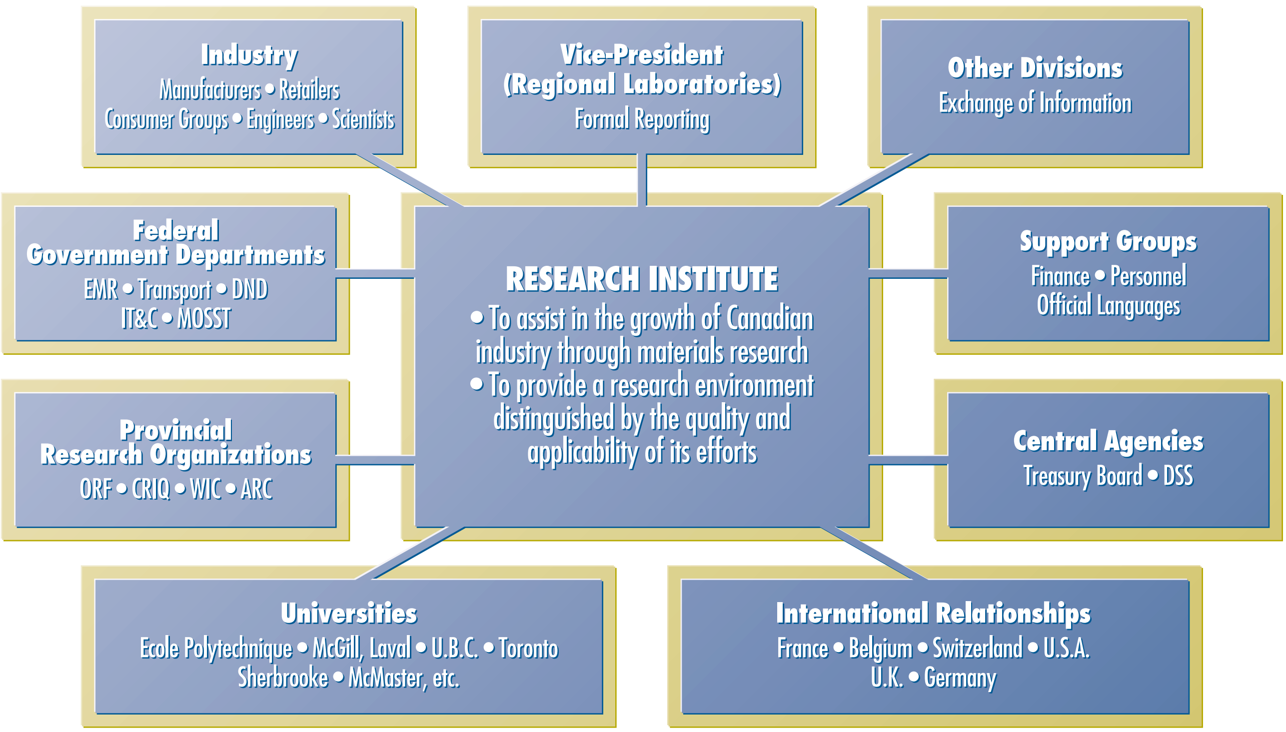
The model shows:

- the source of demand for the organization's outputs and how that demand occurs (people applying for driver's licences); it indicates if output is generated by demand or supply;
- processes/activities from demand to delivery of output, as well as key support activities;
- decision points and related responsibility centres; and
- the key activities—those on which the success of the program mostly depends (supporting documentation should be prepared explaining why they are key).

Environmental model

The third type of model that is helpful in understanding an organization is the environmental model. For the most part, this model depicts the various factors or elements that may influence the operations of the program. It is not necessary at this point to demonstrate the relative importance or impact of these factors—this will happen at the reporting phase. At this stage, it is sufficient to note that these factors exist and to take them into account during the examination. The example chosen for figure 3.4 is of a federal materials research unit.

FIGURE 3.4: ENVIRONMENTAL MODEL



Identifying audit issues

When the survey of the organization or portion under review is completed, and indeed throughout the survey stage, the auditors must assess the information they have gathered and select specific areas or issues for detailed audit testing. The following factors should guide their thinking at this stage:

- financial significance (materiality)
- major activity concerns
- adequacy of systems
- risk
- potential areas of waste/inefficiency or mismanagement
- relationship to organization-wide issues
- visibility and interest
- capacity to influence or control costs
- cost-effectiveness of audit

Financial significance (materiality)

Certain activities within an organization will represent a relatively larger portion of expenditures than will others. The questions of relative costs and materiality should be asked early, to identify potential areas for audit and to contribute to the auditors' understanding of the organization and its activities by focusing attention on areas of significant expenditure.

Major programs

A thorough review and understanding of the programs and objectives of the organization, and how they can be achieved, should indicate to the auditors which program components are key to the organization, especially from the point of view of the targeted client group. To identify audit issues early in the survey, it is advisable to address the activities that are or become important under changing conditions, and to understand why they are important.

Adequacy of systems

An evaluation of the planning, budgeting, control, management reporting and related systems against applicable regulations, guidelines and directives—and against good management practice—should disclose apparent weaknesses and/or noncompliance that may warrant inclusion in the audit.

Risk

In any organization or activity, certain elements are critical to its survival. These elements must be identified. Auditors should pay particular attention to components that could jeopardize the entire functioning or well-being of an organization or one of its activities. Often these are support functions such as EDP or training. Management's ability to control risks to these elements should be assessed as well as the reasonableness of the costs entailed in reducing risk. External risks, which might come from action or inaction by entities identified in the environmental model, should also be identified. To the extent that they can be influenced by the audited organization, they should be addressed in management's forecasting and planning processes.

Potential areas of waste, inefficiency or mismanagement

The auditors should also pay attention to areas that have been identified, either by management or other sources, as containing known or suspected errors or problems. Indicators of such areas include:

- *financial problems:* disparity of budgeted to actual expenditures; heavy year-end expenditures; duplicate payments or overpayments; large write-offs of accounts receivable
- *human resource problems:* poor morale, variously manifested; inadequate or inappropriate organization and assignment of responsibilities; excessive use of consultants or overtime

- *physical resource problems:* underused, unused or obsolete equipment; surpluses or shortages of, or long waits for, materials; inadequate or excess space; scanty documentation of procedures for major acquisitions
- *EDP problems:* proliferation of equipment types; software/hardware imbalance; high downtime and maintenance costs; overuse of consultants; user complaints
- *other areas:* complaints from clients; absence of targets; missed deadlines; lack of performance measurement.

Relationship to organization-wide issues and concerns

When attempting to identify audit issues, the auditors should be aware of both current and impending organization-wide concerns; for example, particularly intricate labour negotiations.

Visibility and interest

Certain elements or activities in an organization may have a high profile resulting either in adverse or positive publicity. Management may wish to avoid adverse publicity by carefully controlling and monitoring these activities. For example, in an industrial situation, management's actions (or inaction) regarding industrial pollution could result in increased interest in the organization. Auditors must take these sensitivities into account when deciding on areas for further examination.

Capacity to influence or control costs

Management's ability to influence or control costs should be considered when selecting areas or issues for audit testing. Although certain activities may result in significant costs in absolute terms, auditors should focus attention on those components that management can change. For example, total land acquisition costs may be a large part of an organization's budget, but management may have limited discretion over the bulk of these costs. The auditors could, however, examine whether all reasonable alternatives had been reviewed and reported to authorized decision makers.

Cost-effectiveness of audit

Some areas or issues may appear important, but are very difficult or costly to audit. Auditors must assess the special skills and resource levels required to conduct the audit in selecting audit issues.

Developing the survey report

Purpose of the survey report

The product of the survey stage is the survey report, which includes an audit plan. The audit plan comprises a number of audit projects, usually—though sometimes fewer than—one for each identified audit issue. The survey report serves the following purposes:

- to communicate an understanding of the audited organization
  - *among the team members*—it is important that all team members have an opportunity to contribute to the survey report to ensure consensus and that each auditor's knowledge and information about the organization is shared with colleagues
  - *to audit superiors*—to communicate what the audit team has accomplished to date, what further work it is proposing and at what cost
  - *to the organization*—to inform them of the work done, preliminary assessment and areas for detailed examination, and to solicit their reaction to the focus and direction of the audit
- to identify critical elements that warrant further examination and the justification for pursuing them
- to display an audit plan

Contents of the survey report

The survey report should contain the following elements:

- audit objective and scope;
- brief explanation of programs/activities surveyed, including program structure, delivery and environmental models;
- identification of environmental/organizational factors and constraints;
- areas for detailed examination and rationale supporting the selection; and
- audit plan, comprising a number of audit projects.

Audit projects

Each proposed audit project should be written up in detail. The description of each project should provide:

- audit objective;
- audit criteria;
- nature of the evidence to be sought;
- methods to be used to gather and analyze the evidence; and
- resource requirements.

It should be noted that the level at which an audit opinion is expressed varies in practice. In some cases, an opinion is provided on each audit project and all the projects are bound together into one report, but one overall opinion is not produced. In particular, this would be the case where the sum of the parts that are being audited does not equal or cannot be reasonably interconnected to form the whole. But where, deliberately so, the sum of the parts does equal the whole, it becomes feasible to provide an overall opinion.

The conduct phase

To achieve audit objectives, the conduct phase involves gathering and evaluating information to compare actual practices or operations against criteria, and to obtain sufficient, appropriate evidence to support any opinions and recommendations that will eventually be reported. Where significant deviations from criteria are identified, the underlying cause and effect will be determined during this phase of the audit.

As already mentioned, the preparation of the audit plan and elaboration of audit projects is the final step in the planning phase. The first step of the examination phase consists of preparing detailed audit programs for each project to guide the work during this crucial part of the audit.

Audit programs

An audit program is a list of procedures to be performed to compare existing systems and/or management practices with audit criteria and to collect evidence to support audit observations.

In the survey report, the auditors developed audit projects with specific objectives and criteria to test for. These are the same elements that carry forward to the audit program. The task now is to specify audit procedures that will allow determination of the actual state or condition of a management practice or control. Comparing the observed condition to the mutually agreed criteria will generate a finding, either positive (criteria are met) or negative (criteria are not met). The audit program should indicate the time and resources budgeted to complete it.

Audit procedures

Audit procedures are the tests that auditors perform to give the necessary degree of assurance that specified audit criteria are, or are not, being met. These procedures could consist of interviews, inspections, analyses of data, confirmations, comparisons, and so on.

Specific audit procedures should provide answers to the following questions about the task to be performed:

- when?— time frame, period, sequence, relationship with other procedures
- who? — individual or team that will carry out the audit procedures
- how? — interview, review, examination, calculation, analysis, comparison
- where? — location: H.Q., division, in Canada, overseas

The type of audit procedure used will vary, depending on the particular subject, the purpose of the procedure and the type of evidence available. For example, to test adherence to the eligibility criteria in offering financial assistance to a manufacturer, auditors would examine the relevant information given on application forms and compare it to the eligibility criteria used by the organization in granting assistance. In other words, a review of the applications on file would be sufficient for testing in this case and would become the audit procedure.

But to determine the efficiency of building maintenance, auditors would have to examine all the relevant factors that have an effect on efficiency. For example, the number of employees used, the standards established, the maintenance methods used, the level of service and the amount of work carried out will all affect the efficiency of maintenance. The audit procedures used in this case would involve: collecting relevant information through interviews, reviewing reports and guidelines, on-site inspection and analyzing the information collected; calculating performance ratios (output/input); and comparing these ratios with those of other buildings.

Difficulties in developing audit programs

Until comprehensive auditing becomes a universal practice, auditors will frequently find themselves breaking new ground. They have to develop criteria that are appropriate and acceptable to management. The objectives for many comprehensive audit projects tend to be specific to the organization audited, with few established audit criteria understood by both auditors and auditees. In such circumstances, auditors must proceed with great care in developing audit programs and recognize that substantial flexibility and judgment will have to be exercised. In some instances, the auditor may not be able to establish criteria to which the client's management will agree. If differences cannot be resolved, it may be up to the auditor to select suitable criteria (using such sources as legislation, policy and program documentation, similar entities/ programs, standards of good practice) and proceed.

Most audit programs will have to be tailor-made for each project in order to address properly the objectives, criteria and operations unique to each audit. This also implies that the audit programs developed have to be flexible, evolutionary documents that are revised and improved as auditors gather more information.

Another difficulty with these types of programs is the breadth of the areas that they cover. This increases the possibility of more than one auditor examining the same subject area. For example, two auditors may analyze the same report or interview the same department head, but for different purposes. This suggests that the senior members of the audit team will have to pay particular attention to the possibility of duplication or overlap when reviewing audit programs. They should seek to make the audit as efficient as possible while minimizing disruption to the audited organization.

Evidence

Much of the detailed examination phase of the audit is devoted to collecting evidence. Evidence is defined *inter alia* by the *Shorter Oxford Dictionary* as "Ground for belief; that which tends to prove or disprove any conclusion." Collecting and using evidence is an essential part of the auditors' task, and is dealt with in some detail in chapter 20.

Audit files and working papers

Auditors keep a detailed record of the evidence they collect and the work they do. This material supports the audit findings, conclusions, recommendations and opinions. The Office of the Auditor General of Canada has adopted the following policy:

> Audit Principals should satisfy themselves that audit files document all important matters which support the content of the report and which demonstrate that the audit was carried out in accordance with the audit and examination policies of the Office.[262]

The following are among the Office's *Comprehensive Auditing Manual* guidelines:

Audit files should be:

- complete and accurate, showing the nature and extent of the audit work and providing proper support for audit decisions, findings, conclusions, recommendations and opinions;
- concise, clear and complete, without requiring supplementary oral explanations;
- pertinent, containing only information that is relevant, important and useful to the objectives of the audit; and

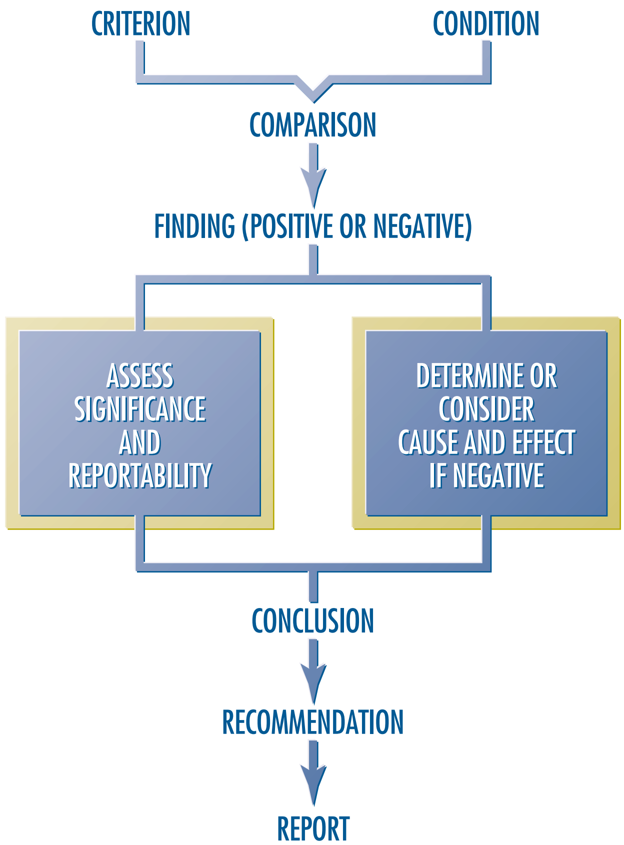
Audit files should clearly state the objectives of the audit, and the reasons behind specific audit procedures or tasks and their relation to the audit objectives. Anyone later using working papers kept of file should be able to readily determine their purpose, the nature and scope of the work, and the conclusions.

All team members should ensure that audit files contain sufficient but not excessive evidence to support audit findings, conclusions and recommendations and that the files record the nature and extent of supervision and review.

All written communication with the audited organization should be filed appropriately in the current working papers, the permanent file or the correspondence file, depending on the nature of the communication.[263]

Other offices have similar policies and guidelines to ensure that high professional standards characterize their work.

Figure 3.5: Audit Process



Audit findings

When sufficient, reliable, relevant evidence of performance is obtained, auditors compare that performance to the predetermined criteria to come to an audit finding. Once an audit finding has been developed, two complementary forms of evaluation take place: first, assessment of significance and reportability; and second, determination of cause and effect.

Significance

The significance of an audit finding should be assessed using four factors: the size of expenditure or revenues; impact (social, economic, environmental); sensitivity; and risk. The inclusion of sensitivity and risk as factors indicates that significance is not absolute. In many cases, a final decision on whether a finding is significant will not be made until all evidence has been gathered.

Where a variance from a criterion has been found, both the size of the variance, if it can be quantified, and the frequency of occurrence must be considered in determining whether the audit finding is significant. It may be obvious that an error that has been discovered or a minor weakness in a system that has been identified, is an isolated case and are not symptomatic of a larger problem. Unless other related errors or weaknesses are found during the audit, insignificant findings will not be formally reported, although in most cases they will be mentioned informally to management. The eventual determination of whether a finding is significant is based on the exercise of sound professional judgment when all the facts are known.

A negative finding may lose significance if the condition is already known to the audit client and steps are under way to correct the situation. Recent reporting of the same or similar findings may also decrease significance.

Reportability

Findings may be significant in size and importance, but may not be reportable.

A finding may be outside the mandate of the auditors. Findings of this nature are often discovered incidentally, rather than by a deliberate comparison of evidence to the criteria established for the audit. While it may be an interesting finding, if it does not relate to the audit subject, auditors are clearly going out on a limb if they do not respect the established audit boundaries or scope. Such findings should be mentioned to management, but probably not included in the auditors' formal report.

Some findings could be sensitive for political, security or other reasons. Auditors should proceed with extreme caution in such circumstances, ensuring that their superiors are advised at all times.

Cause and effect

The cause of a finding is the reason that there is a variance between the condition that the evidence shows and the established audit criteria. It explains why something happened and forms the basis for any constructive recommendations for correction. Auditors should be able to demonstrate a clear link between the cause they have identified and the problems (effects) they have observed or anticipate.

There may be several causes for each finding. For negative findings, auditors need to identify the cause that, if changed, will prevent similar findings. In some instances, the cause may be outside the control of the organization under audit.

The effect of a negative finding is the measure of the problem created by the identified cause. It can be either quantitative (for example, dollars, person years, time) or qualitative (for example, lack of control, poor decisions). To warrant reporting, an effect should be sufficiently serious to justify, on a cost/benefit basis, the action required to correct it.

The effect may have occurred in the past, may be occurring now, or may occur in the future. If the effect occurred in the past, it is important to determine that the situation has not been remedied to prevent it from recurring.

A word of caution: While the analysis of cause and effect may be helpful in piecing together and making sense out of a series of random observations, the analysis should not be regarded as a puzzle with only one solution. Cause-and-effect chains tend to overlap and merge, often making it difficult to establish clear relationships.

The following is an example of an audit finding from a recent audit. The project is highly technical, requiring state-of-the-art equipment.

Cause-and-effect Example

The department has identified $1.5 billion in additional costs related to the capital project to buy a fleet of submarines approved by Treasury Board. The project is being contained within the approved budget by charging these additional costs to operations and maintenance.

Possible causes:

- Project exceeding budget
- Life-cycle costing problems
- Fixed-ceiling funding and technological uncertainty
- Natural desire to want as much as you can get

Possible effects:

- Misleading Parliament
- Misappropriation of funds
- Contradicts Treasury Board guidelines
- Lack of due regard by buying major equipment items without adequate spares
- Drainage of the department's budget

Audit opinions

When the cause and effect of an audit finding have been satisfactorily identified, auditors come to an opinion, either positive or negative. It represents the evaluation of the audit finding based on the available evidence.

In some cases, although they may have found a major weakness, auditors may have determined that management has already planned measures to correct the weakness. In this situation, if they are satisfied that the proposed actions will be effective (and may, in fact, be the actions that they would have recommended), auditors would state the weakness observed, the proposed corrective action and estimated implementation date, but would not necessarily state an opinion or recommendation.

The opinion should sum up the evaluation of the audit finding. It should not be a restatement of the audit finding but an argument for a change that will bring about a needed improvement.

If the opinion is clearly stated, the recommendation often becomes self-evident. If unclear, the rationale supporting the recommendation may be unconvincing.

Recommendations

Comprehensive auditors may provide recommendations where significant adverse results have been identified associated with a negative audit finding. Doing so can help the reader focus on matters of particular importance and may increase the likelihood that observed deficiencies will be corrected. Such recommendations will not be required where the opinion is positive and auditors have found no significant deficiencies.

The purpose of an audit recommendation is to state what improvements are needed rather than to indicate specifically how to achieve them. Unless they take this approach, auditors may find they have a conflict of interest if they subsequently audit processes they have recommended. This approach also allows management to determine the most effective solution, which is their role.

Auditors must consider the following questions in developing recommendations:

- Can management control the factors or causes of the problem?
- Is the recommendation practical and feasible? Has the suggested solution been tried successfully elsewhere? Are the necessary resources and expertise available?
- Is the recommendation consistent with similar recommendations in the past?
- Is the recommendation consistent with internal and centrally imposed guidelines?

The comprehensive audit report

The report is the end product of the audit. While the process of auditing may itself have added value, the report is the most tangible output. It is what the client is most interested in seeing; it is what the auditor has to offer. No matter how careful and complete the audit examination has been, it will be of little help to the client and no credit to the auditor if the report is poorly prepared and presented.

The CICA's *Value-For-Money Auditing Standards*, reproduced in chapter 23 (standards and quality assurance) provides substantial guidance to practitioners in respect of their audit reports. There is no attempt to duplicate that material in this chapter, and readers are urged to read the relevant paragraphs of the *Standards* in conjunction with the information provided here.

Once the audit examination work is completed and the evidence has been analyzed, the reporting phase starts. In reality, the report develops and reporting continues throughout the audit as issues become clearer. A full discussion of the report structure by members of the audit team should signal the beginning of the formal reporting phase. The presentation of the final, formal report is the last step in an ongoing process. This section, as has most of the previous material, is based on the traditional reporting model for conducting comprehensive audits, although most of the principles apply to the other approaches.

Communication with management

Throughout the audit, starting from the first interview, the process of reporting is under way. At least for those who will have to deal with the results of the audit—the auditee's management—the reports of progress of the audit are an integral part of the reporting process. By the time the auditors are starting to prepare the formal report, at least the managers most directly affected should have a general idea what the final document will contain.

As findings emerge and the audit process moves closer to the stage of report writing, it is appropriate to shift what earlier may have been a relatively informal mode of communication between the auditor and management, to a progressively more formal one.

If the report is to be of maximum benefit, it must contain no surprises. This means that senior management should be given an opportunity to see the draft report before it is either finalized or released.

The prime reason for exposing the draft report to management is to ensure that the facts it presents are accurate. These facts should be checked with the managers directly concerned, since senior managers, who are not usually familiar with all the details, will want to be assured that there are no misrepresentations in the draft. A second reason is to allow management to review the opinions and recommendations and offer their suggestions. This is an important step, even though the facts, opinions and recommendations may have been discussed with them informally beforehand. The actual wording of the report is important because the manner in which material is presented in the draft may have implications that are both unknown and unintended by the auditors. It is important, therefore, for auditors to get the benefit of management's views on the presentation of the material in the final report. Done appropriately, this will in no way compromise the auditors' independence.

Another reason for exposing the draft report to management is to give them an opportunity to prepare their comments on the opinions and recommendations slated for inclusion in the final report and to develop plans to deal with those items on which implementation can begin. While it is desirable that there be unanimity on opinions and recommendations, it is too much to expect that this can always be achieved. Courtesy alone dictates that management should have a chance to review and comment on the draft and to prepare any rebuttal or comment they think appropriate. Affording management this opportunity also helps ensure that they will maintain a positive attitude towards the audit and its ultimate findings.

A word of caution: although it should be the objective of all comprehensive auditors to gain maximal cooperation from the auditee, they cannot always overcome some natural resistance. Auditors may find that the auditee procrastinates in returning comments and may even jeopardize the auditors' reporting schedule. Accordingly, it is best if auditors allow an adequate but definite time for management to comment on the draft report. Once the timetable is established, it should be adhered to unless there are sufficiently convincing reason for auditors to change it.

Point-form report

The usual first step towards the final report is the preparation of a point-form report. A point-form report is not intended to be a polished document; it is intended to be clear, concise and simple. This report is a listing of audit findings that the project leader thinks should be brought to the attention of management, including matters thought to be of sufficient import to interest the client governing body.

The point-form report presents findings in relation to audit objectives and criteria, and for each finding includes a description of audit evidence, causes and impact, opinions and recommendations. This report should be cross-referenced to the audit working papers and supporting evidence. The point-form report can be for one audit project or for the entire audit, depending on the size.

It is important that the point-form report be thoroughly challenged internally to ensure that findings are sound. One technique is to arrange formal internal challenges within the audit team (each member challenging the other's finding). In addition, members of an advisory committee or the head of the audit unit could challenge reports.

It is expedient to use the same point-form format in subsequent oral or initial written presentations of audit findings to management of the audit entity. As mentioned above, the information presented must be clear and concise, and must contain convincing support for the opinions and recommendations. It is at this time that the audit team can vet its opinions and recommendations and get an initial response from senior management.

