
3 Government-Wide: Internal Audit

Summary

In fall 2007 we conducted a survey of numerous government entities to determine the extent of internal audit in government. Internal audit services are provided to government departments through the Internal Audit Centre (IAC), and, in two departments, through staff performing internal audit activities. Otherwise, the Nova Scotia Community College (NSCC) and the Nova Scotia Liquor Corporation (NSLC) have internal audit groups. The Workers' Compensation Board (WCB), which delivers a significant social program, also has an internal audit function. In addition, we noted the operations of the entities which conduct the activities of the Nova Scotia Gaming Corporation are subject to internal audit.

We are concerned with the lack of internal audit throughout government. Significant entities such as regional school boards and district health authorities do not have internal auditors. These entities alone account for \$2.1 billion in government expenditures. We recommended an entity with audit oversight responsibility for the government assess the extent of internal audit activity and develop and implement a plan to address deficiencies.

The Province's Internal Audit Centre provides the majority of internal audit services to government departments. We recommended the Centre's annual audit plan be prepared as a result of an enterprise-wide audit risk analysis. The results of this process should be documented. This would help ensure the provision of sufficient and appropriate internal audit services to government departments.

We conducted fieldwork at the IAC, NSCC, NSLC and WCB. Several recommendations were made to each of the IAC, NSCC and NSLC to bring their audit charters, audit plans, audit manuals, and certain practices in line with internal audit best practices. Our procedures included testing a sample of audit files at each entity for compliance with standards of the Institute of Internal Auditors. We found no deficiencies in any files and noted the quality of work performed by each of the internal audit groups.

Despite requests for written responses, the Department of Finance and Treasury and Policy Board failed to provide any response to our findings or to indicate whether they agreed with our recommendations and whether they intended to take any action to implement them.



3 Government-Wide: Internal Audit

Background

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3.1 The Institute of Internal Auditors defines internal audit as follows:

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

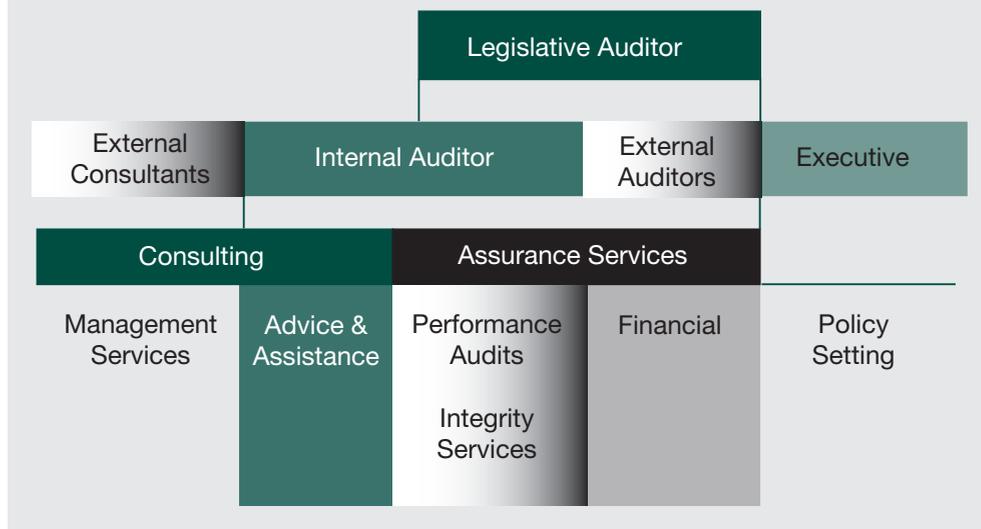
3.2 In a government environment, internal audit differs from legislative audit. The primary purpose of internal audit in government is to serve management and an audit committee, by providing assurance and advisory services. The primary purpose of the legislative audit function is to serve the legislative assembly and the citizens.

3.3 Internal audit differs again from external audit. An external audit is a periodic examination of the books of account and records of an entity and is conducted by an independent auditor. The focus is on the fair presentation of financial information provided by the entity to external users. Both internal and external audit must be independent. Internal audit achieves this independence through the governance and reporting structures within an entity.

