Auditing Systems and Practices Relating To Effectiveness Of Operations In Federal Crown Corporations

Nancy Soper & Henno Moenting
Office of the Auditor General of Canada

RÉSUMÉ

En vertu des récentes modifications apportées à la Loi sur l’administration financière (LAF), il faut désormais procéder à un «examen spécial» dans le but de vérifier l’optimisation des ressources des sociétés d’État fédérales. Grâce à un tel examen, le vérificateur peut assurer, avec un degré raisonnable de certitude, que les systèmes et pratiques d’une société ne comportent aucune faiblesse importante, et permettent de vérifier que ses biens sont protégés et contrôlés, que ses ressources sont gérées de façon économique et que ses activités sont menées efficacement. Le document que voici traite des mesures requises pour vérifier l’efficacité des activités, expose l’historique de la Loi, explique le sens de l’expression «activités efficaces» dans ce contexte et recense les types de systèmes et pratiques qui favorisent l’efficacité. Il conclut qu’une approche axée sur les résultats serait tout à fait indiquée pour formuler une opinion sur l’a-propos des systèmes et pratiques utilisés et s’assurer ainsi, avec un degré raisonnable de certitude, de l’efficacité des activités. Une telle approche peut donc être fondée en partie sur les méthodes et techniques d’évaluation des programmes de vérification de la mesure de l’efficacité. De plus, il est probable que la mise en oeuvre de cette Loi souligne encore davantage le rôle essentiel que jouent la mesure du rendement et l’évaluation au sein des sociétés d’État elles-mêmes.

ABSTRACT

Recent changes to the Financial Administration Act (F.A.A.) introduced a requirement for value-for-money audits of federal Crown corporations through a process called “special examination”. A special examination is designed to result in an opinion by the examiner as to whether there is reasonable assurance that there are no significant deficiencies in the systems and practices maintained by the corporation to provide reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently and its operations are carried out effectively. This paper explores the examination requirements relating to the effectiveness of operations by reviewing the background to the legislation, clarifying the meaning of “effective operations” in this context and identifying the types of systems and practices that contribute to effectiveness. The paper concludes that a results-based approach would be most direct with respect to giving an opinion on the adequacy of systems and practices maintained to provide reasonable assurance of effectiveness.

* This paper is based on one presented at the Annual Conference of the Canadian Evaluation Society, Banff, Alberta, April 28-30, 1986.

* This paper has been prepared as part of the process of developing approaches to the audit of federal Crown corporations in response to recent amendments to the Financial Administration Act. As such, the views expressed are those of the authors and do not represent the policy of the Office of the Auditor General of Canada.
effective operations. Consequently such an approach can benefit from the skills and methods associated with program evaluation and effectiveness auditing. In addition, it is likely that the implementation of this legislation will focus increased attention on the essential role that evaluation and performance measurement can play within the Crown corporations themselves.

**Introduction**

Recent changes to the Financial Administration Act (FAA) introduced a requirement for value-for-money audits of federal Crown corporations through a process called “special examination”. Among other things, a special examination is designed to result in an opinion by the examiner as to whether there is reasonable assurance that there are no significant deficiencies in the systems and practices maintained by the corporation to ensure its assets are safeguarded and controlled; its financial, human and physical resources are managed economically and efficiently; and its operations are carried out effectively.

The primary purpose of this paper is to explore the examination requirements of the FAA with respect to “the effectiveness of operations” by:

- reviewing the background to the legislation and the specific provisions dealing with audits related to the effectiveness of operations;
- discussing the meaning of “effectiveness of operations” within a Crown corporation context;
- identifying the types of systems and practices that might be subject to examination in view of the FAA provisions and the nature of Crown corporations; and
- identifying possible approaches to carrying out the work required, drawing on relevant experience in the fields of audit, evaluation and performance measurement.

Our conclusion is that the work required to meet the FAA mandate with respect to the audit of systems and practices relating to the effectiveness of operations in Crown corporations can benefit from many of the skills and methods associated with program evaluation and effectiveness auditing. In addition, it is likely that the implementation of this legislation will focus increased attention on the role that evaluation and performance measurement can play within the Crown corporations themselves.