The final report

From the point-form report, the audit team leader prepares the draft of the final report, keeping in mind the matters discussed earlier in this chapter and the CICA *Standards*. Findings considered to be of lesser importance can be written up in a management letter. This allows the formal report to concentrate on the main points and to present them in a crisp, succinct fashion.

Writing the final report is often the most difficult part of an audit. Weeks, and often months, of work must be summarized in a short document that presents in a clear and objective fashion the major observations the auditors want to bring to the attention of the governing body.

Since these pages are often the only visible and tangible evidence of the auditors' work, and because their credibility and usefulness to the organization will be judged thereon, it is vital to take great care in preparing this report.

Make this report shorter—and more detailed.

Winston Churchill

The report should be so written as to reflect accurately a clear understanding of the audit entity, its environment and key people. It should bear the hallmarks of truly professional reporting: it should be written in a style and with wording that minimizes the chance of its being misunderstood by the intended reader: it should be clear, objective, fair, reasonable and persuasive. To the extent possible, auditors should try to make their reports interesting—many audit reports fail to be read, or are only partially read, because they lack substance and imagination.

In preparing reports, it is well to keep in mind the interests of—and constraints on—the client. Many members of governing bodies—legislators, for example—are exceedingly busy people who receive vast amounts of material to read and digest. It is unrealistic to expect them to read more than they actually need to know. Brevity, without sacrificing completeness, will increase a report's appeal and utility.

If good communication has been maintained throughout the audit, auditors should know whether management is aware of the findings and is planning or organizing to remedy the weaknesses identified. If management is taking corrective action, the draft and final report should say so, even if it is too early to assess the efforts or to predict their results. Such actions should, of course, be verified when the draft report is reviewed with management.

In some jurisdictions, it is the practice to offer management an opportunity to have their comments on the findings, opinions and recommendations included in the final audit report. In other jurisdictions, management issues separate reports on the auditors' comments.

After submitting the final report, auditors are invariably given an opportunity to discuss it with the governing body or some of its members. This may be a session with the full council or board, or meeting(s) with a public accounts committee or audit committee of the board. Careful preparation will make such meetings productive, and many auditors make liberal use of visual aids for their presentations.

Management letters

During their work, auditors often—even usually—find matters that they think should be brought to the attention of management but that are not sufficiently important to mention in the final report. These matters are customarily the subject of a separate report to management. These reports are analogous to the management letters that are normally provided at the conclusion of an audit. There are, however, some differences that deserve comment.

The traditional management letters are usually concerned with detailed matters of internal control, typically of a minor nature. They are relatively succinct, providing little if any background, analysis or explanation, and they are normally of interest only to financial officers.

Such is not the case with management letters of comprehensive audits. These reports deal with a wide range of issues of interest to many, if not all, senior managers. The reasons for some opinions and recommendations may not be self-evident without appropriate background information. In addition, most managers will not be as familiar with the process as are financial officers with a financial audit.

Management Letters

- POINTS OF LESSER SIGNIFICANCE
- MAY BE REPORTED DIRECTLY TO THE MANAGER CONCERNED
- RESPONSE IS OPTIONAL

As a result, the management letter should be both understandable and professional. Many managers will not be familiar with technical audit language, and the report should be written with its reader in mind. Its organization should be such that it assists readers to find and deal with the subjects that interest or affect them. It should clearly present opinions and recommendations framed in such a way that they can be dealt with expeditiously within the audit entity.

There is some variety of practice concerning reports to management. One approach is to provide the chief manager (deputy minister, executive director, and so on) with a short summary report. These officials are interested in the overview, not the details that they leave to subordinates. These summaries touch on only the most important findings and recommendations, and it is these that are discussed in the exit interview with the auditor. All the other more detailed material is submitted to the managers responsible for the items involved. It has been found that this approach has helped ensure that the exit interview does not become bogged down in a discussion of minutiae and that the chief executive will direct his or her attention to those matters that are truly important. Other practitioners provide a single report that covers all items that the auditors consider suitable.

Management letters may or may not require a response by management, depending on accepted practice in the relevant jurisdiction.

Following up

Most legislative audit offices make a practice of periodically following up on the recommendations they have made in order to assess what action has been taken and to report back to the legislature. The extent and timing of audit follow-up is based on an assessment of such factors as whether the audit conclusions continue to be applicable, what management is saying about the actions they have taken, and the amount of reliance that can be placed on the work of others. Frequently, the detailed follow-up is done by the internal audit staff of the audit entity, with the legislative auditor providing a more cursory check later. Such follow-up and reporting is considered particularly useful by legislative bodies and public accounts committees.

CHAPTER 18

COMPREHENSIVE AUDIT— REPORTING ISSUES

INTRODUCTION

Over time, auditors have devised a standard format for their reports on financial statements. Any departures from that format signal to the reader that something unusual is involved that is worthy of note. This is not the case for comprehensive audit reports, and may never be. The reason is that there are variables involved in these audits and, unless they are specifically dealt with, readers might draw the wrong conclusions from the report. This chapter explores how auditors should deal with these matters. It also discusses the concepts of fair and balanced reporting and audit recommendations, issues that have received careful attention by practitioners.

In chapter 16 (General Considerations) three key variables were introduced—independent but interrelated—that affect and distinguish comprehensive audits: scope, intended level of audit assurance and significance. These variables pose serious challenges for practitioners as they prepare comprehensive audit opinions. As explained:

- *Scope* refers to the breadth and depth of the audit.
- *Intended degree of audit assurance* refers to the confidence that auditors have in the accuracy of the opinions expressed in their reports.
- *Significance* determines what auditors decide to report and what not to report.

SCOPE

As explained earlier, comprehensive audits may cover a variety of subjects, a variety of scopes. They may deal with entities large or small, with organizational units or management functions. Scope must be decided by the auditors, preferably in consultation with the client. A further aspect of scope is the time period covered by the audit. Closely related to scope is the issue of the audit objective, which concerns the nature of the audit information the auditor intends to report to the client.

Because each comprehensive audit is unique, it is important for users of a comprehensive audit opinion to know what the scope of the audit was. Indeed, the CICA *Value-For-Money Auditing Standards* require comprehensive audit reports to describe the objectives and scope of the audit, including any of its limitations. The standards thus recognize not only that auditors should exercise their judgment as to scope, but also that they have a professional obligation to describe the scope of the audit so that the users of their reports are not misled or left to make wrong inferences from the audit opinion.

Since the requirements of the *Standards* are clear, and those requirements are reproduced in chapter 23 (Standards and Quality Assurance), it is not necessary here to elaborate on the issue of reporting scope. The reader is urged, however, to read the relevant section of chapter 23 in conjunction with the material presented here.

ASSURANCE

As described above, *intended degree of audit assurance* refers to the confidence that auditors have in the accuracy of the opinions expressed in their reports. Because the scope of comprehensive audits varies, as does the detail in which examinations are made, there is bound to be variation in the degree of confidence that practitioners will have in the opinions they express in their reports. One must conclude that there is no right or wrong intended degree of audit assurance for comprehensive audits. There are, however, issues to examine.

The central issues dealt with here are the clarity of communication by auditors to clients on the intended degree of audit assurance and the risks that attach to decisions based on audit opinions. Before examining these issues, it will be helpful to consider the concept of association, because, as mentioned earlier, when auditors are associated with information, readers tend to place more reliance on it than if no auditor had been involved.

About association

One of the keys to dealing with the concept of assurance in comprehensive auditing is the well-established notion of association. Auditors, including comprehensive auditors, become associated with information by their involvement in reporting on or preparing that information.

In the vast majority of comprehensive audits, auditors themselves have actually compiled and synthesized most of the performance information that is presented in their reports. In logic, therefore, as well as in practice, this results in the strongest possible association with the information.

Although auditors have no control over third-party assumptions about their involvement with information, or how others represent their involvement with information, auditors can control how they associate themselves with information.

The *CICA Handbook* deals succinctly with association:

> When a public accountant associates himself or herself with information by performing services in respect of that information, the public accountant should appropriately communicate the nature and extent of his or her involvement with the information when such communication is required by the Handbook, or when he or she determines that a communication is necessary to avoid misunderstanding.[264]

When public accountants describe the nature and extent of their involvement through their reports, they are communicating the extent to which readers should place confidence in the information contained in those reports or in the information to which they pertain. This should hold in comprehensive auditing too—comprehensive audit reports should communicate the nature of the auditors' association with the information referred to or contained in them. If the nature of association varies from audit to audit, this should be evident from the auditor's communication. If the nature of association is constant, that too should be stated. This should be done in such a way that readers will have a proper appreciation of the extent to which the auditors themselves have confidence in the accuracy of the opinions expressed in their comprehensive audit reports.

Implications

The assurance implications of reports based on different approaches to comprehensive auditing are worth examining:

Prevailing practice based on audit criteria

It is common for auditors, in conjunction with the client and/or management, to set criteria and then report whether or not, or the extent to which, they have been met. Where criteria have generally been met, the audit opinion will say so and give a positive assessment of the organization or program audited. Where the criteria have generally not been met, the auditors' opinion will likely lead the reader to conclude that the organization is not well managed.

If an organization is poorly managed, auditors may find that all their opinions are negative, and the resultant report will resemble an exception-based report. The difference in assurance that the reader legitimately may draw, however, is profound. In an exception-based report, the reader should not assume anything beyond the reported items. The readers of reports based on performance criteria can legitimately derive a degree of assurance that all significant opinions, good and bad, about the area subject to audit have been reported.

Prevailing practice tends to be for auditors to present their opinions without addressing the issue of risk of error even in cases where the risk of error in the opinion is variable.

Over time, auditors have come to have considerable confidence in their findings using audit criteria. This has, on occasion, led them into making broad statements about the quality of administration of other parts of the organization that have not, in fact, been subject to the same detailed audit. In effect, the auditors assess the results of audit tests from various sources and then form broad opinions at the highest level. The following is an excerpt from the 1988 report of the Provincial Auditor of Ontario.

> It is difficult to establish measurable criteria against which the overall administrative performance of government can be assessed. Consequently, we do not have the necessary audit evidence on which to base such an assessment. Nevertheless, we are not without some conviction in the matter.
>
> We believe that professional training and years of experience enable us to recognize good management and to understand good management practices. We also believe that through our long audit association with government, we have a good understanding of the nature of government and its operating environment. Based on these factors, it is our opinion that the Government of Ontario is being satisfactorily administered overall.
>
> While there will always be instances of weaknesses and deficiencies in operations of the scope and size of the Ontario Government, it is our view that these are the exception rather than the rule, and that on balance, administration of public funds continues to improve.[265]

Note that the opinion is very carefully worded to caution readers that it is not entirely supported by audit evidence. This should make the reader realize that the auditor intends that readers draw something considerably less than normal assurance from his or her opinion. This is a good example of an auditor being clear in communicating the nature and extent of the work performed on information with which he or she has been associated.

A final point deserves mention concerning these types of reports. Some practitioners believe that readers will derive more assurance when the auditors do the reporting directly than when they attest to accountability reports prepared by management. This view is held even though it is generally acknowledged that management is in a better position to provide accountability information. The reason for this view is simple: it is the greater trust that readers presumably place in auditors. Readers expect that auditors are expert in auditing. Add to this the expectation that auditors are objective and independent, and it is logical to assume that the information they provide is even more reliable than information prepared by management and attested to by the auditor. The result is that readers are probably deriving a high degree of assurance from the criteria-based reports prepared by auditors. This underlines the importance of ensuring that the reports clearly state the auditor's intended degree of audit assurance.

The CICA *Value-For-Money Auditing Standards* require that auditors communicate, in their opinions, the scope of the audit work undertaken and their audit criteria. Nevertheless, scope is itself not the determinant of the degree of assurance that auditors may wish their clients to derive from the information contained in this type of comprehensive audit opinion.

Because there is no one generally understood norm for the degree of assurance that should be derived from a comprehensive audit, and because the breadth and depth of such audits vary widely, the opinion pursuant to each audit is unique. Without some form of readily understandable and distinct communication in the report on this matter, there is a danger that the readers' expectations of the opinion will be unjustified.

To avoid this danger, comprehensive audit reports should indicate, as clearly as possible, the intended degree of assurance that auditors want readers to derive from those opinions.

Special examinations

The 1984 amendments to the Financial Administration Act have provided comprehensive auditors with significant challenges, one of which is implicit in the legislation: it is looking for consistent levels of assurance from the examinations of all the Crown corporations. Another challenge has to do with scope and is explicit in the legislation: examiners have been asked to provide opinions on performance matters that cover the whole Crown corporation and its subsidiaries.

Despite the breadth of opinion required of the examiner, and the legislated obligation that the opinion indicate "whether in the examiner's opinion… there are no significant deficiencies," this form of comprehensive audit reporting essentially falls into the same generic category as that described in the preceding section.

Attestation reports

At the time of writing, experience with comprehensive audit attestation opinions is limited, although there are some examples.

There is no question that comprehensive auditors in this mode will be in a position to provide opinions from which assurance will be derived. After all, management will make representations and auditors will attest to their fairness. The scope of the audit will be driven by the breadth of operations or transactions to which the representations apply. This, in turn, will be determined either by legislation or other authoritative forms of mandating, or through an agreed understanding with the client.

The key questions in the evolution of comprehensive audit reporting practice in this area are whether the intended degree of assurance that auditors will ascribe to attestation reports will be the same as for the other forms of reporting they use, and the extent, if any, to which it differs from the intended degree of audit assurance of financial statement attest audits.

Again, there is no single degree of intended audit assurance that can be postulated at this time. There may never be. The diversity in nature, size and complexity of organizations that may eventually come to make representations on their performance, with corresponding audit opinions, suggests that the intended degree of audit assurance will likely vary from one audit to the next.

It is therefore important for auditors to communicate the intended degree of audit assurance so that, by appreciating as clearly as possible the extent to which the auditors have confidence in their opinions, readers can avoid reaching wrong conclusions.

Reporting "instances"

As previously described, this approach, although the first to have been used to report findings on the 3Es, is now a much less prevalent form of practice.

As used here, the term *reporting instances* is meant to have a specific meaning. It refers to instances of deficiency that an auditor has simply come upon in the course of his or her work, not the product of a planned, criteria-based approach as part of a comprehensive audit. Although it might look to the reader to be the same as exception reporting—in the sense that both may be reporting deficiencies—it is not. The latter is based on such a systematic process.

Reporting instances was a form of practice most frequently used prior to the introduction of legislated comprehensive audit mandates. Once formal mandates were introduced, however, auditors quickly began to take a more systematic approach to their work in the 3Es area and adopted the use of predetermined audit criteria. Nevertheless, from time to time, the *reporting instances* approach is used, and thus it is important to examine its implications.

In this form of reporting, no opinions are reported beyond those that pertain to specific deficiencies identified. An important issue of association arises, one that is closely linked to audit scope. In fact, the issue relates more to the auditors' association in the context of the scope of the audit than to the intended degree of audit assurance. The issue is: did the auditors set out to find all the deficiencies that might exist and report them, or did they simply report what was found regardless of the scope of the audit and the rigour of their approach?

The assurance derived is from what is explicitly stated. Certainly the reader will receive explicit information that, in the opinion of the auditors, economy, efficiency or effectiveness was not obtained in certain instances. The reader could also reasonably derive assurance that the information on the reported instances is accurate because the auditors—professionals with expertise, independence and objectivity—have brought the deficiency to light and have been rigorous in collecting and analyzing relevant evidence. Thus, the intended degree of audit assurance with respect to the specific deficiencies reported is high.

Readers may, however, draw inferences from what is not in the report. For example, a reader may assume that the auditors have listed all significant deficiencies or instances in the report and may then conclude that everything else within the organization is effectively managed. This type of thinking has been called "nothing said, all's well" by some practitioners. There is clearly a danger that this message may be given inadvertently. There is also the danger that a reader might assume (probably incorrectly) that, having read about problems in one or two areas, the entire organization is in a dreadful mess.

Because of these possibilities, auditors should make their intentions clear, especially if they are only reporting instances of specific deficiencies that have come to their attention where they have not been deliberately looking for them. Readers can legitimately derive assurance about those areas where there are instances, and they can be confident that only those particular problems exist. The results of these audits should not be extrapolated. Readers should not simply assume that all is well in areas where no instances are reported or, conversely, that unreported problems abound.

These limitations should be stated specifically in the report. Auditors using this reporting approach should be particularly careful to describe the scope of the work accurately. They should also consider cautioning readers that the opinions relate exclusively to specific criteria within the audit area scoped in, that the results should not be extrapolated and that they should not assume that all is well that is not reported as a deficiency.

Making levels of assurance explicit

To date, comprehensive auditors have largely ignored, in their formal reports, the issue of communicating the intended degree of audit assurance to readers. This has occurred even though they undertake widely varying audits that produce substantial differences in the degree of certainty with which opinions can be presented.

The proposition offered here is straightforward: practitioners who prepare comprehensive audit opinions should describe, in their reports, the extent to which they have confidence in the accuracy of the opinions expressed in these reports. In so doing, they will signal to readers, and help them understand, the assurance that they should derive from the information contained in the opinion, or from the information to which the opinion applies.

The need to communicate the intended degree of audit assurance as clearly as possible is underscored by the reality that the intended degree of audit assurance often varies. If it does, it should be described. If, in fact, it does not, auditors still have a responsibility to ensure that whatever degree of assurance is intended is well communicated to readers. This might be done either through an articulation of the level of intended audit assurance, or by comparison to the normal degree of assurance that those same auditors associate with a financial statement audit. The major challenge for practitioners here lies in finding the best words, understandable to readers, to communicate the degree of audit assurance that they intend. It is not appropriate simply to attribute a percentage confidence ranking, as a number of variables will have to be taken into account.

As a separate, but equally important, matter, providing audit opinions that communicate the degree of intended audit assurance opens up new and useful opportunities for communication with clients. Auditors and clients can consult on choices that are available and the value that clients associate with these choices. For example, some clients may prefer receiving a lower degree of audit assurance on more widely scoped audits, while others may want to have relatively high degrees of assurance on more narrowly scoped examinations. For this dialogue to occur and the appropriate choices to be made, however, knowledgeable clients must understand not only matters about audit scope, but also the degrees of assurance that attend audit decisions.

The forgoing deals with the high professional qualities that should be associated with the communication of a completed audit. These same qualities should also be an important part of the communications between auditors and their clients from the outset, for it is in the planning phase that a client's expectations are developed. Accordingly, to ensure that maximum benefit is derived, it is important that auditors address this topic in the consultations that they have with their clients at the time of planning audits.

Significance

The concept of significance is fundamental to all auditing. It is a user-oriented concept that helps auditors decide what information will be important to the readers of their reports. The major difficulty in dealing with the concept is that each reader may have an individual view about what is or is not important. Such views will reflect the reader's background, experience, expertise and particular interest in the subject of the audit.

Auditors cannot be expected to write reports that will completely meet the needs of all users. That would be impossible, given the number and diversity of potential users and the purposes for which they want such reports. Accordingly, auditors must exercise professional judgment in deciding what must be reported and what does not need to be.

In making decisions about what to report, auditors are guided by two central criteria:

- information needed to support the audit opinion, and
- information needed or required by clients to fulfill their responsibilities.

Auditors apply these criteria in deciding what might influence the judgments that a reasonable and knowledgeable reader might make about whether the responsibilities conferred by governing bodies have been adequately discharged by management. In so doing, auditors take into account the breadth of subject matter and the degree of assurance they want readers to have in the auditors' opinions. To date, there are no norms to guide comprehensive auditors in the area of significance, and practice varies widely.

Beyond the above two criteria that attend auditors' judgments on what to report, some further considerations come into play to support their decisions. After all, such judgments are not made in a vacuum. The following section examines the factors that influence comprehensive auditors' decisions about what is and what is not significant, and how they go about dealing with them.

Influence of the Subject Matter of Comprehensive Audits

To understand the factors that influence judgments about significance, one must first reflect on the subject matter of comprehensive auditing: economy, efficiency and effectiveness. These terms, and the twelve attributes of effectiveness, are discussed in detail in Part II.

It is immediately apparent that, to a larger extent than pertains in financial auditing, the subjects of comprehensive audits are described in qualitative, not quantitative, terms. Of course, monetary measurement is important—indeed critical—in many instances, but determination of the extent to which there is due regard for economy, efficiency and effectiveness will often rest on nonmonetary factors. Some of these factors are quantifiable in nonmonetary terms, but some are capable of only qualitative assessments: they are simply not quantifiable. Furthermore, given the range of matters encompassed in these audits, there is of necessity a broad array of measurement tools used in forming judgments about the quality of an organization's performance.

These measurement tools are the performance criteria that have been developed over the years. While there is no single set of generally accepted performance criteria as such, there is no shortage of indicators that can be tailored to individual audit circumstances.

Obviously, the determination as to whether or not performance criteria have been met requires professional judgment. Once that judgment has been made, however, there still remains the question: How does one determine whether success or failure in meeting a performance criterion is significant enough to report? The scope of each audit has a vital influence on the answer to this question.

Influence of Audit Scope

As has been seen, under most legislated mandates, auditors are directed to report matters that they consider to be important, including instances where there is a lack of due regard for the 3Es. Simultaneously, the auditors are given responsibility to decide what will be audited; they determine the scope for each individual comprehensive audit. As a result, they may audit at the government-wide level, the department level, the program level, the activity level or the subactivity level. There are examples of audits at all these levels.

Auditors judge significance in the context of the audit scope. Clearly, a finding that is significant to a subactivity may not be significant to the program, department or government as a whole. The wider the breadth of an audit, the more likely that auditors would ignore minor deviations from accepted criteria in their opinions. In a government-wide audit, for example, such minor deficiencies in subactivities would not be consequential to decision making with respect to the organization as a whole. Conversely, even small deviations from criteria could merit reporting where the scope of an audit relates to only a very small portion of the organization's overall programs or activities. Audit scope clearly influences decisions about significance.

The mandate for special examinations of Crown corporations, for example, calls for an overall opinion on the systems and practices of the corporation as a whole; a very wide scope indeed. The examiners were able to provide these opinions, in some cases without qualification. In all these opinions, the significance of detailed audit findings was considered in relation to the corporation as a whole, and the only deficiencies reported were those that were sufficiently important to affect, or potentially affect, the performance of the whole organization.

At the other end of the scale, opinions written for narrowly scoped audits tend to provide information at a level of detail that would have no place in the report of a government or department-wide examination.

In practice, it would be impossible for the opinion resulting from a widely scoped audit to contain the same level of detail as one resulting from a narrowly scoped audit. This is because the scope influences the design of the audit and the level at which the audit effort is made. In effect, decisions about scope are sometimes made well in advance of detailed planning. These decisions subsequently have an impact on what auditors are likely to report.

Significance factors

Although audit scope obviously affects decisions about significance, it does not provide detailed guidance about what should be reported.

Factors Affecting Decisions About What to Report

- DOLLAR VALUE
- RISK OF OCCURRENCE OF AN UNDESIRABLE EVENT
- IMPACT ON THE PROGRAM BEING REPORTED UPON
- POTENTIAL FOR SAVINGS
- ENVIRONMENTAL IMPACT
- SOCIOECONOMIC IMPACT
- SAFETY
- RESOURCES COMMITTED
- RISK OF POOR MANAGEMENT
- PREVIOUS HISTORY OF LACK OF DUE REGARD
- ACCOUNTABILITY CONCERNS
- QUALITY OF CONTROLS
- DETERRENT VALUE
- ETHICS, INTEGRITY, COMPLIANCE WITH AUTHORITIES
- ISSUES THAT MANAGEMENT OR CLIENT EXPRESS AN INTEREST IN
- INACTION ON PREVIOUSLY REPORTED ITEMS

How to report versus what to report

Discussions with practitioners about significance factors revealed that some factors they cited focus more on how comprehensive audit findings might be reported than whether they should be reported in the first place. A useful first step, therefore, is to distinguish between those factors that affect the manner in which auditors report on a matter and those that help determine whether a matter is worth reporting at all.

While the list at left is not intended to capture all possible significance factors, it does list those that practitioners agree most frequently affect their judgments on what to report.

A number of other factors initially cited as affecting an auditor's judgment about what to report were, upon discussion with practitioners, determined to be factors that influence how auditors report on a matter once they judge it to be significant. The following list lists these factors. Again, it should be noted that the list simply contains those factors that were most frequently mentioned, not necessarily all that were cited or may be considered.

Factors Cited as Affecting How to Report

- PUBLIC EMBARRASSMENT TO GOVERNING BODY OR MANAGEMENT
- POLITICAL SENSITIVITY
- PUBLIC PERCEPTIONS AND INTEREST
- PROBABILITY OF PROMOTING CHANGE
- THE AUDITOR'S THEMES OR PRIORITIES
- CRIMINAL OR CIVIL-LEGAL IMPLICATIONS
- SECURITY CONSIDERATIONS
- PERSONAL AND/OR OTHER PRIVACY CONSIDERATIONS

Comprehensive auditors are acutely aware that they operate in a public environment where the impacts of their reports can be substantial and where their opinions can affect a broad range of individuals or organizations. To the extent possible, they want to avoid their opinions being misinterpreted; thus, they exercise careful judgment about how to report on matters that they deem significant. For example, in some cases, the factors in the above list will affect the language that is used in the report, the context in which the opinion is provided and the level of supporting detail that is included.