3.4 In Nova Scotia, as in all other jurisdictions in Canada, the Auditor General is the external auditor of the Province’s financial statements. The responsibilities of the Auditor General are defined in the Auditor General Act. As an independent audit function, the Auditor General selects engagements based on his selection criteria. These are in addition to specific audits noted in the Act, such as the audit of the Public Accounts. The Auditor General and audits performed by his Office are not a substitute for the work of an internal audit function.

3.5 The following exhibit illustrates the roles of internal audit, external audit and legislative audit in government.

Exhibit 3.1
Role of Auditors in Government



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3.6 Internal audit has evolved in recent years from an activity focusing on transaction processing to a broad function identifying problems before they occur. The focus, as noted above, is not only on controls but also on risk and governance. Internal audit should be proactive. It is a key component in the overall governance and control framework of government. This role is further explained by the Institute of Internal Auditors (IIA) in its publication – *The Role of Auditing in Public Sector Governance*:

“... public sector auditing has broadened focus from individual transactions to control systems and program operations...As an essential element of a strong public sector governance structure, government auditing supports the governance roles of oversight, insight, and foresight.”

Audit Objectives and Scope

3.7 In fall 2007, we undertook a survey of internal audit within the Nova Scotia public sector. The results of that survey directed us to the audit of the internal audit function in several entities, and of the Province’s Internal Audit Centre (formerly the Internal Audit and Risk Management Centre). The audit was conducted under Section 8 of the Auditor General Act and was completed in spring 2008.

3.8 The objectives of our audit were to determine:

- whether internal audit is functioning in accordance with policies established by the government, or a relevant board; and



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- whether the internal audit function complies with the standards of the Institute of Internal Auditors, or international best practices in internal auditing.
- 3.9 Our audit criteria included the standards of the Institute of Internal Auditors and those identified by our Office for the engagement. These criteria were provided to senior management of the entities in which we conducted our audits, and to the Chair of the Province's Audit Committee.
- 3.10 In addition to the survey, our audit approach included interviews with management, documentation review, and testing of audit files. We did not reperform the work completed by internal audit in each audit file tested, and therefore we are not able to conclude on the appropriateness of the opinions provided and/or the conclusions reached in various internal audit files.

Significant Audit Observations

Internal Audit in the Government Reporting Entity

- 3.11 *Conclusions and summary of observations* – The Province of Nova Scotia is similar in many respects to an \$8 billion corporation with numerous locations and divisions. Services are provided through departments, agencies, boards and crown corporations. Some essential services not provided directly by departments are delivered through district health authorities, regional school boards and other entities. Still other services are delivered on behalf of the Province by private sector entities.
- 3.12 We concluded the internal audit activities for the government reporting entity as a whole were inadequate, and in fact did not exist for many significant entities. There was no internal audit function in any of the district health authorities or regional school boards, which account for about \$2.1 billion of Provincial expenditures. In addition, significant agencies, boards and commissions, were lacking internal audit.
- 3.13 *Survey results* – In fall 2007 we conducted a survey to determine the extent of internal audit in government. The entities we surveyed were those listed in Schedule 9 – Government Reporting Entity (GRE) – of the March 31, 2007 consolidated financial statements of the Province (see exhibit 3.2), with the exception of those we excluded because they did not meet our criterion of greater than \$5.0 million in any financial statement balance. There were exceptions to our criterion; specifically those entities which did not have significant financial balances, but did provide significant service.



Exhibit 3.2 Government Reporting Entity

Listed below are the governmental units, government business enterprises and government partnership arrangements that comprise the government reporting entity and which were included in our survey.

Governmental Units

Consolidated Fund (includes government departments)

District Health Authorities

Annapolis Valley District Health Authority
Cape Breton District Health Authority
Capital Health District
Colchester East Hants Health Authority
Cumberland Health Authority
Guysborough Antigonish-Strait Health Authority
Pictou County Health Authority
South Shore District Health Authority
South West Nova District Health Authority

Regional School Boards

Annapolis Valley Regional School Board
Cape Breton Victoria Regional School Board
Chignecto-Central Regional School Board
Halifax Regional School Board
South Shore Regional School Board
Strait Regional School Board
Tri-County Regional School Board

Housing Authorities

Nova Scotia Housing Development Corporation
Annapolis Valley Housing Authority
Cape Breton Island Housing Authority
Cobequid Housing Authority
Eastern Mainland Housing Authority
Metropolitan Regional Housing Authority
South Shore Housing Authority
Tri-County Housing Authority