**Background**

In Canada, the use of government-owned or government-controlled companies as instruments for pursuing public policy objectives began in the 19th century. The corporate form has proved to be suitable particularly in those cases where the organization earns a substantial portion of its revenues through the sale of goods or services or where its activities are such that it requires a degree of administrative and operational freedom from day to day government controls.
By the end of World War II, over 30 federal Crown corporations were in existence. Most had been created by special acts of Parliament or set up by letters patent under federal or provincial companies legislation, and there was no single, consistent framework for their control and direction by the government or for their accountability to government and Parliament.

In December 1951, Parliament enacted the Financial Administration Act (FAA) which, among other things, provided for the financial control of Crown corporations. In so far as audit was concerned, Part VIII of the FAA called for traditional legislative audits of Crown corporations, including a financial attest element, an opinion on compliance with relevant authorities (such as constituent acts, government directives, etc.) and the opportunity to bring any other matters to Parliament’s attention if the auditor thought it appropriate to do so.

The control and accountability framework introduced in 1952 remained in place, virtually unchanged, for the next 32 years — a period that saw significant growth and change in the government’s use of Crown corporations for delivering public policy. Between 1976 and 1984 a number of major reviews of Crown corporation matters were completed by the Office of the Auditor General (1976, 1982), the Royal Commission on Financial Management and Accountability (Lambert, 1979), the Public Accounts Committee of Parliament (1979, 1981, 1983) and the government itself (Privy Council Office, 1977). All of these reviews identified serious inadequacies in the control and accountability regime and called for new arrangements to be put in place. The Auditor General of Canada and the Public Accounts Committee particularly emphasized the need to extend, to the Crown corporation sector, broad-scope (or “value-for-money”) auditing to deal with economy, efficiency and effectiveness issues.

Finally, Bill C-24, an Act to amend the Financial Administration Act in relation to Crown corporations, was introduced in March 1984, received Royal Assent on 29 June and came into effect on 1 September 1984. With the exception of eight corporations exempted from the application of the legislation because of their special natures,* the legislation provides a comprehensive framework for the control and accountability of all parent Crown corporations (those owned directly by the government) and their wholly-owned subsidiaries. Part of this framework is an elaborate and, in many respects, innovative audit regime.

The New Audit Regime In Crown Corporations

General

Exhibit 1 depicts the major components of the new audit regime (Office of the Auditor General, 1985). It shows that the three types of audit — internal audit, annual audit and special examination — all flow from a statutory re-

* The exempted corporations include, for example, the Bank of Canada, the “cultural” corporations (such as the Canadian Broadcasting Corporation) and the Canadian Institute for Peace and Security.
requirement for management to maintain "financial and management control and information systems and management practices" as well as to report results.

Exhibit 1

The Audit Regime in Crown Corporations

Management Charge:
- Keep books and records, and maintain systems and practices to provide reasonable assurance that:
  (i) assets are safeguarded and controlled;
  (ii) transactions are in accordance with specified authorities;
  (iii) resources are managed economically and efficiently; and
  (iv) operations are carried out effectively.
- Report on results of operations; financial position; performance against plan.

Internal Audit
Purpose
- To assess compliance with requirement to keep books and records and maintain systems and practices that provide reasonable assurance that:
  (i) assets are safeguarded and controlled;
  (ii) transactions are in accordance with specified authorities;
  (iii) resources are managed economically and efficiently; and
  (iv) operations are carried out effectively.
Frequency:
- Ongoing
Reporting:
- Management

Annual Audit
Purpose:
- To provide independent opinions on:
  (i) fairness of presentation of financial statements;
  (ii) accuracy of quantitative information; and
  (iii) compliance with specified authorities; and
- To call Parliament's attention to any other matter as appropriate.
Frequency:
- Annual
Reporting:
- Appropriate Minister
- Parliament (in annual report of corporation)