For example, auditors pay careful attention to the topic of partisan political impact. It would be naive to think that auditors would not be aware of items that would likely attract intense public attention. Should partisan political implications affect what an auditor might report? Clearly it should not. Auditors must remain independent and objective to retain their professionalism and credibility. But they should be particularly careful in wording an opinion they know to be politically sensitive.

A final word about the factors in both lists is in order—it is readily apparent that there is a gray area between these factors. Some factors that appear in the *How to Report* list are also reflected, to various degrees, in the *What to Report* list.

A good example has to do with possible criminal or civil-legal proceedings resulting from the content of a comprehensive audit report. This possibility would certainly affect how auditors present their findings. At the same time, it is altogether reasonable that important deficiencies in the observance of ethical standards or compliance with authorities would have to be reported by auditors.

Although it is recognized that the manner of reporting can affect the usefulness of a comprehensive audit report, the focus of attention here is on the central question of how practitioners decide what is to be reported.

What to report

The discussion of how auditors decide what to report focuses on the point in the audit process where all testing has been completed and the findings are being evaluated for possible inclusion in the report. This is not meant to imply that significance decisions begin and end at the reporting stage. On the contrary, significance decisions arise and are important at all stages of the audit. In fact, practitioners say that their perception of significance is fluid. As the audit progresses, more and more information is gathered, and this information affects the auditors' view of what is important. Nevertheless, the focus here is on how auditors decide what to report, having completed their fieldwork.

When all the facts have been collected and analyzed, auditors will find that some matters are clearly reportable, others clearly insignificant. The gray in-between area requires fine judgments. All the factors grouped in the *What to Report* list influence decisions in this area. These factors can be grouped into the following categories:

- relative size of expenditures or revenues;
- trends in an organization's performance;
- comparative indicators;
- behavioural matters; and
- potential risks.

Relative size of expenditures or revenues

It is not surprising that the amount of money involved is an important factor. It has an influence on most reporting decisions, as well as in determining scope. It may be used to quantify or explain system problems and weaknesses by pointing out the dollar value that the problem has already produced or could potentially produce. The term *relative* is used because the significance of the amount of money involved will depend on the context, largely determined by the audit scope. As already explained, what may be considered significant at the program level may be clearly insignificant to the organization as a whole.

Trends in an organization's performance

Trends in performance will affect auditors' judgments. For example, that which may not be significant in an organization that historically has a good performance record may assume reporting significance in an organization whose track record is uneven or eroding. Expressed in either monetary or other terms, the pattern of findings is important.

Comparative indicators

Compared to similar operations or organizations, relative performance will influence whether an item is or is not reportable. Auditors will take into account the constraints under which many public sector managers operate. Management may be performing below a theoretical optimum but, given the environment, may be comparatively high performers. This will influence reporting decisions to avoid misleading the readers.

Behavioural matters

These factors include public perceptions and interest, the probability of promoting change, potential for greater economy, efficiency and effectiveness in operations, social or economic impacts and environmental impacts. These factors are important because of the environment in which public bodies operate. Performance is judged not by a bottom-line profit or loss, but by the amount of benefit delivered to the public relative to the costs. These benefits tend to be qualitative in nature and therefore require sophisticated professional judgments. It is notable that recent legislative audit reports have increasingly focused on such matters.

Potential risks

An item may be significant and reportable solely on the basis that there is risk involved: risk of potential loss, or risk of inefficiency or ineffectiveness. This notion extends to a consideration of the probability of occurrence and the degree of potential severity of consequences. Thus, risk can, in some instances, help define what is significant in the view of the auditor.

Summary of factors

In summary, the five broad areas described above must be considered in each case. The weight given to them will depend on the particular circumstances. Each decision on what to report will be influenced by earlier decisions about the breadth of the audit, the degree of intended audit assurance, the nature of tests applied, the findings from those tests and the auditors' judgment of what might make a difference if reported. The weighting will often depend on the terms of reference, with some being definitive and others (as in most legislated mandates) providing auditors with great latitude in exercising their judgment.

In the end, there is no substitute for the auditor's judgment in determining what to report. But no auditor should hope that management and governing bodies will be satisfied with the answer "trust my professional judgment" when they ask why something was reported or why certain other matters were not. Auditors must strive to explain their rationale in determining how reporting decisions are made.

Of all the issues involved in reporting comprehensive audits, the concept of significance suffers from the weakest conceptual foundation. While practitioners can readily agree on the factors that should influence significance decisions, to date they have given little consideration to distinguishing those that influence the manner of reporting from those that determine what they report. There is an important distinction between these two issues that has a profound impact on comprehensive audit reporting.

Auditors do not generally discuss their significance criteria with their clients or explain them in their reports. And yet, from a client's viewpoint there could be little more important to understand about a comprehensive audit report than why some matters were reported and others were not. Herein lie the dangers: danger of unnecessarily idiosyncratic practice, and danger of distrust—or at best, lack of understanding—of comprehensive audits by clients.

The listing of factors influencing decisions on what and how to report should provide a basis for further thought about this subject and be of use to practitioners in making future reporting decisions. Although it is a start, it will not of itself provide a blueprint. There can be no single, simple formula for using the factors that go into making significance decisions. Like all else, these decisions need careful professional judgment taken in the context of each audit.

Practitioners should pay particular attention to this subject and clearly understand why they included or excluded matters from their opinions. The next step is to communicate this thinking to the users of the opinions. To increase understanding and acceptance of comprehensive audits, auditors should specify in their reports the significance thresholds they are using and the key factors that have guided their decisions about what they chose to include in their opinions. The test of doing this satisfactorily is not necessarily being able to express these thresholds and factors as precise quantitative decision points or terms—in some instances this will be feasible, in others it will not. Rather it lies in the tightness and clarity of the logic being applied, and explained in a way that the reader will understand and judge as reasonable and appropriate to the circumstances.

It is helpful for practitioners to discuss this topic with their clients outside the context of their formal reports. This could include discussion at audit committee meetings or their equivalent and discussion with governing bodies at the time of delivering the audit report. This type of communication with the client is not a substitute for clear treatment in the auditors' formal report. It can, nevertheless, go a long way in ensuring a reasonable level of expectations on the part of the client and an agreed basis of understanding between client and auditors. Such discussions can also help auditors understand what their clients need to know.

AUDITORS' RECOMMENDATIONS

Auditors' recommendations have become an accepted part of most comprehensive audit reports. Indeed, some legislative audit offices have adopted the practice of listing the recommendations they have made over the years and the action that the government has taken on them.

This is what the U.S. General Accounting Office (GAO) has to say about the subject:

GAO ACCOUNTING STANDARDS

7.21 AUDITORS SHOULD REPORT RECOMMENDATIONS FOR ACTIONS TO CORRECT PROBLEM AREAS AND TO IMPROVE OPERATIONS.

7.22 AUDITORS SHOULD REPORT RECOMMENDATIONS WHEN THE POTENTIAL FOR SIGNIFICANT IMPROVEMENT IN OPERATIONS AND PERFORMANCE IS SUBSTANTIATED BY THE REPORTED FINDINGS. RECOMMENDATIONS TO EFFECT COMPLIANCE WITH LAWS AND REGULATIONS AND IMPROVE MANAGEMENT CONTROLS SHOULD ALSO BE MADE WHEN SIGNIFICANT INSTANCES OF NONCOMPLIANCE ARE NOTED OR SIGNIFICANT WEAKNESSES IN CONTROLS ARE FOUND. AUDITORS SHOULD ALSO REPORT THE STATUS OF UNCORRECTED SIGNIFICANT FINDINGS AND RECOMMENDATIONS FROM PRIOR AUDITS THAT AFFECT THE OBJECTIVES OF THE CURRENT AUDIT.

7.23 CONSTRUCTIVE RECOMMENDATIONS CAN ENCOURAGE IMPROVEMENTS IN THE CONDUCT OF GOVERNMENT PROGRAMS. RECOMMENDATIONS ARE MOST CONSTRUCTIVE WHEN THEY ARE DIRECTED AT RESOLVING THE CAUSE OF IDENTIFIED PROBLEMS, ARE ACTION ORIENTED AND SPECIFIC, ARE ADDRESSED TO PARTIES THAT HAVE THE AUTHORITY TO ACT, ARE FEASIBLE, AND, TO THE EXTENT PRACTICAL, ARE COST-EFFECTIVE.[266]

Recommendations result from a constructive approach to comprehensive auditing. It is assumed that clients want to be told what needs to be corrected and that auditors would be remiss not to point out opportunities for improvement. The issue here is simply whether or not the auditor's report is the best vehicle through which to deliver the message. The following questions concerning recommendations are addressed below:

- Why are recommendations provided as an integral part of the comprehensive audit report rather than in a separate communication to the client or the client's management, as appropriate?
- Are comprehensive auditors increasing their audit risk by including recommendations in the audit report?
- How rigorously should recommendations be developed?
- Does providing recommendations create an objectivity problem for auditors?

WHY PROVIDE RECOMMENDATIONS IN THE REPORT?

The usual reason given for including recommendations as an integral part of the audit report is that clients want it that way.

But why not provide this service through a separate communication? After all, it is common practice for auditors to provide management letters that are not made public but contain observations, including suggested improvements. Recommendations could be provided through such a vehicle.

Auditors give three reasons why recommendations should be contained in the published report. First, a number of practitioners think that clients would not want what they may view as the primary benefit from a comprehensive audit to be given secondary reporting treatment and not included in the most visible output of the audit, the report itself. Second, auditors think that including the recommendations in the audit report increases the likelihood of action being taken on them. Third, the recommendations, if included in the audit report, serve as a visible benchmark against which future progress can be monitored by governing bodies.

While there is general agreement that recommendations are not a necessary part of the conceptual framework of comprehensive auditing, most practitioners think it is a useful practice that should continue.

Since it seems that recommendations will appear in comprehensive audit reports for some time, it is appropriate to consider the ramifications of this practice.

Is the auditor's and client's risk increased?

First, it is certainly true that recommendations are elevated in status when they appear in the audit report. The readers will likely infer that the recommendations are important and, if implemented, will result in better performance. After all, they are based on a professional's judgment, and, since they are in the audit report, readers may derive assurance that the recommendations will be effective.

Arguably, this is the biggest problem in including recommendations in the report. It almost guarantees the creation of an unrealistic expectation because in reality the recommendations are rarely subjected to the same audit rigour that is applied in the audits themselves. This does not mean that the recommendations are without sound basis, but it does mean that there is some degree of risk associated with them, both for the auditor who makes them and for the client who acts on them.

Level of rigour required

An auditor's training and experience should provide a basis for practical and worthwhile advice to clients simply as a by-product of the audit work. Such advice is not as reliable as the audit opinions, however, because recommendations are future-oriented and cannot easily be tested *a priori.*

Comprehensive auditors must weigh the risk associated with including the recommendations as part of the report against the apparent client demands for this service. Auditors run the least risk when they simply identify a problem and recommend that it be corrected. But clients may be dissatisfied with such a relatively unhelpful suggestion from a professional who should know how that correction can be made. But auditors run a greater risk when they provide details of how problems may be overcome. Moreover, giving management latitude to determine how best to implement recommendations often fosters greater ownership and leads to actions instead of defensive posturing.

In the end, however, professionalism must prevail, and it appears reasonable that comprehensive auditors should do everything possible to ensure that their recommendations are developed with a rigour equivalent to the contents of the rest of the report. If they are not, auditors should appropriately communicate the limitations of the recommendations.

An objectivity problem?

Some practitioners question the merits of making recommendations because of the long-term implications of the practice. They point out that, over the years, thousands and thousands of recommendations have been made, and it is virtually impossible to follow up on them to assess whether or not any impact on performance was actually achieved. In addition, they think that auditors could find themselves in an awkward position when faced with auditing areas where their recommendations were implemented. In such circumstances, it would be difficult to avoid the perception that the resulting audit opinions may not be as objective as they ought to be.

Some practitioners are also concerned that with so many recommendations being made, some suggestions, despite the auditor's good intentions, will be inappropriate and not actually achieve better performance. This could have a damaging effect on the responsible auditor's credibility and that of their future findings and opinions.

Recommendations are a valuable by-product of comprehensive auditing, but great care must be exercised to avoid creating a situation where they may compromise the auditor's objectivity.

Summary

Providing recommendations is not an integral part of the concept, nor a necessary supporting practice, of comprehensive auditing. The main purpose of the audit report is to provide the client with useful information about the status of due regard to economy, efficiency and effectiveness and/or the fairness and completeness of such information reported by management on the 3Es.

As mentioned above, however, it is appropriate to provide recommendations when both the auditor and client think it desirable. Comprehensive auditors should maximize the value of their work to the client by providing recommendations, but there are alternative means of delivering them that should be considered for example, management letters.

Fair and balanced reporting

Fair and balanced reporting is a term that has been associated with comprehensive auditing from the outset. Although the term is commonly used, there has been little explanation as to what it means and how, as a concept, it influences comprehensive audit reporting. That it has influenced these reports is indisputable:

I therefore emphasize to readers that they should give special weight to those observations that are positive; for while briefly stated they do indeed balance—if not outweigh—negative observations which, of necessity, must be described in full.[267]

It is usually in such a context that the term *fair and balanced* is used: pointing out the positive as well as the negative findings of a comprehensive audit. There are two basic questions:

- Is fair and balanced reporting a supportable auditing concept?
- What is meant by fair reporting?

A supportable concept?

There is remarkable consensus about whether fair and balanced reporting is a supportable concept. However, there is little support for the term *balanced* to be associated with comprehensive audit reports. This is not negative in any way; it is simply a recognition of the practical realities of comprehensive audit reporting.

The biggest problem with the term *fair and balanced reporting* is the word *balanced*. It conjures up the image of a set of scales upon which positive findings are weighed against negative findings. In the world of comprehensive auditing, the likelihood of balance in any true sense is remote. In fact, the term *balanced* raises questions regarding the whole audit process, not just reporting. For example, would an auditor striving for balance be required to develop audit tests that would lead to balanced results? One would hope not, as this would strike at one of the key characteristics that auditors bring to their work—objectivity.

Indeed, striving for balance in the literal sense could lessen the credibility of auditors' reports. After all, if balancing were a fundamental conceptual requirement of comprehensive auditing, how would auditors deal with the reality of unbalanced (positive or negative) findings? The auditor's credibility would be jeopardized if clients and readers believed that some findings or opinions were not reported because they would result in an unbalanced report.

One can therefore conclude that *balanced* is not a part of the comprehensive audit reporting conceptual framework. It is generally agreed that the term *fair* is a more appropriate one that embraces those aspects of balance that are desirable from a conceptual point of view.

What is fair reporting?

Fairness is one of the professional qualities that auditors bring to their work. The quality of objectivity embraces fairness in that auditors have a duty to analyze their audit results and report them in an impartial manner.

The concept of fair reporting does not mean searching for positive findings in an attempt to be fair to management. Rather, it means developing appropriate criteria and then reporting whether or not those criteria are met. Positive findings can and should be reported, not as an end in itself, but simply as the objective outcome of conducting the audit. Furthermore, it means putting the findings and opinions in context. Readers should be able to understand the significance of audit opinions—both in absolute and in relative terms—so that they will come to fair and warranted conclusions.

From the above, one may conclude that fairness in reporting is an essential concept in comprehensive auditing, while balance is not.

262 *Comprehensive Auditing Manual* (Ottawa, Office of the Auditor General of Canada) §6001.02.
263 Ibid, §6001.04-.06.
264 *CICA Handbook,* §5020.10.
265 Office of the Provincial Auditor of Ontario, *1988 Annual Report* (Toronto: Queen's Printer for Ontario, 1988) 2.
266 *Government Auditing Standards, 1994 Revision,* (Washington, United States General Accounting Office) 92.
267 *Annual Report of the Auditor General of Canada*, 1986, para 1.15.

Chapter 19

Audit Criteria

What are audit criteria?

Auditing cannot be done without audit criteria. Criteria are the benchmarks against which auditors compare what they find in order to draw conclusions. In other words, they are the standards that management can realistically be expected to meet. They describe reasonable norms of behaviour in an organization. They are the measurement devices against which transactions, events or systems are compared in order to judge whether or not they are acceptable.

Office of the Auditor General of Canada's Definition of Audit Criteria

In value for money auditing, criteria are defined as reasonable and attainable standards of performance and control against which the adequacy of systems and practices, and the extent of economy, efficiency and effectiveness of operations, can be assessed in the particular circumstances of the audited organization.[268]

In financial auditing, the public accounting profession uses Generally Accepted Accounting Principles (GAAP) as standards or benchmarks against which to form its judgments. The long-standing requirement for financial audits and the technical nature of the subject matter have led to the development and acceptance of these standards.

Comprehensive auditing is a comparatively new field and the subject area is much broader than financial auditing. Nevertheless, the audit process is much the same, and it is based on criteria. In the case of comprehensive auditing, however, auditors need criteria to judge whether operations are economical, efficient and effective.

Audit criteria can apply to several aspects of an organization's operations: to the quality and timeliness of information and its use; to the probity of conduct of officials; to any operating system, from controls over inventories to staff training, and to the organizational structure itself.

At the very highest level, criteria can be very broad statements of expectations—assertions of what is good management practice anywhere. At a lower level, they can describe very specific expectations of performance. Some criteria may deal with the amount and quality of information generated and with the suitability of control systems. Others may focus on specific expectations of such things as output per unit of input, setting and achieving deadlines for work assignments, and so on.

Auditors recognize that the criteria they apply will vary from one assignment to another: what may be a reasonable expectation for information systems in a program spending eight billion dollars, for example, may be unreasonable in a program spending $500,000. The criteria to be used in any audit must be designed for, and appropriate to, the particular circumstances of the organization under examination.

The necessity to devise audit criteria that can reasonably apply in each individual audit arises from the fact that for many management functions there are as yet no universally applicable and accepted practices. But audit criteria must be developed to allow auditors to audit performance information against a standard.

AUDIT CRITERIA

- REASONABLE STANDARDS AGAINST WHICH TO ASSESS EXISTING CONDITIONS
- THEY EQUATE TO GOOD OR ACCEPTABLE MANAGEMENT PRACTICES
- AS MEASUREMENT DEVICES, THEY MUST PROVIDE SOME FLEXIBILITY BUT STILL ALLOW IDENTIFICATION OF NONADHERENCE

Criteria are what could be referred to as good or acceptable management practices. Criteria have to be general enough to allow management some flexibility in style, but specific enough so that nonadherence to them is clearly evident. It is unrealistic to expect that activities, systems or levels of performance in economy, efficiency and effectiveness areas will always fully meet the criteria used to judge them. Satisfactory performance does not mean flawless performance.

And since there are no universally accepted standards for many management practices, it is essential that auditors discuss with management the criteria they propose to use. Auditors who assess management performance by yardsticks of which management is unaware court disaster. Every effort should be made to gain consensus on criteria, although this may not be possible in some cases. Where complete agreement is not reached, auditors should seek precedents, such as practices in similar programs, operations or jurisdictions that would support the appropriateness of the suggested criteria. Of course, it is preferable that the suggested criteria be developed in light of such precedents in the first place.

SUITABILITY OF CRITERIA

As has been pointed out in the CICA public sector auditing guidelines,[269] criteria must be suitable in order to avoid inappropriate conclusions being drawn about the organization's operations. They must be relevant to the matters being audited and appropriate to the circumstances. Suitability of criteria depends on factors such as:

- *The audit objectives.* Criteria that are suitable for matters related to economy are different from those related to efficiency.
- *The activity.* Criteria that are suitable for human resource management are different from those related to capital asset management.
- *The approach of the audit.* Suitable criteria for examining processes would differ from those for examining results. Examinations of processes are usually related to systems, controls and practices. Examinations of results usually focus on program outputs, outcomes and impacts.

Some characteristics of suitable criteria include:

- *Reliability.* Reliable criteria result in consistent opinions when used by different auditors in the same circumstances.
- *Objectivity.* Objective criteria are free from any bias of the auditors or management or the client.
- *Usefulness.* Useful criteria are those resulting in findings and opinions that meet the client's information needs.
- *Understandability.* Understandable criteria are those that are clearly stated and are not subject to significantly different interpretations.
- *Acceptability.* Acceptable criteria may be developed by management or by the auditors and be derived from standards established by regulatory bodies, professional associations or

other recognized authorities.

- *Comparability.* Comparable criteria are consistent with those used in similar comprehensive audits within the organization, in similar circumstances.
- *Completeness.* Auditors should endeavour to ensure that all significant criteria have been identified.

These characteristics are considered together in identifying criteria and in assessing their suitability. The relative importance of the characteristics in different circumstances is a matter of professional judgment.

Using audit criteria

The level of detail of the audit opinions is affected by the level of detail at which audit criteria are specified. At the planning stage, criteria may be relatively general. More specific criteria are usually identified for the detailed examination.

In financial auditing, for example, an auditor may wish to examine accounts receivable. Under GAAP, the general criterion to be used could be expressed as follows: "Accounts receivable should be presented fairly." To arrive at an opinion on this general criterion, auditors would have to examine a number of characteristics of the listed accounts receivable, including ownership, evaluation, classification, and so on. Auditors gather evidence on each of these sub-criteria to see if they are met. The opinion on the general criterion, therefore, is reached through using more specific sub-criteria.

In comprehensive auditing, the approach is similar. For example, in examining the acquisition of a piece of equipment, the auditors' general criterion might be: "The acquisition took place with due regard to economy." To arrive at an opinion, the auditors would develop more specific sub-criteria about which evidence is to be gathered, probably based on central agency or departmental directives regarding the acquisition of equipment. The sub-criteria would likely include the following:

- the need was justified;
- the technical requirements were appropriately specified;
- available options were considered;
- the acquisition process was suitably managed; and
- custody and control of the asset are provided for.

There may, of course, be even more specific criteria to assess performance against individual sub-criteria. For example, to determine whether the acquisition process was suitably managed, auditors would look at such matters as bid solicitation, contractor selection and contract administration, including project controls and work-in-progress payment policy.

Comprehensive audit criteria are used in the same manner as in financial audits, but because of the broad nature of the audit, they may also serve several other purposes, such as:

- to form a basis for communication with management, since their agreement to the criteria is solicited;
- to indicate the scope of the audit in the sense of specifying audit objectives;
- to generate findings and help form and structure the observations; and
- to form a basis for the examination phase of the audit, developing the audit program and formulating audit questionnaires.

However they are to be used, audit criteria should be clearly stated to prevent misunderstanding.

Criteria respecting internal audit: two examples

The following are two sets of criteria developed for comprehensive audits of internal audit functions: one in a provincial liquor commission, one in a general hospital.

The liquor commission

- The audit programs used by the auditors are relevant and adequate
- The contents of the Division's individual audit reports and its annual report are appropriate
- The staff charged with the responsibility for performing this function are competent and independent
- Assigned audit responsibilities are appropriate

The general hospital

- The function is independent from operating departments
- The two person staff charged with responsibility for the internal audit function are competent
- The audit programs and the scheduling of assignments are appropriate to the needs of the hospital in terms of risk, importance and usefulness
- The detailed audit planning for specific assignments is adequate as are the approaches taken with respect to sampling techniques, tests performed and evidence derived
- The audit findings, conclusions and recommendations were reviewed with departmental officials in a meaningful manner
- The audit reports convey adequately the objectives, scope, findings, conclusions and recommendations for each audit assignment
- Follow-up procedures, to ensure recommendations are being acted upon on a timely and proper basis, are adequate[270]

Sources of audit criteria

Since comprehensive audit criteria address a variety of management practices, it is inevitable that they derive from a variety of sources. Criteria respecting probity of behaviour, for example, may be derived from law, from policy statements (such as any policies regarding conflict of interest) and from statements of ethical practice by professional associations. Criteria respecting operating systems and standards may derive from generally accepted good-practice models developed by professions or associations. The sources may be relatively informal, such as those respecting productivity standards for clerks, or they may be quite formal, such as those applying to probity of conduct.

Probably the first place auditors should look for appropriate audit criteria for a specific audit is in their own office files. If they have conducted audits on the same or similar entities in the past, they may already possess a number of useful—and tested—criteria. Auditors should not, however, apply those criteria without first reviewing their suitability in the current circumstances of the audit; time brings changes.

In some instances, in increasing numbers, the audited organization itself has adopted specific management standards for performance. In those cases, the auditors need only assess those standards for reasonableness before adopting them as audit criteria. Gaining agreement of management to such criteria should be automatic.

In other instances, there may be few management standards in place and audit criteria will have to be developed. The sources auditors will use to develop them will be partly their own knowledge of good management practice, partly their findings of what seem to be accepted as standards of performance in similar organizations elsewhere and perhaps partly the expert advice they may have to seek.