Boards, Agencies and Commissions

Art Gallery of Nova Scotia
Conserve Nova Scotia
Conseil scolaire acadien provincial
Industrial Expansion Fund
Izaak Walton Killam Health Centre
Maritime Fall Fair Association
Nova Scotia Business Incorporated
Nova Scotia Community College
Nova Scotia Community College Foundation
Nova Scotia Crop and Livestock Insurance Commission
Nova Scotia E911 Cost Recovery Fund
Nova Scotia Farm Loan Board
Nova Scotia Film Development Corporation
Nova Scotia Fisheries and Aquaculture Loan Board
Nova Scotia Government Fund
Nova Scotia Health Research Foundation
Nova Scotia Innovation Corporation
1402998 Nova Scotia Limited
3039255 Nova Scotia Limited
3087532 Nova Scotia Limited
Nova Scotia Legal Aid Commission
Nova Scotia Municipal Finance Corporation
Nova Scotia Nominee Program Fund
Nova Scotia Pension Agency
Nova Scotia School Insurance Exchange
Provincial Drug Distribution Program
Public Archives of Nova Scotia
Resource Recovery Fund Board Incorporated
Sydney Steel Corporation
Sydney Tar Ponds Agency
Sydney Utilities Limited
Trade Centre Limited
Waterfront Development Corporation Limited

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Government Business Enterprises

Halifax-Dartmouth Bridge Commission
Highway 104 Western Alignment Corporation

Nova Scotia Gaming Corporation
Nova Scotia Liquor Corporation

Government Partnership Arrangements

Atlantic Provinces Special Education Authority

Canada-Nova Scotia Offshore Petroleum Board



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- 3.14 We contacted management or senior management at each entity surveyed and asked whether there was an internal audit function, or whether the entity had contracted externally for internal audit services.
- 3.15 We determined an internal audit function existed at the Nova Scotia Liquor Corporation, Nova Scotia Community College, and for the Consolidated Fund through government's Internal Audit Centre. In addition, although it is not included in Schedule 9, we also contacted the Workers' Compensation Board and found this entity had an internal audit function. Our observations and conclusions with respect to these entities are noted later in this report. We also noted the operations of the entities which conduct the activities of the Nova Scotia Gaming Corporation (NSGC) are subject to internal audit. We did not audit the internal audit function at these entities affiliated with NSGC because neither is controlled by the Province.
- 3.16 In addition to the survey, we also met with senior management of the Province's Internal Audit Centre (IAC). (See discussion of the IAC beginning at paragraph 3.22 below. Briefly, the IAC provides internal audit services to departments forming the Consolidated Fund.) The purpose of our meeting was to determine the extent to which this central group considered internal audit of entities within the GRE. We asked whether the IAC:
- acted as an oversight function to support an existing internal audit activity within the entity;
 - actually provided internal audit services to the entity; or
 - had performed any analysis to determine that the risks of the entity had been evaluated from an overall perspective that allowed IAC to conclude the extent of internal audit, including the absence of internal audit, was appropriate.
- 3.17 We noted IAC was not aware of the extent of internal audit activity throughout the GRE.
- 3.18 The lack of internal audit throughout the GRE is a significant deficiency, and the impact of its absence in the overall governance framework of the Province of Nova Scotia cannot be overstated. The entities which do not have internal audit are significant – district health authorities, regional school boards, regional housing authorities and various agencies of government. District health authorities and regional school boards alone account for \$2.1 billion of total provincial expenditures. They also deliver significant programs on behalf of government.

3.19 The IIA concludes the following in *The Role of Auditing in Public Sector Governance*:

“Because government auditing is key to good public governance, it is crucial to maintain an appropriate (audit) configuration with an appropriately broad mandate to achieve the organization’s governance objectives. The government audit activity’s mandate should be as broad as possible to enable it to respond to the full scope of the government’s or governmental unit’s activities. ... every government requires some form of independent audit activity that has authority to evaluate the full range of the government’s activities.”