Special Examination
Purpose:
- To determine whether, in the period under examination, systems and practices maintained provided reasonable assurance that:
  (i) assets were safeguarded/controlled;
  (ii) resources were managed economically and efficiently; and
  (iii) operations were carried out effectively.
Frequency:
- At least every 5 years
Reporting:
- Boards of Directors
- Appropriate Minister of Parliament (in exceptional circumstances, for corporations in Part I of Schedule C).
The Audit Regime in Crown Corporations

Perhaps the most innovative audit-related requirement is for a "special examination" of a parent corporation and its wholly-owned subsidiaries to be carried out at least once every five years. The purpose of the special examination is to provide independent assurance to the board of directors that there are no significant deficiencies in the systems and practices required to be maintained by the corporation. In effect, the special examination provisions have introduced mandatory "value-for-money" auditing in federal Crown corporations.

Provisions Relating to Effectiveness Auditing

The focus of this paper is on the requirement in Part XII of the FAA (Canada, 1984) for the examiner, who will normally be the auditor of the corporation, to determine through a special examination whether:

"the systems and practices...were maintained in a manner that provided reasonable assurance that...the operations of the corporation...were carried out effectively." (S. 143.1 — our emphasis)

The examiner has to submit a report of the examination to the board of directors. Among other things, this report must include a statement as to whether, in the examiner's opinion, with respect to criteria established before the examination started:

"there is reasonable assurance that there are no significant deficiencies in the systems and practices examined." (S. 143.7).

In addition, the examiner has to rely on any internal audits of the corporation to the extent he or she considers practicable, and must include a statement on the extent of such reliance in the examination report.

These provisions stand in interesting contrast to the provisions of the Auditor General Act that, for the past eight years, have guided the approach of the Office of the Auditor General of Canada to "effectiveness auditing" in government departments and agencies and have influenced similar work in other jurisdictions.
Auditor General Act
(Department & Agencies)

The Report of the Auditor General shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that . . . satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.” (Canada, 1977: S. 7.2) (Our emphasis)

Financial Administration Act
(Crown Corporations)

The report of the examiner “shall include a statement whether in the examiner’s opinion, with respect to the criteria established . . . there is reasonable assurance that there are no significant deficiencies in the systems and practices examined”, i.e., the systems and practices that are required to be maintained by the corporation in such a manner as to provide reasonable assurance that the operations are carried out effectively. (Canada, 1984: S. 143.7) (Our emphasis)

Two important differences stand out at once. First, whereas the Auditor General Act calls for the reporting of instances that have come to notice, the FAA requires the examiner to express an opinion on the systems and practices examined, based on criteria previously agreed with the audit committee of the corporation. The task of the examiner is likely to be the more onerous.

Second, and more important, the FAA requires the scope of the work to be set in terms of all the essential activities that provide reasonable assurance of effective operations. The Auditor General Act, on the other hand, focuses on one type of activity that contributes to effectiveness — namely, on procedures to measure and report the effectiveness of programs.

The significance of the FAA provisions for effectiveness auditing in Crown corporations will be explored in greater depth in subsequent sections of this paper. Before that, however, it is useful to have a brief look at some of the characteristics of the Crown corporations to which the provisions apply.

Federal Crown Corporations

In July 1985, there were 52 active parent Crown corporations, with 134 wholly-owned subsidiaries. On a consolidated basis, Crown corporations commanded total assets in excess of $78 billion and required budgetary funding through parliamentary appropriations of over $5.7 billion during the 1984/85 fiscal year. During this same period, the Crown corporation sector accounted for the employment of over 200,000 people — almost as many as in the regular federal civil service (Moenting, 1986: 4). In view of the share of resources employed by Crown corporations, the efficiency, economy and effectiveness with which they manage those resources are clearly matters of importance.
There is considerable variety in the size of federal Crown corporations, the sectors within which they operate and the objectives that they pursue. Among the corporations are such giants as Canadian National Railways, Air Canada and Petro-Canada, as well as small, specialized corporations (e.g., the pilotage authorities, the Standards Council of Canada and the Canadian Livestock Feed Board). Many of the corporations are in the transportation sector — operating railways, airlines, canals, pilotage services and ports. Others are involved in such businesses as construction, resource extraction and distribution, communications, public utilities, and in providing financial services to the housing, agricultural and export sectors.