Although most entities have their own particular characteristics, there are certain common features of public (and private) sector organizations. It may well be that issues similar to those faced in an audit assignment have been faced by auditors in other situations. Criteria may have been developed in other audit organizations that could be used, possibly with modifications, to the audit of an organization that has inadequate, or inadequately documented, management standards. Gaining access to such criteria can save considerable audit time and expense.

One source of audit criteria to which all auditors should turn are the directives and guidelines promulgated by any relevant central agencies or funders. These are often in a form that permits relatively easy conversion to criteria. These directives and guidelines must, in any event, be taken into account since they set out specific expectations of management and provide a framework within which administration must be conducted. Even if there are no such directives or guidelines constraining the organization, it may be that central agencies or funders of other jurisdictions have promulgated standards that could form the basis of criteria for the audit.

In using any central agency or other source material to develop audit criteria, practitioners should ensure that they do not put themselves in a position where their work will become merely compliance audits on behalf of the central authority. Comprehensive auditors need to keep a broad perspective and must concentrate on those issues that are truly essential to the success of the organization—they should not allow themselves to become mired in administrative detail at the expense of what is really vital.

There are several other sources for criteria that auditors often use. Just because the particular organization under audit has no or few satisfactory, established management standards that could be used as audit criteria does not mean that such standards may not have been developed elsewhere. Similar entities in other jurisdictions may have standards that could provide suitable criteria. Even if there are no such formal standards, the performance of similar entities elsewhere may provide a useful comparison.

Other sources of criteria include the literature in the field of the audit subject and of related professions. In some instances, auditors have consulted experts in the relevant field when their own knowledge of a specialized area is inadequate for the development of suitable criteria. Often, these experts are a part of the audit team from start to finish. At other times, they are used only for specific tasks.

As more and more comprehensive audits are conducted, the number and range of suitable audit criteria grow. By becoming familiar with the many available sources, practitioners can greatly increase the efficiency of their audits.

268 OAG *Manual*, §2307.02.
269 Public Sector Auditing Guideline 1, *Planning Value-for-Money Audits* (CICA, 1990), §.27-.29.
270 Reported in *Comprehensive Auditing in Canada: A Provincial Legislative Audit Perspective* (Ottawa: CCAF, 1985) 116 & 132.

CHAPTER 20

EVIDENCE

WHAT IS EVIDENCE?

The collection and analysis of evidence is at the heart of auditing. The *Shorter Oxford Dictionary* defines evidence as: "Ground for belief; that which tends to prove or disprove a proposition."

For comprehensive auditors, audit evidence is the facts or information used:

- to come to the opinion of whether an organization's management/employees have accepted and carried out appropriate accounting, management or operational principles, policies or standards for effectively, efficiently and economically using its resources (that is, whether the audit criteria are being met); and
- to demonstrate to a third party that the auditors' opinion is the correct one.

As discussed, auditors use agreed criteria to determine whether the auditee has indeed paid due regard to economy, efficiency and effectiveness.

AUDIT EVIDENCE

THE INFORMATION COLLECTED AND USED BY THE AUDITOR TO ARRIVE AT AN OPINION OF WHETHER AUDIT CRITERIA ARE BEING MET.

In carrying out the tasks specified in the audit programs, auditors will obtain information or evidence that will help them arrive at an opinion of whether or not audit criteria are being met. This evidence is obtained during the audit work through some of the techniques that are discussed later in the chapter.

STANDARDS OF VFM-RELATED AUDIT EVIDENCE

To guide auditors, and to ensure appropriate professional approaches to work, various bodies have established standards for evidence to be used in comprehensive audits. The Canadian Institute of Chartered Accountants has established the following standard:

> Sufficient appropriate audit evidence should be obtained to afford a reasonable basis to support the content of the auditor's report.[271]

The policy standard of the Office of the Auditor General of Canada is virtually the same:

> Sufficient, appropriate evidence should be obtained to afford a reasonable basis for the content of the report.[272]

The General Accounting Office of the United States uses the following standard:

> Sufficient, competent and relevant evidence is to be obtained to afford a reasonable basis for the auditors' findings and conclusions…[273]

These standards introduce a number of key concepts concerning audit evidence: *relevant, competent, sufficient* and *appropriate*. It is important to understand what these words signify, although it should be remembered that they are closely related, and audit evidence should be considered in light of all of them simultaneously.

Relevance of evidence

Relevance

Information or facts used as evidence must be related to the subject and period of time encompassed by the audit.

To be relevant, evidence used to support a finding must have a logical, sensible relationship to that finding. For example:

- Auditors trying to verify the labour element of product costs by reference to source documents should be sure that the collective agreement they examine is current. Using an expired agreement would produce irrelevant evidence.
- If the policy is to recap tires at 60,000 kilometres instead of buying new ones, evidence showing that steel-belted radial tires last longer than bias-ply tires is not relevant.

Competence of evidence

Evidence is competent if it conforms to fact. In other words, evidence is competent if it is valid. To be competent, evidence must be obtained from a reliable source. In this context, competence can be thought of as a synonym for reliability.

Competence of Evidence

The reliability that is placed on the source of information used as evidence.

There is general agreement on the following ways of assessing the reliability of evidence:

- evidence obtained from a credible independent source provides greater assurance of reliability than evidence secured from the auditee organization;
- evidence developed under a good system of internal control is more likely to be reliable than evidence obtained where such control is unsatisfactory or nonexistent;
- evidence obtained by auditors through physical examination, observation, computation and inspection is more reliable than evidence obtained indirectly;
- documentary evidence is usually considered more reliable than oral evidence, and original documents are more reliable than copies;
- the reliability of evidence increases when it is confirmed by another source;
- testimonial evidence obtained under conditions where persons may speak freely is more reliable than evidence obtained under compromising or constrained conditions;
- testimonial evidence obtained from someone who is unbiased and has complete knowledge of the area is more competent than testimonial evidence obtained from someone who is biased or has only partial knowledge; and
- statements made by officials of the audited organization are more reliable when they are confirmed in writing.

Sufficiency of evidence

Sufficiency refers to the amount of evidence required to come to an audit finding. Auditors should ask themselves whether they have enough evidence to persuade a reasonable person of the validity of the finding. In some situations, it may be useful and appropriate to use statistical methods to assess sufficiency.

Sufficiency of Evidence

The amount of evidence required to come to an opinion on the audit objective.

Factors to consider in assessing the sufficiency of evidence include:

- the quality of the evidence gathered;
- the level of materiality or significance of the finding;
- the degree of risk associated with coming to an incorrect opinion;
- experience gained in previous audit examinations as to the degree of reliability of the auditee's records and representations;
- known client sensitivity to an issue;
- intended level of audit assurance;
- persuasiveness of the evidence; and
- cost of obtaining the evidence relative to the benefits in terms of supporting the finding.

APPROPRIATENESS OF EVIDENCE

Appropriateness refers to the suitability of the evidence for the purpose of supporting a finding or opinion. It is really another way of describing the quality of the evidence: its competence and relevance.

Auditors should always remember that the burden of proof—providing sufficient evidence to substantiate an audit opinion—is on them. They must use their judgment about what is enough.

Evidence factors to consider in planning

While planning a comprehensive audit, auditors should identify the probable nature, sources and availability of the audit evidence they require. They should consider the following:

- *The effect of the audit approach.* The nature of evidence needed if the audit's primary focus is on processes may differ from that required if the focus is more on results.
- *The ability to integrate audit work with other audits or studies.* If other audit reports or studies are available, auditors may choose to use them as evidence in the audit. If the auditors are aware of other planned examinations, they may choose to coordinate work to be able to rely on their reported results. If evidence is to be obtained from other audits or studies, auditors should assess: the relevance of the objectives, scope and criteria to their planned audit; whether the work was conducted in accordance with value-for-money auditing standards; the competence and independence of the auditor or reviewer; and the reliability of the conclusions of the audit or study. Auditors should also determine the need for corroborating evidence. (This subject is discussed in depth in chapter 22.)
- *The effect of reporting requirements.* The amount of evidence required to form an overall opinion on an organization may be relatively greater than the evidence needed to identify and report deficiencies.
- *The cost of obtaining evidence.* Auditors may not be able to obtain evidence from a particular source at a reasonable cost for the planned timing of the audit. In such circumstances, auditors would assess the possibility of obtaining other appropriate evidence on a timely basis.

Reliance as a form of evidence

The term "reliance" is used in a variety of situations in auditing. Each usage reflects the requirement that auditors base their opinions or rely on sufficient appropriate audit evidence, often involving the substitution of one form of evidence for another.

For example, auditors may reduce the amount of detailed substantive testing they perform on financial statements if they have evidence that the information reflected in these statements is generated by well-controlled information systems. They rely on internal controls to determine the nature, extent and timing of substantive auditing procedures. Similarly, the auditor of a parent company may, after carrying out certain high-level procedures, rely substantially on the work of another competent auditor who has audited the financial statements of a subsidiary.

Auditors may also rely on the work of specialists such as lawyers, engineers, actuaries or gemologists, who, in their capacity as specialists, provide professional opinions about matters that have a bearing on the financial statements. To the extent that auditors can rely on this work of others, their own work can be reduced.

Reliance

Reliance in the context of a comprehensive audit is the substitution of work done by others for work that would otherwise have to be performed directly by the auditors. In the context of this definition, work done by others includes their assessments as well as the detailed supporting work.

Extent of reliance

Regardless of the situation in which auditors rely on evidence, certain ground rules apply. First, auditors do not rely blindly; they take steps to satisfy themselves that reliance is warranted. Thus, before relying on internal controls over key information systems, auditors analyze the systems and ensure that they have been functioning as intended during the period covered by the audit. Before relying on the auditors of a subsidiary's financial statements, the auditors of the parent company satisfy themselves that the auditors of the subsidiary understand their objectives, are aware that reliance is intended and have carried out an audit sufficient to contribute to those objectives. Before relying on a specialist, auditors assess the reputation of the specialist and ensure that the information provided to the specialist is complete, accurate and timely and that the major assumptions used by the specialist are consistent with other evidence obtained by the auditors.

Second, auditors consider the cumulative implications of evidence from many sources in reaching their opinions. It is the accumulative and corroborating effect of evidence from a variety of sources that provides the basis for their opinions. Any significant inconsistencies between evidence from different sources must be resolved before an audit opinion can be offered. Evidence furnished through reliance must be compared with all the other information available to the auditors.

In the final analysis, auditors must have sufficient direct involvement with, and knowledge of, material aspects of the matters under examination to enable them to form their own opinions and render their own reports, for which they bear sole responsibility. This fact, which means that reliance on others in no way transfers responsibility to them from the auditors, helps explain the importance attached to reliance decisions.

Making decisions about reliance requires the auditors to have acquired at least sufficient direct knowledge of the subject matter to assess the validity and significance of the other's findings. Accordingly, relying on the work of others can never eliminate the need for at least some work by the auditors.

The subject of reliance is dealt with more extensively in chapter 22.

Methods of gathering audit evidence

There are a number of techniques auditors use to gather the evidence they need. The following are derived from one authoritative manual:[274]

Review of documents: Written material—such as correspondence, memoranda, minutes, reports, systems documentation, directions to staff and internal audit reports—is a major source of audit evidence.

Analysis: The analytical process often compares figures, trends, ratios, processes, procedures, and so on. Judgment and competence are vital here, and such evidence is best derived by people knowledgeable in the area.

Investigation: Auditors normally investigate the causes and effects of significant audit findings. Where they find unsatisfactory results, they investigate the systems, procedures, management practices, organizational environment, etc., to determine the causes.

Interviews/inquiries: Significant information gleaned from interviews should be documented. Careful preparation (including the development of checklists where appropriate) maximizes the productivity of interviews.

Physical observation/inspection/taking photos: These techniques have long been used to obtain evidence about physical assets and can be helpful in gathering information about people, things or events within the audit scope. It should be remembered that a single observation or photo documents affairs at a specific moment and cannot be used to draw conclusions about matters that have occurred over a period of time.

Systems review or update: This involves understanding how the organization carries out particular functions, including the flow of transactions, the methods used to assure quality and generate data and the controls that apply. It can allow auditors to determine whether a control existed, but will not provide evidence of how control procedures may have operated.

Confirmation: Confirmation is a method of corroborating evidence with independent third parties. It is often used to verify that an asset or liability exists, but may also be used to verify that procedures applying to the clients of the auditee actually operate as claimed or as intended.

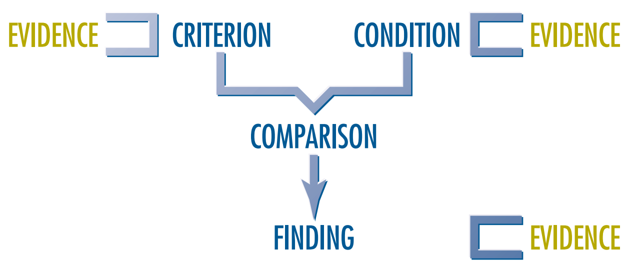
Detailed testing: In general, testing involves applying a given audit procedure to a sample of items within a population. Auditors then project the results to the entire population. Evidence from this technique gives auditors some measure of the assurance needed to conclude whether or not specified audit criteria are being met. The more rigorous the design of the test, the greater the assurance it will provide. Methods of testing vary, depending on the particular operation or area of activity being tested and the type of evidence available. Statistical methods of selecting the sample and projecting the results add precision to a test.

Surveys: also could be added to this list.

Audit process and evidence

How does this understanding of evidence relate to the comprehensive audit process?

Figure 3.6: Audit Process



The above diagram shows familiar information—the audit process, including the statement of criteria, and its comparison with the actual condition, to arrive at a finding. At each of these critical stages, auditors require evidence or proof of statements they intend to make in the audit report.

Evidence and audit criteria are closely related. Remember the following points:

- Criteria are crucial to developing an audit observation. They must be objective and demonstrably practical and applicable.
- With regard to conditions found, auditors have to ensure that their statements and descriptions are accurate and well supported. They need appropriate evidence to support such statements.
- To arrive at a fair comparison of condition to criteria, an understanding of the organization and its environment is required. Evidence must be viewed in context.
- Satisfactory performance does not mean perfect performance. Often, standards for performance are stated in a way that recognizes that the world is not perfect.
- The criteria auditors use and the comparisons they make with the evidence they have found should provide structure to and guide their thinking and analysis—they should not replace them.

In summary, evidence is often persuasive rather than conclusive. The risk, significance, sensitivity of the matter to be reported, and the cost of obtaining evidence should determine the nature and amount of evidence to be collected. In controversial areas, the persuasiveness of the evidence should be high. The reliability of the source and type of evidence influence the degree of its persuasiveness and, therefore, the amount of evidence that will be needed. When based on sufficient, appropriate data, it should be possible for the practitioner to advance opinions with the confidence that they are valid and will withstand critical examination.

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271 CICA *Standards*, §.31.
272 OAG *Manual*, §2501.01.
273 GAO *Standards*,§6.46.
274 This section is derived from the OAG *Manual*, §2501.28-.40.

Section 4

Other Key Considerations

Chapter 21

Internal Audit

The concept of comprehensive auditing was first developed in the context of supporting the accountability relationship between management and governing bodies and the role that external auditors play in this regard. Comprehensive auditing, however, is by no means the exclusive preserve of external auditors. Value-for-money considerations can also be an important aspect of internal audit practice. Internal auditors, and other professionals with internal review mandates, can make an important contribution to their organizations through comprehensive auditing.

The Institute of Internal Auditors' (IIA) *Standards for the Professional Practice of Internal Auditing*,[275] for example, outline the scope of internal auditing work as including (among other matters): appraisal of the economical and efficient use of resources, and review of the accomplishments of established objectives and goals for operations or programs. Indeed, today a significant proportion of comprehensive auditing is carried out by internal auditors, serving the accountability relationship between operating managers and their organizational superiors or, in those fewer cases where the internal auditor reports directly to the governing body, serving the latter's accountability interests.

It is not the intent of this chapter to try to describe the practice of internal audit in all its dimensions and details. There are many excellent publications that do this and a good starting point for the serious student of the subject would be the publications of the Institute of Internal Auditors. What is intended in this and the following chapter is to describe and examine the linkages between comprehensive audit and internal audit practice.

What is internal auditing?

Introduced several decades ago, a constant, prominent feature of internal audit work has been an assessment of the adequacy of an organization's system of internal control. Originally, internal audit was used in connection with the organization's financial transactions and was essentially devoted to determining whether established procedures were being followed. In both the private and public sectors, internal auditing has evolved over the years. Today, most internal auditors have terms of reference that include nonfinancial systems and practices, and it is now common for internal auditors to make recommendations for changes that will produce cost savings and other improvements.

The 1990 IIA *Statement of Responsibilities of Internal Auditing* describes internal auditing as follows:

> Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed … The members of the organization assisted by internal auditing include those in management and the board of directors.
>
> The scope of internal auditing should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities.

This definition is sufficiently broad to encompass a variety of arrangements that may result in a range of benefits for the organization. Some examples of the benefits of internal audit services are set out below. These "products" were identified in research[276] as being delivered by internal audit in different circumstances. They are not mutually exclusive; most internal audit groups provide more than one such product. Few groups would claim to produce all of them; internal auditors cannot be all things to all people—a focus has to be developed in each particular situation. And it is better for internal auditors if that focus is in line with the expectations of the person or persons to whom they report. In one situation or another, internal audit delivers:

- assurance of compliance with established policies and procedures for day-to-day operations (as appropriate, not all are always covered):
  - financial
  - personnel
  - materiel/purchasing
  - production or service delivery
  - marketing and sales
- identification of savings in operating costs in any or all of the areas noted above
- investigation of known problems and development of solutions in any or all of the areas noted above
- overall assessments of the reasonableness of the balance between risk and control in all or part of the systems noted above
- reduction of external attest audit fees by having internal audit staff work under the direction of the external auditor or by undertaking specific tasks—ranging from the preparation of detailed work papers and analysis, to the audit of branches and subsidiaries—on behalf or under the supervision of the attest auditor
- provision of information or special studies for management during periods of major corporate changes such as those resulting from undertaking new programs, work-force reductions or deregulation
- development of operating managers through the use of short-term secondments to internal audit to give them a broader perspective
- contribution to a positive environment, or a heightened awareness of control of performance issues within which cost-effective systems and practices can develop more easily
- assurance of the completeness, appropriateness and reliability of management information
- confirmation that joint-venture operations have been fully and appropriately accounted for and that governing agreements have been complied with
- validation of valuations used and assets acquired in takeovers
- the eyes and ears of senior management regarding suspected problems, bringing a fresh, nondepartmental perspective to bear on the interaction among, and integration of, organizational units

Client for internal auditing

Internal auditing is a key management practice, and usually the function reports to senior management and has management as its primary, if not sole, client.

This is not always the case, however. In some instances, the internal audit function reports directly to the governing body. In some municipalities, for example, the internal auditor reports directly to the city council. In still other instances, such as federal Crown corporations, the internal audit function is overseen by the audit committee of the governing body. In these circumstances, active and supportive oversight by members of the governing body can foster internal auditing and bolster its relative independence.

Organizationally, the internal audit function is usually set apart so that internal auditors can be independent of and objective about the systems, practices and operations they audit.

In that in the significant majority of circumstances internal auditors report to senior management, the remainder of this chapter and the following chapter are predicated on this relationship. Take note that, in cases where the internal auditor reports directly to the governing body, the interpretation placed on certain subsequent points would vary, or be expanded, accordingly.

Three key factors contribute to effective internal auditing and strongly determine the benefits that organizations can expect to realize. Senior management support is, by far, the most important factor. Senior management sets the expectations and controls both resources and access. The second most important element is the quality of the people who lead and staff the function. The third key factor is the organizational arrangements made for internal auditing and the structures within which internal auditors are expected to operate. Structures affect the way that people perceive and perform their roles and the way these are seen by others. They can facilitate or hamper productivity and affect the rate at which change takes place.

Senior management support: the organizational environment

The success of internal auditors depends first and foremost on the actual and visible support of senior officers. Real and recognized support at the highest levels of the organization gives internal auditors the independence they need to operate successfully far more than formal reporting levels, titles or mandates. From such support and the involvement of senior management, the following consequences can be expected:

- appropriate resources will be provided;
- respect for the function will be forthcoming;
- internal auditors will be better able to acquire the senior management perspective needed to implement the kind of internal auditing expected;
- staff of an appropriate calibre will welcome assignments to perform internal audits; and
- the attitude to the function of less senior managers—whose cooperation in the performance of audits and attention to the findings are essential to the effectiveness of internal audit—will be shaped.

Organizational status

The credibility of internal audit findings largely depends on the extent to which the auditors are perceived to be objective about, and independent of, the subjects they audit. This means that the internal audit function should be separate from the operational or support units whose systems, practices and operations it will subject to audit. In addition, individual auditors are more credible when they audit areas for which they are not and have not been responsible. Personal involvement diminishes the aura of independence and objectivity so necessary for effective results.

To some extent, the status and authority of the persons to whom the internal audit function reports will also reflect on the credibility of the function. It is less likely, for example, that a manager will take an internal audit of his or her area of responsibility seriously if it is done by a unit that reports to some relatively low-level functionary than if the function reports to an officer who is senior to the manager in question.

Formal organizational placement is only one way that senior management can demonstrate its support for internal auditing. Visible support can be given by a demonstrated willingness to have audits conducted in the areas for which senior managers are directly responsible. It can also be provided by establishing an environment where internal auditors have frequent informal contacts with senior officers and the audit committee if there is one. When they are known to have access to the top levels in the organization and to be sufficiently secure to report honestly without fear of adversely affecting their careers, internal auditors will enjoy a status within the organization that will facilitate their work substantially. Along with that status will come a respect throughout the organization for the independence and objectivity with which internal auditors approach their work and a growing acceptance of the auditing function and its reports.

Standards

Another way in which formal support for the internal audit function can be demonstrated is through respect for the implications of standards. Like most disciplines, internal auditing is governed by standards that establish expectations of good practice. These standards embody and codify the features that characterize, indeed create, an audit function as distinct from other forms of review. Without standards, there really isn't an audit; nor can there be reliance.

Looking at internal audit practices as a whole, the Institute of Internal Auditors sets out standards for internal auditing that deal with such matters as scope of work, independence and objectivity, performance of work, and leadership, staffing and management of the function. In specific organizational settings, further standards may be promulgated for internal audit work in that jurisdiction (an example of this can be found in the federal government, where IIA standards have been adapted and set forward by the Treasury Board Secretariat). Translation of such standards into specific, operational terms can provide a framework for clearly understood expectations that will help ensure that the work of internal auditors receives the support of senior management and merits being relied upon by external auditors.

Leadership and Staffing

The specific skills and knowledge required of internal auditors will depend on the nature of the businesses and activities of the organization under audit. Team building is a key to success. Sources of talent include both full-time internal audit staff and corporate staff that can be seconded to internal audit, either for brief projects or for longer terms often connected with career development. These resources can be further augmented by contracting out for professional services. The support of senior management is crucial here, since the function needs an adequate budget and executive clout to attract appropriate staff.

Leadership

Good leadership is essential if internal auditing is to implement comprehensive auditing successfully. Experience with comprehensive auditing indicates that particularly heavy demands will be placed on those who lead the process. Leaders may not personally possess all the skills and knowledge required by their teams, but they must be able to identify where and when specific skills are needed, acquire people with those skills and mould them into a team that can credibly complete the audit.

Leaders must display a number of personal qualities:

- insight to identify major issues;
- ability to recognize the need for expertise and the ability to use it;

- interpersonal and organizational sensitivity;
- ability to command respect and gain cooperation; and
- a flexible, constructive and innovative approach.

Skills

The credibility of internal audits depends on the credibility of those performing the work. It is essential, therefore, that the auditing and other skills available be appropriate to the tasks they are called upon to perform. Accordingly, this is one of the issues that external auditors will assess carefully as a predictor of the extent of reliance that can be placed on internal audits.

There will be instances where different types and levels of technical expertise will be important, both to deal with the subject matter of the audit and to establish credibility with those being audited. Internal audit teams will need to possess sufficient technical expertise to understand industry practices for the area under review. Without it, it is unlikely that they will complete their projects successfully or have their reports accepted.

Apart from this sort of technical expertise, there are other areas of knowledge that should be reflected in the team. These requirements arise from the peculiarities of this type of auditing and are described in chapter 24. Areas in which at least a minimum level of competence must be found among audit team members are:

- comprehensive auditing concepts and its components and characteristics;
- governance structures;
- organizational effectiveness;
- management functions and systems;
- appraisal processes and controls; and
- audit process.

Larger organizations are more likely to have internal audit groups with members from a wide range of professional backgrounds, although some smaller organizations have made significant strides in this respect. Assembling teams with all the skills that may be required, however, may be both difficult and expensive. Seconding personnel to internal auditing, especially on a short-term basis, offers one avenue for attracting special skills to the group without incurring major, ongoing, overhead costs.

Organizational arrangements for internal auditing

Not surprisingly, there is no single pattern used to organize the internal audit function. Each entity makes arrangements for its own convenience, reflecting its unique characteristics and needs. Four distinct organizational arrangements for internal audit are described below. The model chosen depends on how far the organization wants to go with internal audit, how fast, and where it is starting from.

Because external auditors often rely on examinations made by internal auditors (as discussed in the next chapter), the implications for such reliance is explored for the various organizational arrangements.