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3.20 Government needs to assess the mandate of its internal audit activity and address deficiencies. The mandate established in the existing Internal Audit Charter for the Province clearly excludes an assessment of the operations in the significant governmental units and government business enterprises, as indicated:

“The mandate and priorities for internal audit reflect the key clients of the function – Deputy Ministers and Senior Managers of Departments cited under the Public Service Act... Where Departments have arms-length relationships with organizations that are funded exclusively or substantially by government; that being, Governmental Units and Government Business Enterprises as outlined in the Provincial Finance Act, the key clients may request that Internal Audit conduct governance reviews and compliance auditing related to the contracts, agreements and other mechanisms that formalize the relationship between the Departments and the arms-length organizations.”

3.21 Boards of directors or management of governmental units and government business enterprises are responsible to ensure the governance framework for the entity includes an adequate and appropriate internal audit function. Such a function contributes to the improvement of risk management and control systems to ensure the reliability and integrity of financial and operational information, compliance with laws and regulations, efficiency and effectiveness of operations, and safeguarding of assets. An entity within government with audit oversight responsibility needs to ensure the extent of internal audit throughout the GRE is appropriate.

Recommendation 3.1

An entity with audit oversight responsibility should assess the extent of internal audit activity within the government reporting entity. The assessment should identify the gaps between what is currently provided by existing internal audit and the audit needs of the government reporting entity. The results of the assessment should be used to develop a plan to address deficiencies, including an implementation schedule.



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Audit Activity in Core Government

- 3.22 *Conclusions and summary of observations* – We concluded the internal audit function within the core government was not adequate. While the Internal Audit Charter described the mandate, responsibilities and authority of the internal audit function, the full extent of the mandate was not met. For purposes of this audit, we have defined “core” government the same as has been defined in the Province’s Internal Audit Charter – that is, departments cited under the Public Service Act.
- 3.23 Internal audit activity in the core government is substantially performed by the Internal Audit Centre (formerly the Internal Audit and Risk Management Centre). To date, the majority of IAC’s work was as a result of requests from senior departmental management, and therefore it was not effectively fulfilling its mandate. We recommended IAC formalize the process for selecting its activities to ensure all departments are receiving sufficient audit services. We have also made recommendations for review and formal approval of the Internal Audit Charter.
- 3.24 Based on the results of our audit testing, we noted audits performed by the Internal Audit Centre complied with relevant attribute and performance standards of the Institute of Internal Auditors. These include due professional care and engagement planning, performance and reporting.
- 3.25 *Internal Audit Centre* – The mandate for internal audit is defined in the Province’s Internal Audit Charter as follows:
- “Internal Audit’s primary role is to determine whether the Province’s network of risk management, control and governance processes, as designed and represented by management, is adequate and functioning in a manner that ensures:*
- *Resources are acquired economically, used efficiently, and adequately protected;*
 - *Programs, plans, and objectives are achieved;*
 - *Risks are appropriately identified and managed;*
 - *Significant financial, managerial, and operating information is accurate, reliable, and timely; and*
 - *A strong governance and control environment is promoted.”*
- 3.26 This reflects the mandate of a fully operational and effective internal audit function within a government. Objective and independent assessments of

these areas by an internal audit function would provide any government with a full accountability of its activities to stakeholders. We noted the Charter does not specifically refer to the IAC as the central group to deliver internal audit services and this should be done. For purposes of this audit, we have determined the IAC performs the majority of internal audit work in the core government. This is supported by our work noted in paragraph 3.42 below. Our findings and conclusions with respect to internal audit refer mainly to the IAC.

- 3.27 While there are aspects of IAC's operations, and therefore, the Province's internal audit function, that are effective, the following paragraphs detail deficiencies that indicate the internal audit function was not operating as intended.
- 3.28 *Annual audit plan* – The projects for the period considered in our audit – 2006 and 2007 – included operational reviews, compliance audits, and transaction processing reviews. These were either conducted by IAC staff or outsourced by IAC to third party service providers. The IAC had 10 staff in 2007. When this Report was written, the IAC had 12 staff, and had recently hired a new Executive Director.
- 3.29 We reviewed the list of projects completed or in progress for 2006 and 2007. There were 46 projects at various stages of completion on the list provided by IAC. Nine of these projects related to central government (i.e., the Department of Finance) and the remaining to government departments. There were no government-wide services provided. We noted internal audit services were provided to 13 of the 20 departments (including Treasury and Policy Board) in 2006 and 2007.
- 3.30 The IAC facilitates the risk assessment process in departments. (Further details of this process are noted in paragraph 3.35 below.) As a result of this process, we were informed senior management in departments for which risk assessments have been performed identifies those areas which they would like IAC to audit. Our audit scope did not extend to determining whether risks identified by departments were part of the IAC plan.
- 3.31 The risk assessment process in 2006-07 led to the development of the 2007-08 audit plan. IAC management could not locate an audit plan for 2006-07. Two audits were initiated by IAC outside of the risk assessment process in response to deficiencies identified during 2006-07. IAC management informed us the requests for audits by senior departmental management are only one aspect of the annual audit plan. They noted the audit plan also results from consultation with deputy ministers and based on IAC management's departmental knowledge. We did not see evidence of any additional analysis which resulted in additional projects on the audit plan for either of 2006 or 2007.