As might be expected, the diversity in the nature and size of Crown corporations is reflected in considerable differences in their mandates. Exhibit 2 provides examples of mandates for some federal Crown corporations (Canada, 1985).

Despite obvious differences in mandates and, consequently, the more specific objectives that flow from them, corporations have generally been created or acquired to promote the achievement of public policy objectives and, in doing so, to operate in accordance with commercial principles, including, where appropriate, the anticipation of profit. The consequence is that the term "effectiveness of operations" in a Crown corporation has to embrace the achievement of commercial as well as non-commercial objectives.

**Effectiveness of Operations**

As indicated previously, an important part of the legislation respecting special examinations deals with the extent to which "operations are carried out effectively". The question is, what is encompassed by this phrase?

One way of narrowing down the issue is to have a look at the three "E's" referred to by the legislation — economy, efficiency and effectiveness. In the Comprehensive Auditing Manual of the Office of the Auditor General of Canada, these terms are defined as follows.

**Economy** — refers to the terms and conditions under which financial, human and material resources are required. An economical operation acquires these resources in appropriate quality and quantity at the lowest cost.

**Efficiency** — refers to the relationship between goods and services produced and resources used to produce them. An efficient operation produces the maximum output for any given set of resource inputs, or it has minimum inputs for any given quantity and quality of service provided.

**Effectiveness** — the extent to which the actual outcome of (an) activity matches with the objectives of that activity. Where there are unintended negative effects from the activity, effectiveness must be judged on the net balance of negative and positive outcomes.
## Exhibit 2: Mandates of Selected Crown Corporations

<table>
<thead>
<tr>
<th>Corporation</th>
<th>Mandate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Canada</td>
<td>To provide a publicly-owned air transportation service, with powers to carry out other businesses incidental to the airline operation, having due regard to sound business principles and, in particular, the contemplation of profit.</td>
</tr>
<tr>
<td>Atomic Energy of Canada Limited</td>
<td>To develop the utilization of atomic energy for peaceful purposes.</td>
</tr>
<tr>
<td>Canada Mortgage and Housing Corporation</td>
<td>To promote the construction of new houses, the repair and modernization of existing houses and the improvement of housing and living conditions.</td>
</tr>
<tr>
<td>Canadian National Railway Company</td>
<td>To operate a national railway system and other transportation and related services, including water transportation, trucking, telecommunications and hotels.</td>
</tr>
<tr>
<td>Canadian Patents and Development Limited</td>
<td>To secure optimum benefits to Canada from commercially utilizable technology accruing to the Crown from expenditure of Federal funds.</td>
</tr>
<tr>
<td>Cape Breton Development Corporation</td>
<td>To promote and assist the financing and development of industry, to provide employment on Cape Breton Island, and to operate the Cape Breton coal mines.</td>
</tr>
<tr>
<td>Export Development Corporation</td>
<td>To facilitate and develop export trade by the provision of insurance, guarantees, loans and other financial facilities.</td>
</tr>
<tr>
<td>Farm Credit Corporation</td>
<td>To assist Canadian farmers to establish and develop viable farm enterprises through the provision of long-term credit and other financial services.</td>
</tr>
<tr>
<td>National Capital Commission</td>
<td>To prepare plans for and assist in the development, conservation and improvement of the National Capital Region.</td>
</tr>
<tr>
<td>Teleglobe Canada</td>
<td>To establish, maintain and operate, in Canada and elsewhere, international telecommunication services for the conduct of public communications.</td>
</tr>
<tr>
<td>Via Rail</td>
<td>To manage rail passenger services in Canada in such a manner as to improve their efficiency, effectiveness and economy.</td>
</tr>
</tbody>
</table>
Effectiveness in Crown Corporations

Generally speaking, the term effectiveness has been used to refer to objectives achievement in a variety of contexts. We can use a structure and logic model to depict the major activities or components required to produce the service(s) or product(s) of a Crown corporation and to identify objectives that range from output objectives to broad policy objectives (see Exhibit 3).