Financial/compliance pattern

The traditional pattern, commonly adopted when internal auditing was introduced, and still found in some organizations, is devoted to assessing compliance with established financial rules and regulations. In this pattern, internal audits address financial systems and practices with a strong orientation towards determining whether prescribed procedures are adhered to in practice. The internal auditors are, effectively, police in respect of such matters as limits of delegated authority and record-keeping procedures.

This pattern is now rarely found in a pure form. Several factors encourage a broadening of the scope of internal audit. One arises from the need to secure the cooperation of managers whose operations are subject to audit. This leads internal auditors to reflect on the reasons for noncompliance and to suggest improvements to prescribed policies and procedures. Another factor is the need to demonstrate the value of internal auditing to senior managers. This also provides an incentive for internal auditors to recommend improvements in existing systems and practices.

Taken together, these factors extend the focus of internal audit beyond compliance with procedures to the design of systems and practices. Initially, suggestions tend to result from inquiries into underlying causes for noncompliance. Only in time do they result from systematic examinations of the design of systems and practices. Similarly, there may be incidental observations in respect of nonfinancial operational systems and practices that can, over time, result in audits that deliberately seek to find improvements in these areas.

So long as these tendencies are neither recognized formally in the mandate of internal audit nor reflected in its staffing and organizational arrangements, internal audit can be regarded as fitting in the financial/compliance pattern.

Key characteristics

Leadership and staffing: In this pattern, groups are typically small and staffed by career internal auditors with a financial audit background who have relatively junior status among managers and professionals within the organization. The head of the unit commonly reports to the chief financial officer or controller.

Products: The scope of internal audits under this pattern is typically restricted to accounting systems and practices and, particularly, to those aspects that relate to record keeping and safeguarding of assets. The objective is to assess whether prescribed policies and procedures have been followed.

Reports of these units deal with such subjects:

- accounting controls over the initiation, recording and collection of revenues;
- physical inventory and related accounting records;
- the accuracy, validity and authority for payroll charges and the related accounting records; and
- the authority, validity and accuracy of recorded expenditures.

Reports result in observations and recommendations such as the following:

- Delegations of authority have not been revised since reorganization and are now outdated. I recommend that the delegation of authority be revised.
- Some units which have dealt with the same clients for several years without collection problems implement credit policy informally. I recommend that (the specified unit audited) adhere to approved credit terms and limits.
- The purchase journal at (name of unit) is redundant as invoices are recorded in the journal only upon payment. The number of invoices is limited and the unit has efficient control over the small number of invoices through an outstanding invoice file. I recommend that the purchase journal be eliminated.

Costs/Benefits: This traditional pattern of internal audit is relatively inexpensive, both in terms of the direct costs and the amount of senior management support and involvement required to maintain it and deal with the audits and resulting reports. It promotes adherence to laid-down policies and procedures, thereby supporting a centralized financial function that provides precise direction in the form of detailed accounting procedures.

Reliance implications

Much of the original impetus for this pattern of internal audit derived from a desire to demonstrate the reliability of an important but limited subset of management systems and practices: the internal accounting controls in which external financial auditors are also interested. Other systems and practices are seldom, if ever, addressed. Accordingly, internal auditing in this financial/compliance pattern is likely to be more relevant to the external financial audit than to comprehensive audits.

Expanded scope pattern

A common internal audit pattern is one in which the scope of internal audits has been expanded to include not only financial controls, but also day-to-day operational and delivery systems and practices. In addition, the focus of these internal audits has been widened to consider not only compliance with prescribed systems and practices, but also the possibility of improvements in their design. This is the most common way in which internal auditing has begun to address issues bearing on economy, efficiency and effectiveness.

In many cases, this evolution has taken place over many years, reflecting repeated successes in attempting to be helpful by producing suggestions for savings. The result is a growing recognition of the value of internal audits and an increase in requests for this kind of examination. Typically, this reflects the long-term impact of a constructive approach on the part of the leader of internal audit, rather than a major initiative of senior management. Eventually, this broadening of the role of internal audit may be formally reflected in the mission of the internal audit group.

Key characteristics

Leadership and staffing: In this pattern, the internal audit group has the advantage of building on an established auditing discipline. However, new skills will probably be required to address new issues and different levels of systems.

In general, such groups are dominated by career internal auditors with a financial auditing background. Depending on circumstances, some of these groups include individuals with skills in such areas as EDP or engineering. Secondments and contracting for services are sometimes used to ensure that the required skills are available for specific audits. Reporting relationships of groups that have expanded their scope tend to vary, some reporting to the chief financial officer, others to the chief executive.

Costs: The costs of such groups, relative to the organization's total work force, assets or expenditures, vary considerably. A survey was made in 1986[277] of internal audit units in federal Crown corporations. As a proportion of corporate expenditures, the budgets of the internal audit groups of this pattern that participated in the research varied from 0.4 cents per $1,000 to 3.6 cents per $1,000, with an average of 0.7 cents per $1,000. The variations may reflect the needs of the different industries in which the corporations operate. For example, internal audit budgets of financial corporations tend to use a higher percentage of expenditures than those of nonfinancial corporations. Size also has an impact. The percentage costs tend to be lower in larger corporations. There are, however, significant exceptions to these generalizations.

Products: Typically, the formal scope of audit of groups following this pattern has been expanded to include all systems and practices of the organization. In practice, the extent to which the mandated scope is actually covered varies, largely depending on the stage of evolution of the group and the skills available. Initially, the focus may continue to be placed on the financial aspects of the systems and practices audited, with observations on efficiency and effectiveness arising in an *ad hoc* way rather than as the primary focus of the audit. As development proceeds and demonstrable results are obtained, both the internal auditors and managers feel more comfortable with internal auditors addressing systems and practices that are more operational in nature. When the internal auditor has established a degree of credibility, internal audits may be used to examine and review known problem areas and to develop solutions.

In addition to those encountered in the traditional pattern, examples of the objectives of internal audits that have been performed by groups organized in the expanded scope pattern include:

- to review distribution system development to date, with emphasis on computerized security and control features, and to review implementation plans
- to review the acquisition, utilization and management of personal computers, terminals and peripheral equipment, including a review of the adequacy of policies and procedures in the personal computer area at all major centres
- to examine the overall purchasing function and its delegation to ensure that the most effective and efficient degree of control and service is being obtained (Included in the audit was a review of computer support, policies and procedures and other activities such as bid procedures, quality control, and vendor analysis.)
- to evaluate whether or not a specified capital project was carried out with due regard for economy, efficiency and effectiveness, and whether or not measures had been taken that might benefit the management of future projects
- to evaluate whether the training, management and organizational development group can and does fulfill its stated role and mission economically, efficiently and effectively
- to review the marketing function, including market research, product development, pricing and advertising

The recommendations produced by internal auditors in the expanded scope pattern are frequently aimed at achieving direct quantifiable savings. Typical examples include:

- recommendations for improvements in cash utilization by deferring mailing of accounts-payable cheques
- recommendations for minor changes in material handling equipment leading to significant reductions in spoilage
- recommendations that specific systems under development be halted pending confirmation of, for example, user needs, feasibility, cost/benefit analysis or volumetrics
- recommendation that a particular group be disbanded as its role is obsolete or redundant

Benefits: A major benefit of this pattern is its gradual approach. Internal audit develops from an auditing discipline applied to financial systems and practices. Expansion into nonfinancial systems and practices builds on this base as existing internal audit staff gain credibility in other areas, or as other skills are added to the auditing discipline. As the internal audit function develops, it engenders its own support through demonstrating its ability to assist managers by identifying cost savings and solving problems.

Expansion can occur, although at a relatively slow rate, with only a moderate investment of senior management time, effort and prestige. Accelerated expansion requires that senior managers make significant efforts to create initial support for the expansion, to assist in securing the services of appropriate staff, often against competing demands in the organization, and to encourage other senior managers to give their time and attention to internal audit findings.

The expanded scope pattern tends to be minimally disruptive to existing internal audit staff. It also tends to be satisfying to them, since all staff are involved in the challenge presented by the expansion of scope.

Finally, because there is at least the potential to integrate all dimensions of audit work in all projects carried out by internal auditors, there is a possibility that the operational impact on managers who are subjected to internal audit will be minimized.

Reliance implications

The reliance implications of this pattern will depend largely on how far the evolution from financial/compliance auditing has progressed and how far the capabilities of staff have advanced in support of expanded scope. External comprehensive auditors will be cautious in accepting the assessments of internal auditors with respect to systems and practices governing day-to-day operations when there has been a significant expansion of internal audit scope but little commensurate change in internal audit personnel.

External auditors will require extensive corroboration of the reliability and completeness of internal audit assessments in areas where internal auditors have little previous familiarity and/or demonstrated competence. Over time, and as both management and the internal audit group develop confidence in internal audit's ability to assess systems and practices of various kinds, the potential for reliance can be expected to increase.

Before relying, however, the auditors will have to be confident of the independence and objectivity of internal auditors in those areas in which reliance is contemplated. With respect to systems and practices governing day-to-day operations, reliance will depend on the status of the internal audit group and its leader, and on their credibility in the eyes of senior management. If the internal auditors have the respect of senior management and their assessments are known to carry weight at the executive level, it is probable that they can attain the required level of independence to perform reliable audits of systems and practices governing day-to-day operations.

As this credibility is established and internal auditors become more deeply involved in operational matters, they will likely begin to touch on issues that relate to corporate organizational practices.

A possible consequence of an expansion in the scope of internal audit, especially where this change is achieved without additional resources, is that the degree of attention paid to financial and accounting controls will diminish. The organization may inadvertently and unknowingly weaken its systems and practices in these areas, and the external auditor may find that additional work becomes necessary in support of the audit of financial statements.

Separate group for performance issues

This pattern has been adopted by some organizations when starting to undertake internal audits of economy, efficiency and effectiveness. In this pattern, a new group is formed to give initial impetus to this type of auditing, while the existing internal audit group continues to perform such internal audits as they have traditionally been doing—usually an expanded scope form. In the longer term, and after economy, efficiency and effectiveness auditing is suitably established, the two groups may be combined.

The main thrust of this approach is to provide faster results through concentration of effort.

The separate group provides a focus for auditing performance issues. It emphasizes that internal auditing is departing radically from previous practice, and it unmistakably signals senior management's support for the initiative.

Key characteristics

Costs: The initial costs of arrangements in this pattern can be considerable. The personnel involved may be more senior that those found in traditional internal audit groups. It requires a substantial investment of senior management time to create support for the function, to assist in identifying and assigning appropriate staff (usually from within the organization) and to ensure that senior managers give their time and attention to internal audit plans and findings. Moreover, the internal audits performed cost more than the average for other groups, a reflection of the complexity of the issues dealt with in the higher-level systems they tend to examine.

Sponsorship: This pattern involves a sponsor at the highest level in the corporation who convinces senior management that the benefits are worth the costs and persuades a suitable candidate that an assignment to lead the group will be a positive career step.

Leadership and staffing: This pattern is also characterized by extensive use of term assignments. The leader may not be a career internal auditor. Similarly, the internal audit staff in these groups may be drawn from technical or operating divisions for limited-term assignments to bring to the group the required familiarity with operations. Auditing skills may be brought in from the traditional internal audit group or by recruiting or contracting from the outside.

Products: It may be expected that such groups would focus on effectiveness and efficiency issues at a higher level than would groups under other patterns in the initial stages. Reports might address such topics as the performance of significant operation units, and the sufficiency and appropriateness of information provided to senior management, and/or to the board, as a basis for ongoing management of the corporation.

Benefits:

- concentration of scarce skills on issues of economy, efficiency and effectiveness, rather than on audits that also encompass financial and compliance aspects;
- the benefits of existing internal audit are maintained.

Reliance implications

These groups would be formed and staffed to address issues that should be directly relevant to comprehensive auditors. Considerable reliance could be placed on their work, provided it has been performed objectively and in accordance with appropriate standards.

Such groups will normally be independent of systems and practices governing day-to-day operations, as long as staff are not assigned to audit activities for which they have previously been responsible, or in which they expect to become involved later.

The issue of independence becomes more difficult when audits are done in the area of corporate organizational practices and information provided to the board. Some of the issues encountered at this level may be so deeply ingrained in the corporate culture and ethic that it is difficult for a person employed by the company to be—and appear to be—objective about them. Accordingly, external auditors may be concerned about internal audit independence and may require rather more corroboration of such opinions. Organizations that have followed the separate group pattern have taken a number of steps to bolster independence when undertaking audits in areas in which their independence or objectivity might be open to question. These include the use of expert advisory groups with internal and/or external representation and the use of external resources on the team.

Contracted execution pattern

The internal audit patterns discussed above are found in larger organizations. Effective comprehensive auditing depends on the synergy generated by a multidisciplinary team. Such synergy, however, cannot be generated in a one-person operation. In smaller organizations, the development of such a team may represent a greater investment than management is willing to or should make. As a proportion of the organization's effort and resources, the costs of a self-sustaining, broad-scope internal audit group may be unacceptably high. And yet there may be a recognized need for some comprehensive auditing within the organization.

Two Crown corporations that participated in the survey mentioned above had a solution for this problem. Although they had internal audit groups, they indicated that it wasn't possible or desirable to maintain a permanent internal audit staff capable of addressing the full range of issues raised by the management systems and practices of the corporations. One-half to one-third of their internal audit budgets are used to contract for external assistance with broader-scope audits. While some internal capacity for auditing is retained, the primary role of the internal audit leader is to make sure that the right things get audited and that the resulting opinions are appropriate.

To this end, the internal audit leader, in conjunction with the audit committee and senior management, selects and puts priorities on projects, and is involved at the planning stage of each project. This includes establishing project objectives and approach, selecting contractors and ensuring that these outsiders understand the project, the nature of the operations and the relevant corporate background. During the conduct phase, the internal auditor serves as a resource to the audit team, assists in the development of opinions and ensures that they are fully supported by the evidence, that they reflect the corporation's environment and that they are practical.

Reliance implications

In such an environment, external comprehensive auditors would apply the same tests concerning reliance as they would to internal audits conducted by corporate employees. There appears to be no reason to suppose that properly conducted audits performed under this pattern should be any less reliable than those performed under other patterns. It would be necessary, of course, for the organization to require that contractors provide external auditors with access to their personnel and files regarding the internal audits performed.

Audit committee oversight

Not all organizations have audit committees comprising members of the governing body. Where they do exist, their oversight, when carried out with sensitivity and care, can foster internal auditing, bolster its relative independence and improve the prospects for reliance. It is a particularly visible manifestation of support. It also has the potential to alienate the internal auditor from his or her primary client—management.

The audit committee's interpretation of its responsibility to oversee internal audits varies from organization to organization. The level of involvement will depend on:

- the availability of members of the committee and their level of interest in internal audit;
- the level of involvement of the governing body in the day-to-day management of the

New ground broken in internal audit in federal Crown corporations

The Financial Administration Act breaks new ground in requiring Crown corporations to conduct internal audits. This is the first reference to the internal audit function in Canadian corporate legislation and is phrased in what is now section 131 as follows:

> *(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.*

The subsections (1) and (2) referred to are those that require corporations to keep books of account and to maintain management systems and practices in a manner that provides reasonable assurance that assets are safeguarded, that the requirements of the Financial Administration Act and other pertinent authorities are complied with, that resources are managed in an economical and efficient way and that operations are effective.

This provides a broad term of reference for the corporations' internal auditors. No restrictions are imposed on them by the act. Here is clear evidence that Parliament wants internal audits that go well beyond more traditional assessments of compliance with financial and accounting procedures.

The act uses the words "reasonable assurance" and, in so doing, implicitly recognizes that the costs of systems and practices should not exceed the benefits likely to be derived. As internal audits must assess compliance with the act, they must also be concerned with the concept of reasonable assurance and must deal with the trade-offs between the costs of controls and their benefits. It follows that it will not be sufficient for internal audits to assess whether the procedures laid down by management have been followed—they must also assess whether the systems and practices are well designed in the first place.

The act specifically requires auditors to rely on internal audits to the extent they consider practicable and to report the extent of this reliance. This, too, is a novel statutory provision.

Although the statutory requirement to conduct internal audits is new, internal auditing is a management practice common to many Crown corporations, as it is to other organizations. The issue facing Crown corporations as a result of the internal audit amendments, therefore, is typically not whether to implement an internal audit function, but rather how to ensure that they capture the benefits (including optimal reliance) of broad-scope internal auditing as called for by the legislation. The act has introduced new considerations that corporations will want to take into account in designing, staffing and allocating resources to their internal audit function. Specifically:

- reliance on internal audits can reduce the costs (in terms of fees and demands on staff time) of special examinations; and
- internal audits bearing on management systems and practices will help the corporation maintain those systems and practices appropriately, thereby reducing the possibility that a significant deficiency might exist and be uncovered by the special examination.

Both of these, of course, are in addition to the benefits that directors and managers are currently receiving from internal auditing.

The act gives no details about how internal audits are to be done or how the internal audit function is to be organized; it does not even define the term. Crown corporations, therefore, are left to decide for themselves how they will arrange their affairs to meet the statutory requirement.

In section 150, the act gives the audit committee the duty to oversee any internal audit that is conducted pursuant to the above subsection (3).

organization; and
- the importance of internal audit in the overall control system of the organization.

Where there are statutory responsibilities to oversee internal audits of management systems and practices (as is the case for federal Crown corporations), audit committee members should be involved in the development of an appropriate and healthy internal audit function for the organization. They should consider the internal audit mission, charter, resourcing strategy and plans, the interaction of internal audit with management and with the external auditor.

Other elements of the committee's role with respect to internal audit may involve members in:
- reviewing long-term plans to ensure that they are appropriately coordinated with the long-term plans of the annual auditor and the comprehensive auditors;
- reviewing the annual internal audit plans for the same reasons;
- reviewing the plans of specific projects that are of particular interest to the audit committee, either because they are of importance to the comprehensive or annual audit, or because significant negative results are anticipated, or simply because the project is considered to be of particular importance to the board;
- reviewing the reports of these important projects, including management's responses to the recommendations;
- receiving and reviewing annual reports from the internal auditors that set out the group's achievement compared to plans, and a summary of its major findings and recommendations.

All concerned should guard against unrealistic expectations about the oversight role. The audit committee is charged with overseeing, not managing, internal audits. Accordingly, they may not wish to see or react to individual internal audit reports even if time allowed them to do so. Instead, their focus may be on satisfying themselves that management has instituted and is maintaining appropriate arrangements for internal audit, that internal auditing is providing reliable assessments of important management systems and practices and that management gives due consideration to these assessments.

It is not uncommon for the head of internal audit to have a right of access to the chairman of the audit committee. Where this is the case, how often and on what issues to exercise this right are matters that require the internal auditor's keen professional judgment. On the one hand, it is important that the audit committee and internal auditor keep each other informed on matters of mutual interest; on the other, in this scenario, internal auditors need to maintain an effective balance in their relationships with both senior management and the governing body. Establishing and maintaining this balance is usually hard won and, all too often, is something that is easily lost.

INTERNAL AUDIT REPORTS

Historically, internal auditors have tended to produce long-form reports that present their findings and focus on opportunities for cost savings or improved procedures. Such a constructive approach helps build support for the audit function, secures the cooperation of the managers audited and leads to adoption of improvements.

Benefits associated with recommendations are sometimes quantified and reported so that senior management can assess the cost/benefit of the internal audit function.

There may, however, be dangers associated with the quantifying of benefits. First, it may be difficult to establish attribution with confidence. In addition, the focus on quantifiable savings may bias auditors towards issues where quantifiable results are likely to be achieved, at the expense of softer issues such as long-range planning that can have a significant impact on costs. Furthermore, having to quantify the benefits and effectively take credit for them may not enhance the relationship between auditor and auditee.

In the past, internal auditors have seldom attempted to reach an overall opinion regarding the adequacy of the systems and practices audited. Several of the groups participating in the aforementioned survey, however, were working towards reporting in this manner in order to improve their usefulness to senior managers. This trend can be expected to continue as internal auditors respond to the requirement in the Financial Administration Act to assess whether the degree of assurance afforded by systems and practices is reasonable. In addition, without such concise assessments, examiners may find it difficult to evaluate the significance of internal audit findings, and the potential for reliance may be diminished. A mere listing of findings, opportunities for improvement or departures from criteria will not be particularly helpful to an examiner.

Indispensable features of a good audit report are that it presents its findings fairly in the context of an overall opinion and provides sufficient information to give the reader an opportunity to appreciate the significance and basis of the auditor's findings. Guidelines have been developed, and widely accepted, for the reporting of comprehensive audits in other milieus (discussed in chapter 18), and for dealing with such issues as significance and level of audit assurance. Consensus exists that those guidelines would be appropriate for internal audit reports and that their adoption should prove useful in facilitating reliance.

275 The Institute of Internal Auditors, *Standards for The Professional Practice of Internal Auditing* (Florida: The Institute of Internal Auditors, 1978).
276 Reported in *Special Examinations, Internal Audits and Reliance: A Practitioner's Guide* (Ottawa: CCAF, 1987).
277 Ibid. This survey was a key element of the supporting research for the *Special Examinations, Internal Audits and Reliance* publication.

Chapter 22

Other Review Processes—Coordination & Reliance

As discussed in the previous chapter, many organizations subject to comprehensive audits are themselves trying to promote improved performance through internal audit. Frequently, not all this kind of work done inside organizations is called internal audit. Program evaluations, for example, are often engaged to assess whether the results of operations are worth the investment of time and resources; some organizations have units exclusively devoted to this practice. In addition, managers often initiate studies of elements of their operations that deal with performance issues. These may be done in-house or by using outside consultants, or by a combination of the two.

While internal audit is used as the main example here, similar factors apply to all these kinds of examinations when external comprehensive auditors consider relying on their results.

It is important for comprehensive auditors to know about work of the kind described above because reports of this work can provide them with important information that improves their understanding of the organization. Those reports may also lead the external auditors to examine more intensely, or effectively to ignore, an area that has already been studied. Thus, these studies can have an important impact on scope decisions for comprehensive audits. Finally, if they have been done with appropriate objectivity, independence and professionalism, external auditors may be able to rely on the reports, thus economizing on audit effort and cost.

Coordination and cooperation

A constructive, professional relationship between the external auditors and the internal auditor and others doing work of interest to the former is essential if the full benefit is to be derived in the long term. This relationship is not an event that happens at one point in time; it involves more than one evaluation and a once-and-for-all conclusion. Reliance is significantly influenced by the ongoing relationship that should, through regular contact over time, become a relationship of trust and mutual respect between the two parties.

External auditors should realize that the way they approach, treat and refer to internal auditors and others is going to have an impact on developing a sound working relationship with them and their ability to rely on their work in the long term. One key element in establishing trust is that the external auditors have a clear appreciation of the state of development, mandate and value of internal audit or other appropriate function.

As trust and mutual respect develop, the benefits derived from the relationship can be expected to increase substantially. Regular contact between the two parties may result in the identification of numerous opportunities to improve audit effectiveness and reduce audit costs. In addition, each party is likely to benefit from the sharing of methodology, terminology, training, follow-up efforts and evaluations that will inevitably occur.

Given substantially compatible objectives, it only makes sense that the two parties coordinate their activities. Coordination might include:

- seconding personnel from one group to the other, usually on a project basis
- combining forces on a particular project, but with ultimate responsibility for the project resting with one group
- coordinating plans to ensure not only that reliance is effectively implemented, but also that the inevitable demands they make on the time of the staff of the organization are minimized
- one group performing specific tasks for the other

In addition to minimizing cost and disruption, an important objective of coordinating activity is to make the best use of available resources. For example, internal auditors typically have the considerable depth of knowledge of the organization that one would expect of a professional employee, and may also enjoy knowledge and skills in relevant specialist areas. Similarly, the external auditors may possess particular skills in relevant specialist areas such as EDP that are not available within the internal audit group. There may be opportunities to mix and match resources to produce a synergistic improvement in results for either or both groups while, at the same time, containing costs.

It is possible, of course, that over time the relationship between external and internal auditors or other officials could sour. This is particularly likely if either party sees a decline in the credibility of the other in the eyes of the governing body or senior management. It is in the interest of all to see that this does not occur.

No matter how good the relationship between external and internal auditors, there are still several inherent differences in the nature of the two types of audit, and in the responsibilities of those performing them, that will affect the degree or extent of reliance that can be expected. Where these factors are well understood by both parties, the relationship between them should be strengthened, not weakened.

Reliance

As discussed in chapter 20, in appropriate circumstances external auditors may rely on the work of others and avoid having to replicate what has already been done. As noted earlier, reliance in the context of a comprehensive audit is the substitution of work done by others for work that would otherwise have to be performed directly by the external auditors. In the context of this definition, work done by others includes their assessments as well as the detailed supporting work.

The importance of reliance is recognized by all auditors. The Office of the Auditor General of Canada *Manual*, for example, contains this policy statement:

> Audit teams should rely, to the extent practicable, on the work of internal auditors and program evaluators and on other studies, if they have been carried out in accordance with appropriate professional standards.[278]

For purposes of convenience, the discussion below refers primarily to reliance on the work of internal auditors. It should be remembered, however, that there may be other groups in the audited organization that produce reports dealing with management systems and practices, program performance, and so on. The work product from such groups should also be assessed for its reliance potential. These studies are considered later in the chapter.