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- 3.32 In order to be fully effective, and to ensure sufficient and adequate internal audit services are provided to core government, the IAC should develop its annual audit plan as a result of enterprise-wide audit risk analysis. Due to the current audit selection process, there is potential for any number of departments, in any year, to not have internal audit services because departmental senior management had not requested them and because an analysis had not been prepared by IAC.
- 3.33 IAC management indicated it recognizes the need for a more robust audit selection process and with recent increases in staff resources, internal audit will continue to evolve and mature. This process will also ensure the internal audit function operates as an effective internal control.
- 3.34 A unique aspect of internal audit in a government environment, and one that is evident in Nova Scotia's core government, is the dual role of deputy ministers and internal audit. Both must consider the needs of government as a whole. However, deputy ministers must also consider the needs of their departments, and the IAC must ensure the audits it selects meet the needs of its clients – i.e., deputy ministers. There can be a conflict between what internal audit activity is needed at an enterprise level and what is needed in individual departments. It is up to the Audit Committee to ensure the audit plan for IAC reflects the appropriate balance.

Recommendation 3.2

Senior management of the Internal Audit Centre should prepare IAC's audit plan based on an enterprise-wide audit risk analysis, and considering consultation with deputy ministers. The results of this consultative and evaluative process should be documented. The Audit Committee should formally approve the plan.

- 3.35 *Risk management* – Risk management is the process of identifying and assessing risks. It involves strategic decisions on mitigating risks and accepting residual risk. Risk management is a management function. The role of internal audit in risk management, according to IIA Standards, is to “...evaluate and contribute to the improvement of risk management...using a systematic and disciplined approach”.
- 3.36 The IAC has facilitated risk assessments in various departments in each of the last two years. In 2006-07, IAC management indicated risk assessments were conducted in seven departments. As of June 30, 2008, 16 assessments had been completed or were pending throughout core government. We did not audit the process or results of these risk assessments.
- 3.37 The risk assessment process facilitated by IAC is a component of the Province's developing risk management process, and IAC management indicated the Province is exploring the implementation of a risk

management framework. It was noted IAC will be in a better position to assess whether risks have been identified and appropriately managed across core government once the risk management framework has been fully implemented.

- 3.38 *Independence* – An internal audit group must be independent of the activities it evaluates in order to be effective. The IIA Standards indicate the organizational structure of an entity should facilitate the independent planning, execution and reporting of audits.
- 3.39 The IAC Director previously reported to the Province’s controller on administrative matters and this did not reflect best practice. The newly-hired Executive Director now reports administratively to the Deputy Minister of Finance. This was a significant step toward independence and compliance with IIA Standards.
- 3.40 The IAC reports functionally to the Audit Committee. This committee is the oversight body for the IAC. It consists of deputy ministers of various departments and is chaired by the Deputy Minister of Treasury and Policy Board. We note the Charter includes a statement regarding independence and objectivity with respect to providing advice to departments, specifically; “*Internal Auditors may provide advice but may not install procedures or systems, prepare records, or engage in any line activity that would compromise independence and objectivity.*” This clarifies the role of internal audit on consulting activities.
- 3.41 IIA Standards require the Charter be formally approved. This has not been done. The Charter should be reviewed by the audit committee on a regular basis to ensure it reflects the needs of the Province. The Charter should also be updated to reflect the Internal Audit Centre as the group which performs the services detailed in the Charter. At present, the Charter does not refer to the IAC.