Exhibit 3: Corporate Structure and Logic Model
Strategic, or corporate, planning involves the development of a business strategy. It typically includes such things as the identification of potential markets, product lines and a financial strategy. Operational planning in a corporation involves the identification and allocation of required resources, determination of specific product or service characteristics, and specification of the general activities required to produce the product or service (the production process). Operational planning in the corporate setting also involves identifying the activities that are required to make the product accessible to potential markets; that is, the pricing, advertising and distribution of the product.

The heart of the corporation or business is its operations. They involve the implementation and management of a series of activities that together result in the service or product being made available to clients. The corporation has certain objectives with respect to the service or product. These we call output objectives in Exhibit 3. They may include goals of service quality, quality, timeliness or accessibility and are related to the broader objectives of client satisfaction. Because some Crown corporations are operating in a competitive environment, client satisfaction may be linked to a broad external objective of increasing market share.

At the level of ultimate objectives, most Crown corporations have some goals or targets with respect to financial performance. For example, in some corporations the goal may be stated in terms of self-sufficiency, for some it may be reductions in operating deficits, for others it may be the achievement of certain rates of return on investment and so on. In addition, however, the raison d'être of operating any government-owned corporation is that this permits the pursuit of high level public policy objectives of various types such as, for example, national sovereignty and unity, regional development or the promotion of competition in the interests of economic efficiency.

As in the case of government programs, there exists a chain of objectives that extends from immediate goals and objectives related to outputs to the far-reaching policy objectives of the government in setting up or acquiring the corporation. Because 'operations' refers to the total businesses and activities of the corporation, including those carried out in pursuit of both commercial and non-commercial objectives, the phrase "the extent to which operations are carried out effectively" refers to the extent to which the businesses and activities achieve their objectives — including output objectives, market objectives and financial policy objectives.

Although the provisions of the FAA with respect to special examinations do not appear to limit matters relating to effectiveness to any specific level of objectives, what must focus the examination in the case of any one corporation are the objectives of that corporation as set out in its legislative mandate, as well as government approved corporate and operating plans. These will typically include commercial as well as non-commercial objectives.
Often, the public policy objectives are not clearly stated in a Crown corporation's mandate. In many cases, the objectives are stated in terms simply of providing a service, with little clear specification of expected impacts. Examples include:

- to provide an air transportation service;
- to operate a national railway; or
- to operate a postal service.

All of these objectives beg the question — to what end? The effectiveness issues in these cases are likely to be mainly at the level of output and market objectives and typically would concern the frequency, quality and timeliness of service, as well as issues related to client satisfaction and, where appropriate, market share.

Whatever the level of objectives involved, a special examination will have to concern itself with whether the objectives are clear, whether the corporation is carrying out activities to meet them, and whether there is accounting for performance in relation to them. These are matters central to program evaluation and effectiveness measurement in general.

**Systems and Practices**

To help ensure that, among other things, operations are carried out effectively, the legislation calls for corporations to maintain:

- financial control systems;
- management control systems;
- information systems; and
- management practices.

At the most general level, a system may be defined as a regularly interacting or interdependent group of elements that form a unified whole designed to achieve some specific purpose. A control system, for example, is a system designed to achieve and/or maintain a defined result or condition. Control itself has been defined by the Institute of Internal Auditors (1983) as "any action taken by management to enhance the likelihood that established objectives and goals will be achieved". (i.e., that operations will be carried out effectively). Therefore, control results from "proper planning, organizing and directing by management".

Management "practices" are much more difficult to describe than "systems". For practical purposes in this context, it may be useful to think of them as including all those things that management actually does. As such, management practices may include any behaviour (e.g., decisions made, actions taken) that affects the implementation or use of systems or that, by itself, influences the operations and results of a corporation.
Exhibit 3 shows that, whatever the specific level of effectiveness issues that may be relevant in a particular case, there is a wide range of systems and practices that potentially contribute to the effectiveness of operations. These include, for example:

- setting corporate strategies and objectives;
- determining operational plans and budgets;
- guiding corporate activities towards the achievement of objectives;
- measuring and reporting on results in relation to objectives; and
- identifying appropriate action to be taken in the corporation's interests.