Planning for reliance

External auditors do not place reliance blindly. They must satisfy themselves that the work on which they rely meets appropriate standards. As the OAG Canada *Manual* says:

> Where the auditor relies on entity studies, internal audits or evaluation work, he or she should obtain sufficient independent evidence to judge the quality of that work.[279]

External auditors can be expected to look at internal audits and internal auditing arrangements in two ways. The first is to evaluate the overall appropriateness of the function and the arrangements provided for it. External auditors will do this where internal auditing is one of the management practices that falls within the scope of their inquiry. Even where internal audit is not included within the scope of the comprehensive audit, external auditors will examine these arrangements because the assessment that results will serve as a predictor of the extent to which they can rely on internal audits.

The second way is the assessment of individual internal audit projects. External auditors will initially identify the groups, however named, that are carrying out internal audit work, and assess the suitability of the arrangements for internal auditing in the organization.

Assessment of arrangements

The overall assessment can embrace all significant aspects of the arrangements for internal auditing in the context of what can reasonably be expected in an organization of the size and nature of the specific one under examination.

External auditors will be interested in more than just the current state of internal auditing in the organization. To get a realistic appreciation of the function, they will have to consider its historical development, stability and the manner in which its relationships with other parts of the organization have developed. A mere snapshot of the function might ignore a significant trend in its development and result in an assessment that might on one hand underestimate the growing credibility of an internal audit group or, on the other, provide a false sense of security to directors and managers.

Each organization must determine the level of internal audit services that is appropriate to its circumstances and culture and then establish the function accordingly. In a specific organization at a particular time, the internal audit function might be consciously established with a mandate, organization and/or resourcing strategy that does not allow it to address fully all aspects of management systems and practices. This does not necessarily mean that the function is inadequate. Rather, it points out the need for external auditors to take into account the respective contributions of both senior management and internal auditors towards an effective internal audit function. Accordingly, the external auditors should first explore the role and resources that senior management establishes for the function and compare these with the what might be expected in such an organization. Differences identified are the responsibility of senior management and should be discussed with them. External auditors can then realistically compare the actual organization scope and performance of internal audit work to the mandate it has been given.

As in other aspects of comprehensive audits, the ideal situation is one in which the external auditor substantiates management's evaluation. Situations where the auditors' assessment is significantly different from that of management or where the auditors must generate the assessment from scratch, might indicate that the auditors have failed to understand management's perspectives, or could even suggest that management is not taking its responsibilities for internal auditing sufficiently seriously. Accordingly, in developing their opinions, external auditors will need to interview people other than internal auditors, including members of the audit committee, if one exists, and senior management.

The following is a discussion of the key factors that bear on the assessment and the kinds of questions that external auditors might first ask themselves in this regard.

Questions bearing on the auditors' assessment of internal audit arrangements

Questions regarding the role of the internal audit function within the organization

- Do the general scope and specific plans of internal audit make sense in terms of the inherent risks of the operations, the organization's strategic plans and the environment in which the organization operates?
- Do senior managers, the audit committee, if there is one, and the head of internal audit agree on the role of internal auditing and the benefits it is intended to produce?
- Do organizational, staffing and reporting arrangements for internal auditing make sense in relation to the general scope and specific mission assigned?
- Is internal auditing producing the intended benefits?
- How well is internal auditing accepted in the organization? Do senior mangers and managers being audited trust and respect the internal auditor? Do they consider seriously and follow up on internal audit findings?
- Are undesirable potential effects of internal auditing, such as substitution of internal audits for good management practice or an unduly adversarial environment, recognized and avoided?
- How well does the internal audit function adapt to new issues and interact with management to secure resources and obtain management's cooperation and consideration of its findings?
- Is the overall cost of internal auditing reasonable compared with industry norms and the work produced? Are there more cost-effective means of providing some of the benefits this organization derives from internal auditing?

Questions regarding the internal audit group itself

- Are responsibilities for the delivery of the internal audit program clearly understood and reflected in the organization, structure and auditing processes of the group?
- Do internal audits and the unit's support activities (such as training) logically contribute to the mission of internal audit in the organization?
- Do all members of the internal audit group understand the role of internal audit in the organization and how they should act as individuals to further that role?
- Does the morale of internal auditors suggest that the function is healthy and that competent professionals will be attracted and retained? Are internal auditors challenged, provided opportunities for personal development and encouraged to use their initiative?
- Is there reasonable assurance that there will be appropriate continuity of key people within the internal audit function to provide an effective "corporate memory"?
- Are key aspects of internal audit performance (quality, timeliness, acceptance) monitored and reported appropriately? Are these reports used?
- Are standards of performance met? Do monitoring reports accurately reflect the performance against standards?
- Are appropriate auditing techniques and staffing patterns used to maximize the output of the function? Is the level of nondirect time reasonable?

Key factors in the assessment

To assess the overall arrangements for internal audit, auditors must appreciate the factors that contribute to effective internal audit and the relationships between those factors. These factors can be grouped under the following headings:

- supportive senior management and organizational environment
- a clear mission and adequate direction within the mission
- appropriate leadership and skills
- standards of performance and quality assurance

Supportive senior management and organizational environment

Checklists for the evaluation of internal audit function are typically based on standards. They provide a list of questions to be addressed and a framework for organizing the information gathered in the course of the review. They must, however, be tailored to reflect the expectations of internal auditing in the specific organization; they do not in any way relieve the external auditors of responsibility for assessing the function in the context of any relevant legislative provisions and the organization's circumstances.

Because of its importance to the function, external auditors must have a solid appreciation of the strength of, and limits to, management's support for internal audit, not only as reflected in formal documentation, but also in terms of the behavioural aspects—the day-to-day interaction between internal audit and management. The implications of senior management support are discussed in chapter 21.

A clear mission and adequate direction within the mission

As described in the previous chapter, the systems and practices subject to internal audit could range from the purely financial, to the full array of management systems and practices; and the level at which internal audits are expected to operate can range from day-to-day operations, to the information provided to the board. Moreover, the focus of internal audits can range from assessing compliance with clearly defined requirements, to identifying opportunities for improvement (or deficiencies), to providing overall opinions on the systems and practices audited. The focus of internal audit in an organization may change over time to reflect changes in management structure, style or priorities.

As internal audit functions can experience so much change, external auditors will be concerned that the benefits that internal auditing is intended to produce are clearly understood by all concerned and that they are reflected in internal audit plans and capabilities. An internal audit charter typically provides a general description of the scope of systems and practices to be subject to internal audits. Beyond this general description, expectations should be as clear as possible about the mission of internal audit—what it is supposed to do in respect of the systems and practices that it audits, and how it is supposed to benefit the organization.

Internal audits cannot be all things to all people in the organization at the same time. Attempts to please everybody usually result in just the opposite: internal audits are not exempt from this truism. A clear, realistic and shared understanding of its mission is important for the internal audit function's success.

In this connection, it is worth noting that if the internal audit function is directed unduly to producing reports on which external auditors may rely, there may be a tendency to pay less attention to other issues of more direct interest to managers. If left unchecked, this could result in the eventual loss of support for the internal audit function and in the loss of some of the benefits that the organization had previously been receiving from internal audits. Accordingly, it is important to keep in mind that the primary purpose of internal auditing is to serve the organization, not the external comprehensive auditor.

A mission is only a string of words until it is reflected in plans. External auditors should look for internal audit plans that are realistic and that reflect a logical relationship between the mission to be achieved and the specific work to be done.

Typically, internal audit plans are based on a three- to five-year cycle, updated annually. The plan for the current year is usually developed in greater detail than the plans for the balance of the cycle and is subject to change as the internal auditors respond to changing circumstances, management or audit committee priorities and specific requests.

External auditors will be interested in the plan and the process by which it is developed. Specifically requested audits and the involvement of senior management in the development of the basic plan are indicators of support for internal audit and should yield a plan that focuses on important issues. At the same time, numerous changes in internal audit plans to accommodate requested audits may suggest either that internal audit judgments were faulty to begin with, or that management has drawn the function into the management process to an extent that blurs its proper role. Although flexibility is good, excessive *ad hoc*ery will be judged a weakness.

Appropriate leadership and skills

External auditors will consider whether the knowledge, skills and experience of the internal audit staff mirror the scope of their work. In doing this, they will consider the attributes of good internal auditors indicated in the previous chapter.

Standards of performance and quality assurance

Standards of performance and quality assurance are key characteristics of the practice of internal auditing. For reliance purposes, they are essential.

The external auditors will seek evidence that standards have been established for the performance of internal audits and that effective processes have been adopted to assure the quality of individual audits. The degree to which the evidence suggests that appropriate standards are applied to all internal audits will affect the amount of corroborative work the external auditors will perform in respect of any particular audits on which they are planning to rely.

It is important to note that external auditors will apply the same standards to any specific projects undertaken within the organization by groups other than internal audit if they are to rely on them in the audit. It is the standards that define the audit, not the organizational designation of the people performing the work.

These, then, are the key factors in the assessment. What might the outcomes be? The next section examines the range of outcomes that might result from this assessment and their reliance implications.

Outcomes of the assessment of overall arrangements

In preparing their overall assessment of internal audit arrangements, external auditors will address the following questions:

- Have an appropriate role and resources adequate to the role been given to internal audit in light of the nature and needs of the organization?
- How well is internal audit using the resources to fulfill its given role?

Appropriateness of role and resources

As noted earlier, effective internal auditing demands that both senior management and internal auditors play their respective parts. The direction and control of internal audit is a senior management prerogative and responsibility; senior management must balance a number of sensitive factors when they exercise their prerogative. This investment of management effort should prove worthwhile, however. An organization that sets realistic but challenging expectations for its internal audit function, and provides it with commensurate resources, has provided a firm foundation upon which the internal auditor can build. The prospects for an effective internal audit function—and therefore for reliance—will have been significantly enhanced.

Organizations can enhance the prospects for reliance by providing internal audit with an appropriate role and resources.

A situation that should cause the external auditors concern would be one in which an unduly restricted role has been given to internal audit. For example, the auditors may find that, notwithstanding an apparent capability, internal audits of certain functions are not performed, perhaps not permitted. Or they might find that the resources made available for internal auditing are not sufficient. Such a situation would suggest that the internal audit function is either not understood or not accepted. It might well raise the possibility in the external auditors' minds that the organization is not fulfilling its responsibilities with respect to the other aspects of the management charge and that there may be undisclosed weaknesses in underlying systems and practices. At the very least, the auditors would have to consider reporting a significant deficiency regarding internal auditing.

Organizations that have not provided internal audit with an appropriate role and resources run the risk of having a significant deficiency reported.

Internal audit's fulfillment of its role

It may be found that internal audit is failing to fulfill, or to fulfill completely, a role that has been reasonably defined, even though sufficient resources have been provided to it. In the course of the transition to comprehensive internal auditing, for example, internal auditors will, on occasion, fail to meet completely the objectives that they set for themselves. Provided these occasions are acknowledged and honestly reported, auditors will recognize that it is better to have achieved part of an ambitious goal than not to have tried.

In the worst-case scenario, internal audit is found to provide assurance where it is not warranted. Either by undertaking work for which they lack the capacity, or through failing to communicate the significance of their findings, internal auditors might convey a false sense of security to senior management. In such circumstances, the external auditors will have to determine whether the situation is sufficiently serious to constitute a significant deficiency.

Where the organization has provided an appropriate role and resources, but the internal audit function has failed to perform up to expectations, the auditors should consider whether a significant deficiency exists.

In such cases, the prospects for reliance are considerably diminished. Reliance requires a degree of trust; a situation in which internal auditors allow a false sense of assurance to be drawn from their work does not generate that feeling.

Even though their assessment has disclosed some weaknesses in the overall arrangements for internal auditing, it may still be possible for the auditors to place some degree of reliance on specific internal audits that are relevant to the audit and that have been performed in accordance with appropriate standards. In such cases, of course, the auditors may require more evidence regarding the conformity to standards of individual internal audits than in situations where the overall assessments are satisfactory. The depth of this project review will be correspondingly greater.

Notwithstanding deficiencies in the overall arrangements for internal auditing, auditors should consider placing reliance on any relevant internal audit that is satisfactorily performed.

Developing a tentative strategy for reliance

Identifying projects for reliance

To rely on internal audits, external auditors will have to evaluate individual internal audit projects to establish their relevance to the comprehensive audit and the competence with which they have been conducted. Although the competence issue cannot be finally assessed until the internal audit work has been completed, much can and should be done prior to that time to provide a basis for a realistic reliance strategy.

The first step in any reliance strategy, then, is to identify all those internal audits, whether planned or completed, that are relevant to the comprehensive audit. An auditor's preferred option should be to rely on relevant internal audits unless the cost of doing so will clearly outweigh the cost, to the auditor and to the organization, of doing the work directly.

During the survey of the organization, external auditors assess the risks inherent in the organization's operations and identify those systems and practices that are vital to the audit opinion. Once these systems and practices have been identified, auditors should ascertain if internal audits have covered, or plan to cover, all or part of the ground in which they are specifically interested.

As mentioned earlier, there may be groups within the organization that conduct studies that, although given a different name, could be considered internal audits. Auditors should consider the work of all such groups to determine if they, too, produce candidate projects for reliance.

It may well be that a proportion of the work of internal audit is not of interest to external auditors. Such a situation may simply reflect differences in the internal audit priorities of management and the auditors' particular selection of issues to be examined in detail.

Preliminary review

The external auditors should investigate the nature of the chosen internal audits to determine whether they actually address issues relevant to the audit. Where differences in scope, design or focus of internal audits appear to present barriers to reliance, the external auditors and the internal auditor should explore whether the latter is willing to make adjustments to accommodate reliance. It must be stressed that internal auditors serve the organization, not the external auditors; similarly, auditors must avoid giving the impression that they are trying to take over internal audit. In the long run, such a perception could diminish the potential for reliance by eroding management support.

Unless there are obvious reasons that the external auditors could not expect to rely on internal audits—for example, internal audits are being planned that address management systems and practices of a nature, at a level or in a quantity for which the internal audit group clearly has not commensurate resources—it should, in most cases, be possible to place at least some degree of reliance on internal audits, notwithstanding some differences in scope, design or focus.

Documenting the strategy

The audit plan will typically include a list of projects to be carried out by the external auditors. The plan should also describe the overall strategy for reliance and the extent of reliance contemplated for each audit project. All the internal audit projects planned could be displayed and those of relevance to the auditors highlighted along with their expected impact on the auditors' work.

The presentation of the reliance strategy will vary greatly among organizations depending, in particular, on the audit strategy and the approach to internal auditing. The reliance strategy must be described as tentative, especially in the case of a multi-year audit plan, because it could change over time with changing evaluations of internal audit performance and other changes in the entity's circumstances.

Where appropriate, the audit committee can then approve the strategy and monitor its implementation.

> **The first step in developing a reliance strategy should be the identification of all internal audits that are relevant to the comprehensive audit.**

Optimizing planned reliance potential

Although reliance may be planned and expected, the decision to rely on a particular internal audit project cannot be taken before the project is completed and its performance can be assessed. Much can be done prior to the final decision, however, to ensure the success of tentative reliance strategies. Perhaps the key for optimizing reliance is for all concerned—audit committees, senior management, internal auditors and auditors—to work closely in planning and coordinating the comprehensive audit and internal audits. Two areas in particular deserve close attention: criteria and significance.

Criteria

An important facet of the audit plan is the identification of the criteria proposed for assessing the systems and practices to be studied. Criteria are the yardsticks or standards that auditors use to assess the suitability of a system or practice. As explained in chapter 19, criteria describe the characteristics of a satisfactory mechanism.

As is also explained, in comprehensive auditing there are no generally accepted criteria for management practices similar to those that have been adopted by the accounting profession for financial accounting practices. Nevertheless, if internal audits are to be relied on, the external auditors and the internal auditor must agree on criteria. If different criteria are applied, different conclusions will follow. Although the interests of internal auditors may go beyond the interest of the external auditors, the criteria must be compatible where their interests converge and reliance is contemplated. The earlier agreement is reached, the greater the likelihood that reliance strategies will be successful, since from the beginning both parties will know the criteria.

The criteria established for the audit can influence the time that will be required for the audit and, hence, its costs, both direct and indirect. Accordingly, these yardsticks should be examined carefully before the audit plan is finally approved.

> **Management, the audit committee (where appropriate), internal auditors and external auditors should reach early agreement on the criteria to be used in internal audits that might be relied on in a comprehensive audit.**

Significance

As discussed in chapter 18, the concept of materiality is fundamental to any form of audit. In essence, it is the determination of what is important or significant and what is not. It affects the amount of work that auditors will perform, since an audit is designed to detect such material departures from acceptable criteria as may exist. In addition, it affects the auditors' response to any departures they find from the criteria that have been applied. Auditors can expect directors and managers to be interested in the interpretation given to the question of significance because it will influence the costs of audits and the nature of the matters that will be brought to their attention in the final report.

It can be expected that, just as the concept of materiality is still being clarified and refined in the financial auditing field, so will it develop over time in comprehensive audits. Until more experience is gained and guidance becomes available, the prime determining factor will be the judgment and common sense of auditors and members of governing bodies with whom they discuss the issue.

The issue is important and unavoidable because the prospects for successful reliance are considerably diminished if the external auditors and internal auditor are applying different standards of significance. The significance levels applied by the auditors and the internal auditor must be compatible if reliance is to take place. This will occur when the level used by internal audit is at least as stringent as that used by the auditors. Each has a separate perspective. Typically, the internal auditor will consider significance in the context of the specific organizational unit or system or practice under review, whereas external auditors must consider significance in the context of what is important to the governing body. But each must understand the other's perspective for a satisfactory reliance relationship to be established.

Internal audits should use the same concept of significance as the external comprehensive auditors or a more stringent one.

The perspectives of users and potential users of comprehensive audit reports may vary widely, as, indeed, may their motives for wanting to know about significant deficiencies in management systems and practices. An understanding of these perspectives in and of itself, important as it is, will not provide complete answers to the significance question for the auditors. They must bring their own judgments to bear.

Readers will find a more extensive discussion of the concept of significance in chapter 18.

Timing

There is no general rule that specifies the period covered by a comprehensive audit opinion or the timing of the work supporting the opinion. Nevertheless, the work, including internal audits on which reliance is placed, must relate to the period covered by the opinion. Depending on when internal audit projects were performed and the period they covered, follow-up work may be needed to confirm that conclusions remain valid for the period covered by the comprehensive audit.

External auditors, internal auditors and audit committees, where they exist, should therefore, consider the impact that the period selected for the audit will have. Factors to examine include the disruption caused for staff, the amount of work required to support the audit opinion and the amount of follow-up entailed. Once the period for the audit has been decided, it may be possible to organize the various projects in a way that will minimize costs.

COSTS CAN BE REDUCED AND THE PROSPECTS FOR RELIANCE IMPROVED IF EARLY AGREEMENT IS REACHED ON THE TIMING OF THE CONDUCT OF THE VARIOUS ELEMENTS OF COMPREHENSIVE AUDITS AND INTERNAL AUDITS.

CHANGES IN TENTATIVE RELIANCE STRATEGIES

A strategy to rely on internal audits will necessarily be tentative. For example, a strategy would require amendment if, for any reason, internal audit performance falls short of expectations or if it appears that unwarranted conclusions have been drawn. In addition, comprehensive audits may be carried out over an extended period. It is possible that conditions might change between the planning phase and completion of the audit. Accordingly, it is important that auditors monitor the progress and results of internal audits on which reliance is contemplated to determine if changes are required in plans for reliance. Where such changes are necessary, auditors should report this to the client, management and the internal auditors.

EXTERNAL AUDITORS SHOULD INFORM THEIR CLIENTS OF ALL PLANS FOR RELIANCE ON INTERNAL AUDITS AND ANY SUBSEQUENT CHANGES.

PLACING RELIANCE

THE NEED TO EVALUATE INDIVIDUAL INTERNAL AUDITS

Before external comprehensive auditors can be expected to rely on internal audits, they will have to satisfy themselves that the internal audits were designed with appropriate procedures and particularly with appropriate criteria. They will ascertain that each project was devised to provide a level of detail and rigour of assessment at least equal to those the auditors need for their own purposes.

For projects that pass these tests, auditors must determine whether the calibre of personnel involved in the audit was adequate to achieve satisfactory results. Even the best-designed project is apt to fail if those who conduct it have insufficient ability, experience and training to complete it competently.

An assessment must also be made of how well each job was done: whether enough appropriate evidence was collected and whether it supported the analysis and conclusions drawn by the internal auditor.

If these conditions are met external auditors will likely rely on the internal audit, accept its conclusions and reflect this in the comprehensive audit report. This assessment will have to be made for each project on which reliance is planned.

EACH INTERNAL AUDIT PROJECT ON WHICH RELIANCE IS PLANNED SHOULD BE EVALUATED SEPARATELY.

Focus of evaluation

External auditors must evaluate each individual internal audit to determine its persuasiveness as a source of evidence and the significance of its findings to the audit opinion. To do this, auditors will want to understand the internal audit—including its results as well as the auditing methods used—in sufficient depth to allow them to appreciate the basis for the internal audit findings and conclusions, and their reliability. In this respect, auditors should explore, to the depth justified by the importance of the internal audit in the overall comprehensive audit strategy, the following:

- the organization, function or program subject to internal audit;
- the objectives and scope of the audit and, particularly, any limitations on the scope of the audit;
- the criteria applied in performing the audit;
- the evidence gathered by the internal auditors;
- the logical links between the findings, conclusions and recommendations;
- the independence, objectivity and qualifications of the professional staff who carried out the audit;
- the supervision and quality assurance procedures applied to ensure that the audit work met appropriate performance standards;
- the significance considerations applied in evaluating the detailed findings;
- the processes used to finalize the report and obtain acceptance by management; and
- the formal and informal responses of management to the internal audit assessment.

External auditors must also compare the evidence produced by internal audits with information from other sources. Inconsistencies between evidence from different sources should be explored so that auditors can reach a reasonably confident opinion.

Factors influencing the depth of evaluation

External auditors will make as detailed an evaluation of individual internal audits as is required in their professional judgment. The extent of corroborating evidence required by auditors who intend to rely on an internal audit will vary from project to project. The rigour and depth of the auditors' evaluation of an internal audit project is a matter of professional judgment, reflecting the importance of the subject matter, the consequences of being in error about deficiencies in the area and the likelihood that an erroneous conclusion might be drawn. Among the factors auditors might consider in making such judgments are:

- the importance of the project to the overall audit strategy;
- the confidence the auditors have in the internal audit function based on their overall assessment and on their experience with evaluations of other specific internal audit projects;
- the amount of time that has passed and the degree of change that may have occurred between the completion of the internal audit and the date of the evaluation;
- the relative independence of the internal auditors *vis-à-vis* the manager who is responsible for the systems and practices under review;
- the apparent consistency of the conclusions with the evidence;
- the manager's formal and informal reaction to the report;
- the availability of complementary evidence collected in other facets of the audit; and
- the rigour of the specific internal audit plan and approach, including the calibre of the people involved in the audit, and the nature and extent of supervision exercised over the work done and the judgments made.

External auditors can obtain the information needed to evaluate an internal audit project in a number of ways. The techniques they employ may include:

- discussing key aspects of the audit project with the internal auditor and/or team members;
- considering the consistency of the internal audit assessment with other evidence available;
- ensuring that internal auditors understand the context in which auditors intend to rely on specific audits and inquiring if the internal auditor knows of any reasons for not relying;

- reviewing audit project files to confirm the nature and extent of the work done and evidence gathered, to support the conclusions and recommendations;
- reperforming some of the detailed testing to supplement the internal audit work or to provide direct, hands-on knowledge of the subject matter; and
- performing additional work in the same area.

As auditors proceed through this spectrum of increasing amounts of effort, they are essentially obtaining additional evidence to corroborate or refute the internal audit assessment, thereby maximizing their level of comfort in their assessment of the findings and conclusions of the internal audit.

At the point where the external auditors decide to gather additional direct evidence in the same area, they have essentially concluded that they cannot tolerate the possibility that the internal auditor's assessment might be in error. They have decided that evidence regarding the validity and rigour of the process followed in the internal audit is not sufficient; the risk of error in the audit opinion is too great to accept the internal audit report without direct corroborating evidence. This may or may not be a reflection on the performance of the internal auditors. The issues involved may be so central to the audit that the auditors feel a need for direct evidence to corroborate the internal audit findings or to put themselves in a position to appreciate their significance properly. Possibly, though, the auditors may have concluded that there is an unacceptably low probability that the internal audit assessment is valid. To avoid possible confusion or misunderstanding, the external auditors should clearly differentiate between poor internal audit performance and other reasons for doing work directly.

EXTERNAL AUDITORS SHOULD PERFORM AS DETAILED AN ASSESSMENT OF INTERNAL AUDITS AS NECESSARY, BUT ONLY AS DETAILED AS NECESSARY, TO COME TO A PROFESSIONAL JUDGMENT ABOUT RELIANCE.