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Recommendation 3.3

The Internal Audit Charter should be periodically reviewed, and updated as needed, by the Audit Committee. The Charter should be formally approved by the Audit Committee.

- 3.42 *Internal audit activities within departments* – In order to assess the extent of internal audit activity in the core government, audit activity not conducted by the IAC must be considered.
- 3.43 During the survey phase of this audit, we were made aware of internal audit activity within two departments, Community Services and Justice. There are individuals in those departments who are termed internal auditors,



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either formally or informally. Management in both departments indicated these positions were established because it was not possible or practical for IAC to meet their needs.

- 3.44 Internal audit in each of these departments is in its early stages and therefore we did not evaluate audit activities against IIA Standards, which consider a more mature internal audit function. However, we did review files detailing their audit activity. We noted in each of these departments, procedures were performed and evidence documented in the files to support the conclusions formed and recommendations made. In most cases each file included a planning memo, risk assessment and audit program. One department indicated their primary focus at present is to show their presence as a means to increasing controls.
- 3.45 In addition, we also requested information from departments as to the extent of audit activity in their departments not conducted by IAC. Based on the responses we received, there was not a significant amount of audit activity outside of that requested to be performed by IAC. Therefore, we concluded IAC is the primary means through which internal audit activity is conducted throughout core government.
- 3.46 The governance structure within the core government establishes the responsibilities of deputy ministers over their respective departments. Consequently, deputy ministers have the authority to direct activities to ensure an identified need is met. However, these activities should be considered by the Audit Committee or an audit oversight body as part of the overall assessment of internal audit activity within the government. If departments continue to develop internal audit activities outside IAC, there should also be a process to ensure the selection, planning, execution and reporting of audits is in accordance with recognized professional standards.

Recommendation 3.4

The scope, nature and quality of internal audit activity throughout core government should be evaluated by an entity responsible for audit oversight. The results should be used to determine whether departments are receiving sufficient and appropriate internal audit services, and a plan should be developed to address the deficiencies.

- 3.47 There appears to be a lack of clarity about the role of an internal auditor. We reviewed work performed by the internal auditors in the Departments of Community Services (DCS) and Justice and noted internal control evaluation was one of the objectives in the majority of the audits we tested. Typically, internal control evaluation is an internal audit function. However, senior management at DCS informed us there was no internal audit function; rather, the individual was referred to as a Financial Compliance Officer.

- 3.48 As noted, IAC recently hired a new Executive Director. He provided us with information he has presented to the Audit Committee on the role of internal auditors, in which he explains an internal auditor provides independent assurance and evaluates and improves departments' processes. This definition should clarify the role of the IAC and its internal auditors.
- 3.49 *Compliance with auditing standards* – We selected five audit files at IAC and tested against IIA Standards including adequate planning and an indication in the files that engagement objectives had been met. We found the files were well-prepared and organized, and in all cases met the Standards. There was evidence of due care and quality assurance, the latter through supervisory review.
- 3.50 *Quality assurance and continuous improvement* – IAC has prepared an extensive Policy Manual. There are policies which address quality assurance such as supervisory file reviews and the use of assurance standards issued by the Canadian Institute of Chartered Accountants.
- 3.51 In addition, the Policy Manual supports continuous improvement. Customer surveys are to be sent after each audit. This has recently begun at IAC. There is also a performance measure to determine how many recommendations have been implemented. We acknowledge the efforts of IAC to ensure their work adds value.
- 3.52 In order to be fully compliant with IIA Standards, the IAC needs to have an assessment performed by the IIA. IIA Standards require an external assessment be conducted at least once every five years. IAC is approaching its first five years of service and management indicated this timeframe for an external assessment will be met.

Recommendation 3.5

The IAC should ensure it obtains an external assessment of its activities in the timeframe required by IIA Standards.

- 3.53 *Reporting* – Each audit file we tested concluded with a report to management of the related activity. In addition, we were informed the executive summary of each report is provided to the Audit Committee. IAC management informed us the Audit Committee may request the full report, and has done so on occasion. We noted the minutes included a status report of IAC activity.
- 3.54 *Follow-up* – There is a tracking system for recommendations made in each audit. A letter is sent six months after the report was issued requesting information as to whether the various recommendations have been implemented. At the time of our audit, this was a one-time only process.