The important point to note is that any audit relating to the "effectiveness of operations" cannot depend exclusively on a review of systems and practices related to measuring and reporting the effectiveness of operations (as has been the case in "effectiveness auditing" under the mandate provided by the Auditor General Act). The existence of systems and practices for measuring and reporting effectiveness may be a necessary condition for management to assert reasonably that operations are carried out effectively — but it is hardly sufficient. It is also necessary for the full range of systems and practices related to planning, directing and controlling the businesses and activities of the corporation to work together in such a way that there is a reasonable likelihood that effective operations will be achieved.

Scope and Nature of Special Examination in Relation to Effectiveness

Reasonable Assurance

There is, then, a broad range of effectiveness issues potentially of relevance in a special examination. These concern a variety of systems and practices in any corporation. The question that follows is — what is the scope and nature of special examination work in relation to the "effectiveness of operations" and how can it benefit from (or contribute to) other undertakings in the fields of audit and evaluation?

An important factor in this is the requirement for the examiner to give an opinion on the systems and practices examined. It is worth re-iterating here that the FAA requires:

- the corporation to cause systems and practices be maintained in a manner as will provide reasonable assurance that . . . operations are carried out effectively;
- the examiner to determine if the systems and practices . . . were . . . maintained in a manner that provided reasonable assurance that . . . operations were carried out effectively; and
- the examiner to report his/her opinion as to whether there is reasonable assurance that there are no significant deficiencies in the systems and practices examined.
There are two types of "reasonable assurance" referred to by the special examination provisions. The first is the assurance management (including the Board of Directors) has, by virtue of certain systems and practices being in place, that operations are being carried out effectively. As we have mentioned earlier, there are many systems and practices that contribute to assuring management that operations are carried out effectively, including performance measurement and reporting systems and a variety of systems and practices for planning, directing and controlling the production process. The second relates to the independent opinion that the examiner is asked to provide with respect to how well the systems and practices of the corporation do, in fact, provide assurance to management that operations are being carried out effectively (i.e., that there are no significant deficiencies in the systems and practices).

The requirement that the examiner express an opinion as to whether there is reasonable assurance that there are no significant deficiencies in the systems and practices maintained by the corporation sets this legislation apart from other value-for-money audit mandates. The definition of the scope of the examination becomes very important. All critical areas must be covered and there must be sufficient and appropriate evidence to support findings — including both 'positive' and 'negative' findings.

On the other hand, it is a matter involving reasonable assurance. This should be viewed as being different from guaranteeing or insuring. A professional opinion on the reasonableness of systems and practices examined can be based on sampling or secondary data and does not imply absolute certainty. Further, the use of the word 'reasonable' suggests a careful weighing of the requirement for evidence and the cost of acquiring it.

Criteria for Assessing Systems and Practices

Value-for-money audits in the past have usually employed a systems-based approach, where the auditor assesses a particular system or management function to determine such matters as, for example:

- whether the system conforms to established guidelines, or generally recognized management practice, for such systems;

- whether the system has been adequately designed, given the particular circumstances;

- whether the system has been implemented as designed; and (only occasionally)

- whether the results or outputs of the system meet some expectations.

Whether a particular system or practice conforms to central agency guidelines, or is consistent with common practice, is not really a central concern in a special examination. Rather, the examiner must deal with the question of whether the systems and practices of the corporation, taken together, provide reasonable assurance to management that operations are carried out effectively. In effect, the examiner has to determine whether systems and practices are maintained to a certain standard defined, first and
foremost, in terms of results — that is, in terms of the effectiveness of operations. The proof of the pudding is in the eating!

This type of analysis is similar to that of a formative evaluation. Information is gathered about the extent to which an organization or program is meeting its objectives and then these observations are related to the activities undertaken to deliver the program. Explanations are sought for variations in effects in the way activities are designed or implemented.