Reporting on reliance

External auditors should attempt to be descriptive as well as declarative in reporting on reliance. They should do more than state that they have "relied on internal audits to the extent practicable" regardless of the extent to which reliance on internal audits has contributed to the audit opinion. While such a statement might always be factual, it is not informative to the readers of the audit report.

TO MAKE REPORTING ON RELIANCE MEANINGFUL, EXTERNAL AUDITORS SHOULD PROVIDE A CONCISE DESCRIPTION OF THE NATURE AND EXTENT OF RELIANCE PLACED ON INTERNAL AUDITS AND NOT MERELY STATE THAT THEY HAVE RELIED ON THEM TO THE EXTENT PRACTICABLE.

Instead, reports on the extent of reliance will be more meaningful if auditors provide a concise statement of the nature and extent of the reliance placed on internal audits. Depending on the circumstances, it may be appropriate to describe such matters as the areas in which the assessment of internal audits have been accepted in reaching the audit opinion and the areas covered by internal audits where reliance could not be placed. In the latter case, the external auditors should differentiate between instances where they concluded that doing the work directly would be less expensive than doing the work required for reliance, where they could not agree with the internal audit assessment without substantial additional work, and where they arrived at a contrary assessment.

The discussion of areas where reliance could not be placed should be carefully written to avoid any unintended criticism of internal audit.

Other forms of review

As mentioned earlier, there may be other groups within an organization—such as program evaluation groups—that produce reports dealing with management systems and practices or other aspects of an organization's performance. Neither internal auditors nor comprehensive auditors will want to cause unnecessary costs by ignoring or replicating such reviews.

Federal Crown corporations

As mentioned in the previous chapter, federal Crown corporations are required by law to conduct internal audits in order to assess whether the corporation's systems and practices give reasonable assurance that:

- assets are safeguarded;
- the requirements of the Financial Administration Act and other pertinent authorities are complied with;
- resources are managed in an economical and efficient way; and
- operations are effective.

The act also charges auditors to rely on the work of internal audit to the extent they think practical and to report on the extent of that reliance.

For these corporations, the scope for internal auditing is potentially identical to that of the special examination (in essence, a comprehensive audit) that must periodically assess management systems and practices. This similarity in scope creates the potential for significant reliance: two auditors are charged with examining the same subject matter to make similar sorts of judgments. The legislation specifies that internal auditors assess whether systems and practices provide reasonable assurance and that examiners do the same. To the extent the internal audits fulfill the statutory expectation, reliance by examiners on internal audits will be facilitated.

This presents the auditors with a dilemma, however. It is well established that external auditors cannot accept management's assessments without corroboration, yet auditors are called upon to rely on internal audits—a management practice. To some extent, the act mitigates this dilemma and, at the same time, underlines the importance of the internal audit function by prescribing that the board of directors, through its audit committee, oversee internal audits. The board of directors has been given a responsibility to make sure that appropriate internal audit arrangements are instituted and, through this responsibility, has a stake in reliance issues. This arrangement allows for some distance between internal audit and management, thereby increasing the independence of the internal audit function.

Auditors can be expected to take into account the nature of the oversight role played by the audit committee in their reliance decision.

Some of these reviews may have the characteristics of an audit. These characteristics relate to the independence, objectivity and competence of the auditors and the rigour of the approaches they employ in the performance of their work. Provided an internal review possesses the characteristics of internal auditing set out above, it can and should be regarded as an internal audit for purposes of reliance.

All an organization's internal review activities should be taken into account in considering reliance.

Although they may not be regarded as internal audits, reviews that do not adhere to these standards should not be ignored. They may be an important part of the organization's systems and practices and provide information, insights and suggestions that should be taken into account. Unless internal reviews meet the standards, however, it is unlikely that auditors will be able to rely on them to as great an extent as on work that meets all the criteria of an internal audit.

The degree of reliance placed on specific internal reviews should reflect the extent to which they have met appropriate organizational and performance standards for internal auditing.

Some organizations are assessed by outside reviewers other than external auditors. For example, hospitals and a number of other institutions are subject to an accreditation process. This is an inspection by a provincially or nationally recognized body to evaluate if established standards are being met. An accreditation survey provides a snapshot of the organization's performance with regard to those standards, and is usually repeated on a regular basis. Because accreditation is carried out by recognized experts in the relevant field or fields, the reports they generate are authoritative and may provide a source of reliable evidence for comprehensive auditors.

Altogether, there may be a substantial constellation of reviews that may provide evidence in a comprehensive audit. By way of illustration, the following two tables describe the sorts of reviews that a team engaged in a comprehensive audit of a hospital, or a community college in British Columbia, are likely to be able to consider. Depending on the terms of reference of the audit, and the calibre of the work that the auditors determine has gone into such reviews, these reports may provide valuable evidence upon which some degree of reliance may be placed.

Hospital Review Process

	Financial Audit	Accreditation	Quality Assurance	Clinical Reviews
Description	Opinion on the financial statements	Inspection survey Reviews all or some functions of hospital against national standards. A "snapshot" of hospital structure and process, with objective of promoting quality of care. CCHA survey covers all hospital departments and services. Other accreditation surveys focus on specific, esp. teaching areas	A system for ongoing measurement of quality-of-care delivery, encompassing both process and outcomes Action to eliminate problems and to monitor activities to assure desired results have been achieved Required for full hospital accreditation	A professional peer-review process that examines the quality of care provided to individual patients. May be retrospective (review of charts) or concurrent. Medical audits are often undertaken separately from quality assurance activities
Report recipient	Board of trustees or members of the hospital corporation	Board of trustees Senior management Senior medical staff representative	Senior management Middle management Senior medical staff representative	Senior medial staff representative Clinical department heads
Performed by	External auditor	External survey team	Quality assurance committee and coordinator	Professional audit committee
Use of results	Funding bodies, board and senior management	Action to correct deficiencies prior to next survey	Senior management, departmental and clinical staff implement methods to resolve problems	Identification of continuing education needs for physicians and other health care personnel Mechanism for developing standards of clinical care
Frequency of review	Annual	Re-survey after one, two or three years depending on previous accreditation award	Ongoing	No specified frequency
Review criteria and process documented in	CICA *Handbook* gives process standards. Canadian Hospital Accounting Manual (CHAM) provides criteria	Standards manuals for different types of hospitals. Forms completed by hospital in advance of review. Survey questionnaire for use by survey personnel	Hospital develops quality assurance (QA) manual containing standards set by each department head under the Quality Assurance Committee's guidance	No external manual on criteria or process

Risk Management	Utilization and Impact Reviews	Program/Procedure/ Product Evaluation	Other Reviews
A process for evaluating and minimizing risk in order to improve the quality and safety of hospital operations Deals systematically with incidents in order to minimize hospital's liability	Evaluation of the use of resources against internal or external criteria Often focuses on length of stay, use of diagnostic and therapeutic procedures, drugs and complementary services Impact analyses predicts resource utilization of new medical staff and expanded or new programs	Evaluation of the outcomes of a particular program, procedure or product against set objectives Often involves comparison of established new methods of providing care	Role studies and Master programs assess the relevance and capacity requirements of services provided by a hospital. Operational and other reviews assess functioning of one or more departments, usually focusing on economy and efficiency
Board of trustees Senior management	Senior management Senior medical staff representative	Senior management Senior medical staff representative	Board of trustees Senior management
Risk management committee and or risk manager	Utilization review committee and or admissions and discharge committee. Hospital-wide resource management committee	Evaluation specialists, usually external	External agent (typically a management consultant)
Establish methods to minimize risks and limit liability	Management and clinical staff implement recommendations affecting overall use of resources or the practice patterns of individual clinicians	Funding bodies, boards and senior management use information to approve, modify or eliminate programs	Funding bodies, boards and senior management normally require implementation of some or all recommendations
Ongoing	Usually monthly	One time projects, often associated with a trial phase	Role studies/Master programs: Occasional, often associated with redevelopment planning Operational reviews: Occasional, usually when an operational problem has been identified by senior management
Manual developed internally to meet needs of hospital Insurance industry developing external manuals	No external manual on criteria or process. But certain hospital and medical associations have developed guidelines	Established research methodology for measuring outcomes and verifying causal relationships	Various manuals on criteria and process developed by different consulting firms

College and Institute Review Processes

			Review of Instructional Programs						
	Strategic Plan Reviews	Institutional Evaluation Process	Internal Program Reviews	Accreditation	Course Articulation	Student Follow-up	Link File Project	Support Service Reviews	Financial Audit & Enrolment Audit
Description	Update & amend institutional objectives in light of changing conditions	Evaluation of institutional goals, activities and quality control processes. Usually carried out in two phases: 1. internal self-study 2. external validation of the self-study	Review of program content, instructor qualifications, delivery methods, facilities, processes for curriculum updates, student outcomes	Review and approval of specific educational programs to ensure they meet the requirements of the accrediting body	Review of course content to ensure material and expectations of students are harmonized for course-credit transfer purposes between postsecondary institutions	Survey of student outcomes and satisfaction by means of provincewide surveys	Tracks student flows into, and through full-time academic and career/tech programs in the postsecondary system. Tracks education-outcome data, not employment data	Review of institutional support services, e.g., library admissions, finance	Opinion on the 1. financial statements and 2. enrolment statistics
Report recipient	Board, ministry, public	Board of governors, ministry, institution	Board, administration, educators, advisory committees	Administration and the accrediting body (e.g. registered nurses association, engineering technologists association, etc.)	Instructors, department heads, deans	Administration, ministry, boards, students, advisory committees, educators	Adminstration, ministry, articulation committees, educators	Board, administration, staff	Board of governnors, ministry, public, funding bodies, senior management
Performed by	Administration and faculty/staff team	1. Cross institutional internal team 2. External audit team appointed by provincial steering committee.	Ad hoc program review team, usually includes external component	Varies, usually a team named by accrediting body	Subject articulation committees (e.g., mathematics, English, engineering, trades) which include instructors from articulating institutions	Survey conducted by each institution	Registrars contribute data to provincial steering committee	Ad hoc review committee, including external component	External auditors

College and Institute Review Processes

	Strategic Plan Reviews	Institutional Evaluation Process	Internal Program Reviews	Accreditation	Course Articulation	Student Follow-up	Link File Project	Support Service Reviews	Financial Audit & Enrolment Audit
			Review of Instructional Programs						
Use of results	Guides institution in setting priorities and in allocating resources	Renewal and improvement of the institution Base for and check on strategic planning	Renewal and improvement of the program Part of institutional evaluation process	Validate use of the institution's education and training as a basis for awarding the credential rights and/or privileges of the accrediting body	Granting of course credit to students transferring between institutions	Ongoing appraisal of programs, in formal program reviews, in overall appraisal of institutional quality, in identifying employers of graduates	Understanding of student education and training patterns and achievements	Renewal and improvement of support services; part of institutional evaluation process	Monitor financial needs, processes and resources
Frequency	Annual review, three-year update	Six years	Each program is reviewed on a 5-8 year cycle	As determined by accrediting agency	Ongoing monitoring with change depending on pace of change in subject areas (e.g. computer science vs. medieval English)	Annually, nine months after student has left the institution	Annually	Each service is reviewed on a 5-8 year cycle	Annual
Review criteria and process documented by:	Ministry of Advanced Education	Provincial steering committee Institutions can adapt process to suit their own needs. Advanced Education Council of British Columbia (AECBC) through Provincial Institutional Evaluation Steering Committee	AECBC through Provincial Institutional Evaluation Steering Committee	Accrediting agency	As agreed between participating institutions	Student Outcomes Working Group	Link File Steering Committee	Established by Provincial Institutional Evaluation Steering Committee	1. Ministry specifies format in consultation with institutions, CICA *Handbook* 2. Ministry guide for enrolment audits

Not all organizations, of course, may have as wide a range of reviews as these institutions typically do. Where they exist, however, studies which are germane to the audit should be considered by the auditors with a view to reliance. This applies to reviews made in-house, by professional associations, and to studies made under contract by outside consultants.

All relevant studies made by reviewers outside the organization should be considered for their reliance potential.

278 OAG *Manual*, §6051.01.
279 Ibid, §6051.05.

Chapter 23

Standards and Quality Assurance

No professional discipline can long survive without establishing criteria for its practitioners. Prospective clients must be confident that the services they are contracting conform to objective standards of performance and must be assured of the competence of the people who will be performing the work.

The issue of quality assurance has engaged comprehensive audit practitioners from the outset. They recognized that, young though the discipline may be, it is important for its credibility to stakeholders, its acceptance by governing bodies and managers and its usefulness in the public sector that its practice be characterized by true professionalism and due care. To this end, practitioners took action on two fronts: the establishment of professional standards, and the development of techniques to assure the quality of each audit undertaken. It is these two issues—value-for-money audit standards and quality assurance—that this chapter addresses.

Value-for-money audit standards

As discussed in chapter 14, in 1987 practitioners of comprehensive auditing turned to the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants to develop a statement of standards. CICA completed its work in 1988, and in March of that year issued *Value-For-Money Auditing Standards*. These standards are a central reference point for comprehensive audit practitioners, and are reproduced in their entirety as follows:

Value-for-money Auditing Standards

Introduction

.01 Value-for-money auditing is one of the three main elements of comprehensive auditing, the others being the audit of financial statements and auditing for compliance with legislative and related authorities.

.02 In general terms, comprehensive auditing is concerned with accountability for the discharge of assigned responsibilities. *Auditing in the Public Sector*, **Section PS-5000**, discusses comprehensive auditing and accountability and includes a description of the roles of governing bodies, managers and auditors in the accountability process. The other two main elements of comprehensive auditing are addressed in *Audit of Financial Statements in the Public Sector*, **Section PS-5200**, and *Auditing for Compliance with Legislative and Related Authorities*, **Section PS-5300**.

.03 This Section recommends standards for auditors engaged in value-for-money auditing that relate to the professional qualities of those auditors, the conduct of their audit examinations and the content of their audit reports.

.04 These standards are intended to apply to audits carried out for the purpose of examining and reporting on matters related to any or all of the following:

(a) 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.

(b) The extent to which resources have been managed with due regard to economy and efficiency.

(c) The extent to which programs, operations or activities of an entity have been effective.

.05 Value-for-money audits may be carried out with respect to an entity or only a portion of an entity, such as a program, management control system or organizational unit. The terms of the auditor's mandate, whether embodied in legislation or established by contract, specify the audit and reporting requirements. The auditor may be asked to examine all or only some of the matters set out above. For example, regarding effectiveness, some legislated mandates require the auditor to examine, assess and report on the existence and adequacy of procedures to measure and report on the effectiveness of programs but do not ask the auditor to report on the extent to which the programs, operations or activities are themselves effective.

.06 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.

.07 The auditor may also attest to written assertions prepared by management to demonstrate management's due regard for economy, efficiency and/or effectiveness in discharging their responsibilities.

As practice develops in this area, additional guidance may be required to clarify the interpretation and application of these basic standards.

.08 In this Section:

(a) "Economy" refers to the acquisition of the appropriate quality and quantity of financial, human and physical resources at the appropriate times and at the lowest cost.

(b) "Efficiency" refers to the use of financial, human and physical resources such that output is maximized for any given set of resource inputs, or input is minimized for any given quantity and quality of output provided.

(c) "Effectiveness" refers to the achievement of the objectives or other intended effects of programs, operations or activities.

General Standards

.09 Auditing is predicated on the audit team's knowledge, competence and objective state of mind, and on the due care exercised in carrying out the examination. Accordingly, these professional qualities are reflected in the following General Standards.

.10 *The person or persons carrying out the examination should possess or collectively possess the knowledge and competence necessary to fulfill the requirements of the particular audit.* [March 1988]

.11 The auditor, who is in charge, has overall responsibility for a particular audit engagement, including the responsibility to determine the content of the report. However, in fulfilling the audit engagement, the auditor may delegate portions of the work pertaining to the planning, execution or supervision of the engagement to other members of the audit team. The ability to make judgments and assessments in fulfilling the requirements of the particular audit is dependent on the audit team's knowledge and competence to perform the tasks necessary. Collectively, they will need adequate knowledge in both relevant value-for-money auditing techniques and the matters subject to audit, as well as the ability to apply such knowledge. In addition, an overall understanding of the nature of the operations is important so that the members of the audit team have an appreciation of the context of the matters subject to audit.

.12 Knowledge and competence in value-for-money auditing can be obtained through a combination of training and experience. The nature and extent of the training and experience required by individuals on the team will vary according to the objectives and scope of the particular audit, and the work responsibilities and functions allocated to each individual. Nevertheless, all audit team members require an understanding of the basic objectives of auditing and the audit process sufficient to understand and apply these value-for-money auditing standards.

.13 Knowledge in many fields may be required to carry out specific value-for-money auditing engagements. The audit may focus on any of the entity's management systems, controls and practices and/or its operating performance or program effectiveness. Depending on the matters subject to audit, knowledge of and competence in fields such as engineering, statistical analysis, human resource management and economics, among others, may be required to make appropriate analyses and competent assessments. The auditor is not expected to possess the expertise of specialists on the audit team but must have a level of knowledge sufficient to define the objectives and terms of reference governing the work assigned to them. When using specialists on the audit team, the auditor should obtain reasonable assurance concerning the specialists' competence in their fields.

.14 *The examination should be performed and the report prepared with due care and with an objective state of mind.* [March 1988]

.15 Due care and objectivity are requisite professional qualities for all auditors, including those involved in value-for-money auditing. Due care imposes a responsibility on audit team members to perform their work diligently and conscientiously. Audit team members should maintain an objective state of mind in order to remain unbiased in forming their conclusions. They should also be free, and appear to be free, from relationships that may bias their professional judgment.

.16 Value-for-money audit reports often include recommendations to address identified deficiencies. The auditor should consider the effect that offering such advice may have on his or her objectivity in subsequent audits of the same entities. The auditor's recommendations may point to the direction in which positive changes can be made; however, detailed plans and implementation of changes are the responsibility of management.

Examination Standards

.17 *The work should be adequately planned and properly executed. Audit team members should be properly supervised.* [March 1988]

.18 To plan and carry out an audit examination, all members of the audit team need to possess or obtain knowledge of the entity, or portion thereof, being audited and its environment appropriate for their assigned responsibilities. Such knowledge would include an understanding of the entity's relevant objectives, constraints, resources, management processes and accountability relationships.

.19 Planning consists of developing an overall strategy and a detailed approach for the expected nature, extent and timing of the examination. In a value-for-money audit, planning involves establishing the objectives, scoping the examination, assessing the suitability of identified criteria and determining the specific procedures required to achieve the objectives. Decisions made in the planning stage with respect to these matters may need to be modified as information is acquired in the course of performing the audit.

.20 Supervision is designed to ensure that the planned procedures are properly carried out.

.21 When multi-disciplinary audit teams are used, adequate planning and supervision are particularly important so that the team members' different perspectives, experience and specialties are appropriately used in the overall audit. It is important that all team members understand the objectives of the particular audit and terms of reference of the work assigned to them. Adequate supervision is important so that the work of all team members is executed properly and is in compliance with these auditing standards. The auditor needs to have an adequate appreciation of the methods, assumptions and source data used by all team members, particularly specialists, to be able to assess the reasonableness and significance of their findings.

.22 In planning the matters to be examined and the work to be performed, the auditor should be cognizant of the concept of significance. Significance and materiality are synonymous concepts; however, significance is the term often used in the context of auditing in the public sector because it is embedded in legislation and practice. Both terms encompass qualitative as well as quantitative considerations.

.23 Significance is judged in relation to the reasonable prospect of a matter influencing the judgments or decisions of a user of the audit report. For example, factors that may influence the auditor's judgment as to what is significant in a particular circumstance might include the potential public, legislative, economic or environmental impact.

.24 *Criteria for evaluating the matters subject to audit should be identified and the auditor should assess their suitability in the circumstances.* [March 1988]

.25 Auditors need criteria against which to evaluate matters subject to audit. Criteria are reasonable and attainable standards of performance and control against which the adequacy of systems and practices and the extent of economy, efficiency and effectiveness of operations can be assessed.

.26 There is no body of generally accepted criteria for all aspects of value-for-money auditing. Criteria may be developed from various sources, including:

(a) legislation or policy statements;

(b) standards of good practice developed by professions or associations;

(c) statistics or practices developed within the entity or among similar entities; and

(d) criteria identified in similar value-for-money audits.

Criteria identified from these sources may require interpretation and modification to ensure their relevance to the entity under audit.

.27 The auditor has a responsibility to assess whether identified criteria are suitable. Suitable criteria are those that are relevant to the matters being audited and appropriate to the circumstances.

.28 When management has developed criteria for assessing systems, practices and operations, the auditor would use those criteria if in his or her opinion the criteria are suitable. If the auditor believes that criteria proposed by management are not suitable in the circumstances, the auditor should attempt to resolve differences in opinion. If differences cannot be resolved, the auditor should consider the alternative courses of action available. Some auditors, such as federal and provincial legislative auditors, are obliged under their mandates to carry out an examination and report. Therefore, in the event that differences cannot be resolved, they would select suitable criteria and proceed. Other auditors may limit the scope of the examination to those areas in which agreement on criteria can be reached or, depending on the extent and significance of the disagreement, they may have to consider resigning the engagement.

.29 In no circumstances should the auditor perform the audit and report on the basis of criteria that he or she believes are unsuitable.

.30 If suitable criteria cannot be identified by either management or the auditor for some of the matters subject to audit, the scope of the audit would be correspondingly reduced and the limitation in scope addressed in the report.

.31 *Sufficient appropriate audit evidence should be obtained to afford a reasonable basis to support the content of the auditor's report.* [March 1988]

.32 In determining the sufficiency and appropriateness of evidence, the auditor is guided by the need to minimize the risk of reporting erroneous findings or inappropriate conclusions.

.33 The sufficiency and appropriateness of evidence are interrelated concepts and refer to the quantity and quality of evidence. The decision as to whether a sufficient quantity of evidence has been obtained will be influenced by its quality.

.34 Generally, evidence obtained directly by the auditor (for example, through observation or analysis) is more reliable than information obtained indirectly, and documentary evidence is more reliable than oral evidence.

.35 The auditor may find it necessary to rely on evidence that is persuasive rather than conclusive. Thus, the auditor normally seeks corroborating evidence from different sources or of a different nature in making assessments and forming conclusions.

Reporting Standard

.36 There is no standard report in current value-for-money auditing practice that is analogous to the auditor's standard report on financial statements. Value-for-money auditing reports vary between jurisdictions and audits depending on differences in audit mandates, and in the scope and complexity of the particular audit and its findings. Regardless of variations in reporting, there are some fundamental elements that should be included in any value-for-money auditing report. These are set out in the general Reporting Standard below.

.37 *The auditor's report should:*

(a) describe the objectives and scope of the audit including any limitations therein;

(b) state that the examination was performed in accordance with the standards recommended in this Section and accordingly included such tests and other procedures as the auditor considered necessary in the circumstances;

(c) identify the criteria and describe the findings which form the basis for the auditor's conclusions; and

(d) state the auditor's conclusions. [March 1988]

.38 It is important that the report describe the objectives of the audit examination and what has been audited so that readers can understand and properly interpret the results. The objectives of the audit are based on the audit mandate and should set out clearly the purposes of the particular audit. The scope of the audit is described by identifying the entity, or portion thereof, subject to audit (for example, the corporation, department and/or program); identifying or referring to the matters examined; and describing the time period covered by the audit.

.39 Any limitations in scope and the reasons therefor should be described in the audit report. A scope limitation occurs, for example, when the auditor is unable to audit key organizational units or systems or to perform necessary audit procedures due to factors beyond the auditor's control. The scope of the audit can also be limited by the inability to identify or agree on suitable criteria, as discussed in paragraphs **PS-5400.28** and **PS-5400.30**. The auditor would consider whether it is appropriate to comment, in the report, on the implications of the lack of suitable criteria for the entity being audited.

.40 The general and examination standards set out the professional qualities expected of auditors engaged in value-for-money auditing and basic standards for the conduct of value-for-money audit examinations. Thus, the report should inform readers that the examination was performed in accordance with these standards and that the auditor made judgments as to what tests and other procedures were necessary in the particular circumstances to comply with the standards.

.41 The report should identify the criteria and describe the findings sufficiently to allow readers to understand the basis upon which the auditor formed his or her conclusions. Audit findings arise from an examination of the underlying facts, comparisons with suitable criteria and the auditor's analyses. The criteria upon which the auditor made his or her assessments and formed his or her conclusions may be made apparent in the description of findings or may be set out separately in the report. Alternatively, the auditor may refer the reader to an accessible source. In any case, the criteria should be clearly identifiable.

.42 The report should clearly state the auditor's conclusions. Conclusions should be related to the objectives and scope of the audit and should follow logically from the description of the criteria and findings.

.43 Value-for-money audit reports may also incorporate the auditor's recommendations, as well as management's responses with respect to the matters reported.

Application of the reporting standard in specific circumstances

.44 Reporting requirements vary in accordance with the specific value-for-money auditing mandates, whether embodied in legislation or established by contract. The following provides general guidance to legislative and other auditors who are required by current legislation to state their conclusions: (a) in the form of an opinion with respect to the entity, or some portion thereof, or (b) in the form of observed deficiencies.