**General Approach to Effectiveness Work**

How does the examiner go about developing an informed opinion on whether systems and practices do provide such assurance? Because effectiveness is influenced by the interplay of a variety of systems and practices, the logical place for the examiner to start is with corporate objectives and performance in relation to them, rather than on systems and practices *per se*.

The first question for the examiner is — what are the key operations of the corporation and what are the objectives of those operations? Identifying the key operations and their objectives is similar to identifying the structure and logic of a government program in an evaluability assessment.

The examiner should then review information relating to the effectiveness of operations. Information relating to some aspects of financial performance should be relatively easily obtained — and at least some of it will have been audited. However, with respect to performance of a non-financial nature, the examiner would need to establish whether valid, reliable effectiveness information is being generated in relation to the identified objectives. This part of the analysis would require an assessment of the underlying systems and practices used to produce the information and would employ well established effectiveness auditing techniques that, in turn, require knowledge of effectiveness evaluation and performance measurement methods. An assessment of this type might be done directly by the examiner, or indirectly, by relying on internal audit's assessments of the relevant systems and practices.

The following logical possibilities in terms of findings may be identified for the sake of simplicity (in practice, findings may be a combination of the possibilities listed below):

- effectiveness information is not being produced;
- effectiveness information is being produced but is not valid or reliable; or
- valid and reliable effectiveness information is being produced.

**Sound effectiveness information not available.** If effectiveness information is not available, or if available information does not provide an adequate measure of performance, there is prima facie evidence of a significant deficiency in systems and practices. The question then becomes one of how much further the examiner need go. Because there can be no reasonable assurance that systems and practices result in effective operations in these circumstances, the examiner could simply finish at this point and draw the deficiency to the corporation's attention. Alternatively, the examiner could
actually set out to measure performance, with the intention of determining whether operations are effective.

Although the legislation does not prevent actual testing of effectiveness by the examiner, we would argue that, as a rule, it should not be undertaken. Not only would such work by the examiner be prohibitively expensive in many cases and fraught with potential 'political' problems, it would in no way change the fact that management has failed to meet the statutory requirement to have systems and practices in place that provide reasonable assurance of effective operations. It is not the examiner's responsibility to compensate for management's failure.

Nevertheless, there will be occasions when limited testing of effectiveness may be useful. For example, the compilation of some actual performance information might be used to demonstrate the feasibility of measurement, to emphasize the importance of cause and effect relationships or to establish the importance of having sound performance information.

In the absence of sound effectiveness information, we believe that it would not be cost-effective for the examiner to proceed to a review of systems and practices related to the effectiveness of operations. Without ultimate criteria (i.e., information on results) for judging the operation of the collectivity of systems and practices, such an examination would likely be costly as well as inconclusive.

**Sound effectiveness information available.** If valid and reliable effectiveness information is being produced there are again two broad alternatives facing the examiner, depending on whether the information shows that operations are being carried out effectively or that they are not.

Where the information shows that operations are effective, the examiner has the responsibility to ensure that the results derive from the systems and practices maintained by management and are not purely serendipitous. Here again, a process similar to an evaluability assessment could be employed. This would involve an examination of the structure and logic model to determine whether the systems and practices of the corporation have been designed to manage its critical operations and whether there are plausible causal relationships between activities and results.

The examiner would need to develop a thorough understanding of the critical processes of the business, as well as their linking logic and vulnerability to external or internal events that could jeopardize success. The actual tasks that an examiner would undertake might include reviewing the systems design, planning documents or feasibility studies, and systems operations documents such as procedures manuals and directives. The examiner should also review the key systems and practices to ensure that they operate as intended. This is comparable to testing for compliance, where the examiner would observe the way things actually operate and make comparisons with what is intended. In addition, the examiner should assess how the individual systems and practices fit into the organization as a whole and how they interact. Finally, the examiner should satisfy himself/herself that there are no conditions present in the design, implementation or interaction of key systems and practices that put continuing effectiveness of operations at risk.
If valid and reliable information generated by the corporation shows that operations are not being carried out effectively, at least one possibility is that a significant deficiency (or a number of deficiencies) exists in the systems and practices of the corporation. The examiner should identify whether ineffective operations result from weaknesses in systems and practices maintained by the corporation or whether they arise from circumstances beyond the corporation’s control. One approach would be to go up the chain of objectives in an attempt to locate the source of the problem(s). For example, if ultimate objectives with respect to financial performance are not being met, one could look at achievements at the level of ‘market’ objectives (client satisfaction, market share), then output objectives and so on. The purpose here would be to isolate the problem areas so as to determine whether there are systems and practices that, individually or in concert, are either badly designed or badly implemented.

For example, if overall service targets are not being met one could ask: Are the sub-activities involved in delivering the service meeting their time or quality targets? Does management have information on performance at this level? Is such information used to adjust either work plans or overall service targets? Are there deficiencies in the resourcing, scheduling or quality control practices in certain operations that do not meet their internal objectives? If there is no evidence of weakness in results at the operations level, are there deficiencies in corporate planning processes? Are the information and analyses upon which corporate or operational objectives are based reliable and valid? Are all relevant environmental constraints and opportunities monitored?

**Reliance on Internal Audit**

The legislation requires the examiner to rely on any ‘internal audits’ of the corporation to the extent that he or she considers practicable. Further, the examiner must state the extent of such reliance in the examination report.

The legislation establishes a scope for internal audit work that is essentially the same as that required of the special examination. Internal audit is required to assess compliance with the charge on the corporation to maintain systems and practices that provide reasonable assurance of economic and efficient management of resources, the safeguarding and control of assets, and the effectiveness of operations. What distinguishes the special examination from internal audit is the former’s independence, the need for it to render an opinion and its cyclical (at least once every five years) nature.

For the purposes of this paper, there are two things worth noting with respect to the role of internal audit and the examiner’s reliance on it:

- First, the statutory scope of internal audits is set very broadly and includes the work normally associated with effectiveness auditing. The role of internal audits is to assess compliance with the requirement for corporations to maintain systems and practices (including “program” evaluation, performance measurement and reporting systems) to a certain standard. The implication is that not only may federal Crown corporations need to place more emphasis on evaluation/performance measurement activities, but also that internal audits of Crown corporations will have to include “effectiveness audits”.
• Second, in so far as the examiner is concerned, the work of internal audit constitutes a potential form of audit evidence. As such, the examiner will have to assess the extent and quality of internal audit work to determine whether reliance on it is the most efficient and effective way to gain needed assurance.

In view of the importance of internal audit as a potential source of evidence for the examiner, a special examination would normally include assessments of specific internal audit work to establish a basis for modifying the nature and extent of examination procedures as well as for drawing conclusions about the validity and reliability of information available to the corporation.

Summary and Conclusion

Given the breadth and nature of the special examination requirement, we believe that a results-based approach would be the most direct with respect to giving an opinion on the adequacy of systems and practices maintained to provide reasonable assurance of effective operations. The examiner should start by identifying the various levels of objectives of the corporation, obtaining information indicating whether operations are meeting these various objectives, testing the validity and reliability of the information and then reviewing the systems and practices to determine whether and where deficiencies exist (or may arise) that cause operations to be carried out ineffectively.

Our view is that the nature of the audit work that will have to be done to meet the FAA mandate differs from "effectiveness auditing" as it has been practiced at the federal level over the past several years. Nevertheless, the skills and methods associated with program evaluation and effectiveness auditing have much to contribute in implementing the special examination regime set out by the legislation. In addition, it is likely that the introduction of this regime will focus increased attention on the role that program evaluation, performance measurement and effectiveness auditing techniques can play within Crown corporations themselves.

We would also argue that systems and practices that provide management with information on the effectiveness of the corporation's operations are essential to providing reasonable assurance that the operations are carried out effectively — if indeed they are. Without them, there is no basis for confirming achievements or for taking actions directed to improving results. Systems and practices generating effectiveness/performance information at all levels provide an entry point for the examiner.
References