(a) When required by the audit mandate to express an opinion with respect to an entity, or portion thereof, the auditor's opinion should be clearly expressed, or a statement made that an opinion cannot be expressed and the reasons therefor. Adequate explanation should be provided with respect to any reservations contained in the opinion.

The precise wording of the auditor's opinion will depend upon the objectives and scope of the audit mandate. The auditor's opinion should be related to the criteria upon which it is based. In addition, the words “in all significant respects” are often added, to convey to readers the importance of judgment in relation to significance.

A qualified opinion would be expressed if there is a limitation in scope, unless the limitation is so pervasive that there is no basis for an opinion. In the latter case, the auditor would deny an opinion. Similarly, there may be matters, such as deficiencies reported, that qualify the audit opinion but are not so significant as to necessitate an adverse opinion. Qualifications should be clearly described in the report.

(b) Auditors, such as those of federal and provincial governments, may be required by their mandates to report observed deficiencies in management systems, controls and practices, or other instances when there has not been due regard for, or the achievement of, economy, efficiency or effectiveness. In these circumstances, the auditor’s conclusions relate to deficiencies observed, and accordingly the report should, in the context of the scope and objectives of the examination, identify each deficiency and identify the criteria and describe the findings related thereto. In addition, the auditor should consider whether, for greater clarity, it is appropriate when describing the scope to include a description of the approach followed to select matters for examination.

Quality assurance

A set of professional standards does not alone ensure that auditors will in fact comply with them. What practitioners need is a method of assuring that the standards are maintained in their audits. To this end, the various offices practising comprehensive auditing have established regimes for quality assurance. Such regimes comprise several elements and document the safeguards that must be observed at every stage of an audit.

Audit manuals

One element of quality assurance regimes is the preparation and use of audit manuals, which detail how practice in the office will be conducted. Typically, these manuals are based on the various documents issued by CICA respecting auditing, but provide more detail and are designed with the nature, mandate and circumstances of the individual office in mind.

Although they vary, audit manuals usually cover, amongst other things, the following subjects:

- governing legislation and office mandate;
- the ethical standards expected of auditors (for example, the Code of Ethics for Internal Auditors in the federal government[280] that, in turn, were adapted from the Code of Ethics of the Institute of Internal Auditors);
- office organization, with the responsibilities of each area and level described in detail;
- an outline of the steps to be taken in an audit, and the procedures to adopt;
- the actions that should be taken at each step to ensure quality, including the required supervision and review;
- the audit methodologies and techniques to be used in various circumstances;
- advice on issues commonly faced by auditors, such as determining appropriate criteria, collecting and weighing evidence, and preparing and presenting reports;
- requirements for documentation of audit work;
- procedures for dealing with clients and other organizations; and
- policy and procedures for such issues as confidentiality of auditee and office information, reliance on and coordination with internal audit and communicating with the public.

As offices gain experience with comprehensive auditing, audit manuals tend to be modified and expanded.

However adherence to the policies and procedures of even the most elaborate manual does not ensure competent audits. Comprehensive auditing is an extended exercise in using professional judgment. It is conceivable that an otherwise impeccable audit could contain such errors of judgment that the result would be invalid and an embarrassment to the office.

It is for this reason that offices have incorporated checks in their procedures to subject individual audits to peer or other review processes as they progress.

Review processes

Supervision

Offices ensure that their audits are led and supervised by experienced auditors. The requirements of supervision are outlined in some detail in the chapter 24. This supervision is intended to ensure that all major decisions and judgments proposed by audit team members are reviewed by someone who can subject them to rigorous challenge. Team leaders themselves are supervised by their seniors, whose responsibility it is to ensure that audits under their jurisdiction are properly conducted.

Peer review

In most offices, it is common to have senior auditors review the plans, evidence collected and conclusions of their colleagues. This provides an opportunity for team leaders to have their judgments tested against the collective experience and wisdom of the office. Another benefit of this kind of review is that it keeps those who are doing the review current with what is happening in other parts of the office and can contribute to uniformity and improvement in practice through sharing of innovative approaches and successful experiences.

Another form of peer review involves auditors from other offices reviewing work in relation to specific audits or perhaps examining the function as a whole. This practice might also be seen as a form of independent review.

Independent reviews

Some offices establish audit advisory committees for individual audits. Typically, these committees are composed of people from inside and outside the office, with the outsiders bringing specific knowledge or expertise in some vital aspect of the audit. The OAG of Canada *Manual* identifies the following three purposes served by the advisory committees it requires for all audits except attest audits and follow-ups to audits:

- Advisory committees help the Office take a consistent, high-quality approach to its work, by providing advice, guidance and counsel to the audit Principal and the responsible Assistant Auditor General.
- The committee is designed to provide a forum in which the auditor can present plans, findings, conclusions and recommendations, and discuss difficult, ambiguous or contentious issues and alternative reporting strategies.
- Individual members of an advisory committee who have specialized knowledge in a particular area may also act as special advisers to the audit Principal and AAG, on matters related to their respective areas of expertise.[281]

A subsequent paragraph of the same section of the *Manual* identifies when committee advice should be sought:

The Assistant Auditor General should obtain the advice of the committee members:

- before implementation of the survey plan;
- at the end of the survey, to review the survey report and the proposed examination plan including the scope, approach and criteria for the audit;
- at the end of the examination phase, to review proposed observations, findings and reporting strategy; and
- when drafting the audit report with particular emphasis on the conclusions and recommendations.

The *Manual* makes it clear that advice may be sought from the committee or individual members at other times if required.

Of course, not all offices use advisory committees to the extent that the OAG of Canada does, but where they are used they are extremely helpful in assuring effective, high-quality audits.

Practice reviews

The internal practice review within practitioners' offices is one method that has been used to conduct sample reviews of audits after they have been completed.

In the Office of the Auditor General of Canada, practice reviews seek to provide assurance to the auditor general and executive committee about how well the office is carrying out its responsibilities. Such reviews would, for example, assess audit quality, information on audit-objective achievement and reasonableness of audit cost, and compliance with office and professional standards.

The practice review teams also provide audit teams with constructive suggestions for improving the economy, efficiency and effectiveness of the latter's work.

Staffing

One thing all offices doing comprehensive auditing agree on is the need to have competent auditors available to manage and conduct audits. The qualities they look for are outlined in chapter 24.

Comprehensive auditing cannot be mastered solely by academic knowledge. Practitioners and potential practitioners typically have respectable academic credentials; what they need to become proficient at is on-the-job experience and training specifically designed for comprehensive auditing. An emphasis on professional development characterizes the offices doing this work. Participation in training courses is active.

All offices doing comprehensive auditing give careful consideration to their internal organization. They recognize that knowledge of the audited organization is essential for successful auditing, and most offices are organized so that auditors concentrate in certain areas (such as on a group of government departments) so that the time they need to gain knowledge of the organization is minimized and their understanding of the problems and constraints they are apt to encounter is enhanced. Such organizational arrangements help give assurance that the quality of the audits will remain high.

These, then, are the main methods that comprehensive auditors and their offices apply in order to ensure that the quality of the work meets standards that bring satisfaction to their clients and credit to the profession. It can be expected that, over time, there may be further developments in these regards as comprehensive auditing itself tries to give its clients even more value.

280 Treasury Board of Canada, *Treasury Board Manual—Review, Internal Audit, Evaluation* (Treasury Board of Canada, May 1994) 36-37.
281 OAG *Manual*, §6031.03-.05.

Chapter 24

Profile of the Comprehensive Auditor

No audit is better than the people who conduct it. In a discipline like comprehensive auditing, where so much is expected, it is essential that practitioners enjoy the requisite competence to do the work satisfactorily. Sloppy or unsatisfactory work brings opprobrium not only to those directly involved, but also to the auditors' professions. As mentioned in the previous chapter, since the practice of comprehensive auditing is relatively young, particularly in comparison to financial statement auditing, it is important that client acceptance be fostered, and that comes through benefiting from proficient audits. Professional competence, therefore, is a matter of vital concern.

The need for this competence is clearly recognized in the profession. The CICA *Standards* have this to say:

> The person or persons carrying out the examination should possess or collectively possess the knowledge and competence necessary to fulfill the requirements of the particular audit.[282]

A somewhat similar policy is adopted by the Office of the Auditor General of Canada:

> The audit Principal, in consultation with the Assistant Auditor General, should ensure that the team conducting an audit has the appropriate disciplines, skills, and experience levels necessary for the assignment.[283]

The IIA standards in this area are also similar:

> Internal auditors should possess the knowledge, skills and disciplines essential to the performance of internal audits.[284]

Comprehensive auditing requires such a wide variety of subjects in such a broad range of environments that no one individual could accrue all the skills, knowledge and experience required for all comprehensive audits. Indeed, the issue of qualifications has interested practitioners since they first began to conduct comprehensive audits. In conjunction with its professional development program, in 1983 CCAF asked a group of comprehensive audit practitioners to consider the skills required for this kind of work. As a result of that group's deliberations, the foundation published *Knowledge Requirements for Comprehensive Auditing: A Practitioner's Guide* in 1984. This was considered a preliminary document, subject to reconsideration as more and more experience is gained in the discipline. At the time of writing, a major review of this subject is being undertaken. The material presented in this chapter relies heavily on the 1984 publication, and readers should recognize that it is more indicative than authoritative.

What skills are required to conduct comprehensive audits? First, it is helpful to make some distinctions. One is between people who regularly conduct comprehensive audits and others who are occasionally involved in this work. Individuals in the former group are auditors; those in the latter group are usually technical specialists who are brought in for specific audits where their expertise is necessary for a competent, thorough, comprehensive audit. A second distinction is between those who lead the audits and those who work under the leader's supervision. A third distinction is between the skills required by individual auditors and the collective skills of the comprehensive audit team.

What is needed in someone who leads a comprehensive audit?

Comprehensive audit leaders

The audit team leader is responsible for the quality and cost of the work undertaken. To fulfill these responsibilities, leaders have to bring a combination of diverse qualities to the assignment. They must have an understanding of a wide range of management practices and a sensitivity to their practical application in specific circumstances. Moreover, they must be able to use, but not be dominated by, the technical and specialist skills of members of their team, and be able to foster the understanding and cooperation of management throughout the process.

Among other things, team leaders are called upon to make informed judgments about:

- the importance of the component elements of the assignment—without a basic grasp of the concepts of each element, a practitioner may not devote sufficient resources to some. For example, without a basic understanding of human resource management, inefficiencies in an organization's use of staff may not be recognized as an area warranting investigation;
- the need for and alternative sources of reliable specialized staff support—practitioners must know enough about a subject area to recognize when they are not qualified to deal effectively with the issues identified. The leader must be aware of available sources of expertise to meet this need; and
- the need to manage and assess the quality of the contribution of any specialized advisers or staff support that may be obtained—they must be in control of the work done by a specialist. They must have a level of knowledge sufficient to enable them to interpret the specialist's work in the context of the overall audit, and to report the specialist's findings to management.

In order to make these judgments, audit team leaders must have a sound grasp of the six following general subject areas.

Comprehensive auditing concepts and practices

Knowledge of the history of comprehensive auditing in Canada and elsewhere, the concept, its characteristics and limitations, the role, services and publications of CCAF, and CICA's *Value-for-Money Auditing Standards*, and generally accepted auditing standards allows practitioners to understand this concept's appropriate application and to explain it to clients. It provides an understanding of the way in which other audit concepts relate to comprehensive auditing and the standards of professional competence, independence, objectivity and fairness required.

Governance structures

For practitioners to apply the concept of comprehensive auditing within the context of their assignment it is necessary for them to have an understanding of the law and practices of the sector in which the audit entity operates, its organization structure, services and/or products and its information needs and flows. This understanding provides the knowledge necessary to assess the completeness, relevance, timeliness and accuracy of information made available to the governing body and its impact on accountability issues. Knowledge of the relevant statutes and regulations ensures that the audit effort is directed to matters that are genuinely within the competence of the organization.

Organizational effectiveness

Team leaders need a sound knowledge of organization and accountability structures, programs, management processes and procedures. This includes a knowledge of behavioural science theory respecting organizational behaviour and the impact of working environments on managers, employees and the entire organization. This knowledge allows practitioners to choose the most appropriate ways of assessing the organizational structure and reporting relationships within the organization. Concerning the organization itself, leaders must understand:

- its relationship with other organizations or functions;
- its accountability relationships;
- its procedures and processes for management;
- the sources and nature of any constraints that may affect "due regard"; and
- its services, outputs and effects.

Management functions and systems

Knowledge of what constitutes good practice is essential for auditors to assess the systems and practices used by the organization and to judge whether they contribute to good accountability and to a due regard for economy, efficiency and effectiveness. Among the several practices affecting information management, human, physical and financial resource management are the following:

- forecasting—including economic, demographic and market forecasting;
- planning—including the generally accepted conventions of strategic planning, program and budget planning, and various resource allocation techniques;
- operations control—including process controls and project controls for major capital, research and administrative projects;
- human resource management—including the respective roles of line managers and the personnel function in accountability and decision making in respect of: manpower planning, staffing and career planning, training and development, appraising performance, directing, motivating and sanctioning staff, job evaluation, classification and compensation and staff relations;
- the role of the financial function in accountability and decision making;
- the form and content of budget documents;
- budgetary control and financial reporting;
- accounting and control of revenue, expenditure and asset transactions;
- asset, cash, property, material, supply and information management;
- EDP resources management;
- information sources—including those of political, management, physical and social sciences;
- mechanisms for assembling, storing, analyzing and accessing information; and
- analytical techniques—including financial, statistical and quantitative analysis.

Appraisal processes and controls

Practitioners must have a knowledge of how peer review programs, internal audit programs and other systematic assessments and analyses of organizational and program performance operate. With this knowledge, they can better judge in which circumstances each of these methodologies is likely to be useful and the level of effort required to apply them.

Audit process

Audit leaders must be well versed in the audit process. They must be able to do, and oversee, the planning, conducting and reporting of fieldwork that meets the relevant professional standards. The various aspects of the audit process include:

- audit planning;
- understanding the organization;
- understanding and evaluating systems, results and value for money;
- sources and use of audit criteria;
- audit evidence, including a wide range of collection and analysis techniques; and
- audit reporting.

Leaders should know how to select and efficiently apply all the available tools and techniques for assembling and analyzing information into a logical, comprehensive, constructive report that addresses accountability and due regard for value for money.

Ethics

Audit leaders should be imbued with the ethics required of comprehensive auditors. Honesty, fairness, objectivity, independence and compliance with the law are necessary values, and these should be combined with a sensitive understanding of the need for confidentiality of certain information. Because members of comprehensive audit teams often come from disparate disciplines, audit leaders should be able to convey and exemplify appropriate ethical standards to other team members.

Managing the people dynamics

Much more than financial statement auditing, comprehensive auditing calls for highly developed skills in managing human relationships. There are two dimensions to this: dealing with clients, and assembling and managing the audit team.

Dealing with clients

In some instances, members of governing bodies and their managers will have a relatively scanty understanding of comprehensive audit. Indeed, they may have none at all. Whether the auditors' mandate for this type of audit is legislated or not, they should explain to both the governing body and management the overall concept, its approaches, processes and benefits. They must ensure realistic expectations. In addition, they should explain the concept of management representations on effectiveness and, where the governing body decides to proceed with it, assist in the design and initiation of implementation strategies.

Particularly where there is no legislated mandate for comprehensive auditing, auditors act as advocates, advisers and educators to appropriate degrees. Ideally, they will participate with the governing body and management in deciding what will be audited, and (as discussed in chapter 18) explain the implications—both for costs and the ultimate report—of decisions about the options available for scope, significance and degree of audit assurance.

Auditors should encourage clients to participate in the decisions regarding these matters. The greater their participation, the greater the chance the audit will meet their needs and the less chance of disappointment arising from unrealistic expectations.

Frequently, management of an organization that has little or no experience of comprehensive auditing will be sceptical, anxious or hostile to the process. But experience has shown that the best results come when there is full cooperation between the auditors and those who manage what is being audited. It is important, therefore, that auditors possess the interpersonal skills to gain the necessary cooperation and to overcome whatever initial reluctance they find in an organization.

Managing the audit team

Audit team leaders must be just that: leaders. Their first responsibility is to ensure that all the relevant expertise needed for a specific audit is available to, or represented in, the audit team. Some legislative audit offices have professionals from other disciplines than audit on staff; some private audit firms have associated consulting or other units from which nonfinancial expertise can be drawn. In some instances, it is necessary to contract out for the expertise required by an audit. Audit team leaders must satisfy themselves that team members from other disciplines truly have the expertise required. The cost of recruiting this expertise must, of course, be taken into account.

The supervision of what is so often a multidisciplinary team brings challenges the leader must meet. Sometimes the experts from other disciplines may be senior in rank to the leader, a situation that calls for careful handling. More junior members of the team also require supervision. The OAG of Canada *Manual* says the following about supervision:

> Policy requires that audit team members be properly supervised. The audit Principal is responsible for the overall direction, co-ordination and control of all audit work. Project leaders should monitor all individual tasks and provide support to all team members as required.
>
> Supervision of audit work is an essential and continuous process. It starts with planning and giving clear directions to team members about their work, seeing that the work is done, and evaluating the significance of problems encountered. Supervision should ensure that:
>
> - audit work conforms to policy;
> - the audit approach and procedures adopted are effective and properly carried out;
> - only essential work is performed;
> - the audit evidence gathered is sufficient and appropriate to support and sustain audit conclusions;
> - audit work is appropriately documented in working papers;
> - audit budgets, timetables and schedules are met;
> - personnel with the correct mix of skills are properly assigned to audit projects;
> - audit facts and findings are reviewed with appropriate levels of management in the audited organization; and
> - matters included in audit chapters are significant, factual, fair and supported by sufficient and appropriate audit evidence.[285]

Clearly, substantial skills are required in order to accomplish all these supervisory tasks successfully.

In addition to all the above, audit team leaders must ensure that their audits are properly coordinated with any other audits the office is conducting simultaneously. Any duplication of audit effort is not only costly for the audit organization, but can be unnecessarily bothersome and disruptive to auditees.

The audit team

The audit team that the leader supervises should have all the necessary capabilities to conduct a successful comprehensive audit. When the subject under examination encompasses technical matters not within the usual areas of expertise of financial auditors, the necessary professional assistance of other disciplines is required. Multidisciplinary teams are as much the rule as the exception in comprehensive audits.

Often, individual auditors have developed expertise in a variety of relevant areas, such as EDP or human resource management, that are frequently required in audits. Where such specialized knowledge exists in-house and is called for in a specific audit, an office will not have to engage outside expertise. Where it does not exist, the team may have to be supplemented by one or more outside experts.

Technical, nonaudit experts may be used at any stage in an audit. They can contribute to the identification of potential trouble areas in the planning phase, to the identification of audit criteria, to the design of audit programs to obtain relevant evidence, to the analysis of evidence and to the drawing of conclusions and framing of recommendations arising from them.

As with the team leader, all team members should have an understanding of the organization under examination, and understand the concept of comprehensive auditing and its implications. They should also have a good knowledge of:

- relevant audit techniques;
- the standards that must be adhered to in comprehensive audits;
- accounting principles to understand costing processes; and
- the means of gathering and analysis of evidence.

In addition, all team members must embrace the attitudes, values and ethics required of auditors.

282 CICA *STANDARDS*, §.10.
283 OAG *MANUAL*, §2601.01.
284 *IIA STANDARDS*, 13.
285 OAG *MANUAL*, §1507.12-.13.

CONCLUSION

Although a relatively new concept, comprehensive auditing has been widely accepted in the Canadian public sector as a valuable means to achieve better accountability and improved administration and governance. Initially introduced in federal legislation in the 1970s, this kind of auditing has now been adopted in virtually all provincial governments, many medium-to-large municipalities and a number of health care, educational and social service institutions. Although developed in the public sector, the concept is finding increasing interest and application in the private sector, as well.

The concern with achieving better accountability and performance is not restricted to Canada; other countries are demonstrating the same strong interest. In the United States, for example, the General Accounting Office has introduced *performance auditing*, the U.S. government term for comprehensive auditing. In Britain, the process has been mandated for local governments for many years under the term *value-for-money auditing*. Most developed countries, and many in the developing world, are taking similar initiatives.

Precedents for auditors reporting on performance issues stretch back in history. For decades, auditors reported instances where they found that mistakes were made, money was wasted, and the like. These instances were simply matters the auditors came across in the course of their financial audits. Comprehensive auditing represents a step beyond this: a systematic approach to the analysis of whether management is paying due regard to matters of economy, efficiency and effectiveness in the administration of the resources entrusted to them.

Comprehensive auditing is not a static concept. In fact, there are three very different models for comprehensive auditing, each of which approaches the issues of accountability and economy, efficiency and effectiveness in 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. In the second model, audit concentrates on providing assurance on reports by management to the governing body regarding the overall performance or effectiveness of the organization, as viewed, for example, through the prism of the twelve attributes framework discussed in Part II. Still another model is for audit itself to attempt to provide the performance report.

When comprehensive auditing was first introduced, it adopted the management systems and practices model; this is still the most prevalent approach today. In these audits, the assessments of auditors are guided by specific criteria, and determine, as objectively as possible, how well those indicators of good performance are being met. Where good performance as well as deficiencies are reported, this has done much to alleviate management's concerns. No management group likes to think that auditors will comment solely on problems and deficiencies. Moreover, the fact that a rigorous set of criteria are being applied to the process is comforting to management, and to the governing bodies that commission the audits.

Nonetheless, there are limitations to this approach. For instance, this type of auditing is only a proxy for an assessment of an organization's performance since it focuses on management systems and practices, not directly on the performance of the organization. It is one thing for an audit report to say that management has or has not followed certain reasonable criteria in terms of a management system, but it is a more difficult matter to know what such a finding really means in terms of the bottom-line performance of the organization.

This brings us to the second model—audit attestation to management reports on performance or effectiveness. Historically, the lack of management reporting on performance has meant that this approach could not be used much. And, as mentioned earlier, one of the main reasons that management didn't report much was that there was no agreed framework within which to do so. Such a framework has now been developed; management is beginning to use it in reporting, and auditors are beginning to issue audit opinions on that reporting. Experimentation is ongoing with this form of comprehensive auditing.

The attestation model offers several key challenges to auditors. Practitioners need to be able to maintain a careful balance between preserving professional independence and avoiding isolation from the whole process. They also have to assess information that contains varying degrees of uncertainty and imprecision. In addition, this model presents a professional development challenge to auditors to increase their knowledge and expertise in relation to the much broader range of concepts involved and to the methodologies associated with their measurement and analysis.

All this requires that auditors work closely with the governing body and management to define an audit approach that is rigorous, yet one that also remains flexible enough to accommodate and support the learning curve that auditors, governing body and management must experience.

In the third audit model, the auditors are commissioned by the governing body to examine the performance of the organization directly, possibly applying the twelve attributes framework.

This approach would be used where, for one reason or another, management is not providing this information in a sufficiently rigorous fashion and where members of the governing body feel that an audit focus on systems and practices is insufficient to meet their due diligence needs. Although there is provision for it in some legislation, historically this model has not been used very much in Canada. Recently, however, some legislative audit offices have moved towards what is called "results-based auditing."

An approach that would see the auditor examining the performance of the organization directly would at least partially compensate for the lack of effectiveness information provided by management and, certainly, would go beyond the limitations of systems and procedures-based audits. But, it could have its own pitfalls—principally that auditors might become too involved in matters relating to policy determination.

Nonetheless, if management does not fulfill its responsibility to report on its performance, it is not reasonable to expect that the governing body will simply decide to go without. They need that information to exercise necessary oversight, to assess alternatives and make decisions, and then to be able to explain these decisions to their constituencies. In these circumstances, governing bodies could very well go to others for this information, and their auditors would be prime candidates for this function.

Whichever model is right for a particular organization will depend on a number of factors. The state of the organization's systems and practices, the nature of management's commitment to demonstrating their accountability and the organization's track record are a few of these considerations. The main determinant of which model is most appropriate, however, lies in the quality of the accountability relationship between senior management and its governing body—that is, the extent to which the governing body is informed about key aspects of the organization's effectiveness, the methods by which it is informed and the way in which it uses the information it receives.

The choice of which audit model to adopt should be based on the individual circumstances and needs of the particular organization. What is important is that this decision not be made in a vacuum. It ought to be the product of informed discussion between the governing body and management, with the auditors also involved to help ensure that the two parties have sufficient background and information about each of the potential audit model choices.

Whichever approach they are using, comprehensive auditors must conduct themselves in accordance with the standards of their profession. The demands on practitioners of this kind of auditing are substantial, and the true benefits of this work can only be achieved through adherence to the highest professional principles and practices.

Comprehensive auditing is now an accepted part of public administration in Canada. It has already demonstrated that its conceptual basis is sufficiently strong and flexible to meet emerging challenges and to adapt to varying circumstances. It can be expected in the future to continue its contribution to good accountability, management and governance.

INDEX

A

B

C

D

E

F

G

N

O

P

Q

R

S

T

U

V

W