The Executive Director of IAC informed us the follow-up process is to be revised to ensure the status of recommendations is tracked until the issues prompting each recommendation are fully resolved.

Nova Scotia Community College

- 3.55 *Conclusions and summary of observations* – The internal audit group at the Nova Scotia Community College functions in accordance with key aspects of the audit charter for the group. It operates independently of College management and reports audit results regularly to the College’s Finance and Audit Committee. We made recommendations for improvements to the Internal Audit Charter and the group’s policy and procedure manual. Further, we note that based on the results of our audit testing, audits performed by the internal audit group at the Nova Scotia Community College comply with those performance and attribute standards of the Institute of Internal Auditors that are relevant to the conduct of audits.
- 3.56 *Risk management, controls and governance* – The internal audit group at the College requests divisional managers prepare a risk assessment every two years. Internal audit also prepares a risk assessment. These risks are ranked and used by internal audit to prepare the audit plan.
- 3.57 The IIA Standards reference internal audit’s evaluation of risk management. We spoke with management and confirmed there was no evaluation by internal audit of the risk management system at the College, and we suggested consideration be given to this to ensure compliance with the Standards. It is evident, irrespective of this, the College relied on the risk assessment process facilitated by internal audit to identify and rank risks.
- 3.58 The IIA Standards also note internal audit is to evaluate and contribute to the improvement of controls and governance. We noted, just as with risk management, there was no formal evaluation of control and governance. However, internal audit at NSCC includes both control and governance aspects in its audits, especially its audit of individual NSCC campuses. We suggest this reflects an appropriate consideration of these aspects of the control framework at NSCC, and is meeting the needs of the College.
- 3.59 *Independence* – The internal audit group operates as an independent function at the College. We noted the internal audit group prepares an annual audit plan which is presented to the Finance and Audit Committee although not formally approved by that group. The audit plan notes audits are to be conducted in accordance with IIA Standards.

Recommendation 3.6

The Finance and Audit Committee of the College should approve the annual audit plan.

3.60 *Audit charter* – The Internal Audit Charter was provided to the Finance and Audit Committee in April 2003. The Charter included the authority and responsibility of the Director of Internal Audit, the scope of activities, and the responsibilities. It also established the reporting mechanisms and requirements of the Director. The minutes note there were comments and feedback regarding the Charter, but there was no formal approval. The Charter was updated in 2005.

Recommendation 3.7

The Internal Audit Charter should be approved by the Finance and Audit Committee of the College.

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3.61 *Results of testing* – We tested five audit files prepared by the College’s internal audit group. Details of the files were tested against IIA Standards and indicated engagement objectives had been met. In all cases, the files complied with applicable IIA attribute and performance standards.

3.62 *Quality assurance and continuous improvement* – The internal audit group at the College has a detailed policy and procedure manual. There is specific guidance on the preparation of working papers and the process to be used to conduct an audit – how to perform a preliminary survey of an audit area and what audit program to use. Although the manual does not specifically indicate working papers in audit files are to be reviewed, we saw evidence of this in all files we tested.

3.63 With respect to quality assurance and continuous improvement, the IIA Standards note the following. *“The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness.”*

3.64 This standard is directed toward continuous improvement of the internal audit function itself. It is not meant to establish how internal audit improves the organization it serves. The IIA Standards further notes internal and external assessments, the latter by the IIA itself, provide support for the direction of an internal audit function.

3.65 The Internal Audit Charter at the College notes the group *“...uses continuous improvement as an integral part of the group’s activities.”* However, the Charter and the policy and procedure manual focus on how internal audit contributes to the improvement of the College, not on continuous improvement of the function. While we acknowledge recommendations made by the internal audit group aim to improve the College, the manual should address how internal audit at the College intends to monitor its activity, and use these results to ensure it continues to add value, in order to comply with IIA Standards.



Recommendation 3.8

The policy and procedure manual should be revised by the College to indicate how the internal audit function will evaluate its results and improve its performance. An external assessment to ensure compliance with IIA Standards should be performed.

- 3.66 *Reporting* – The Charter notes “*The Director of Internal Audit shall have the authority to report directly to the College’s President and the Finance and Audit committee.*” The Charter further says “*The Director of Internal Audit, at his discretion, may forward copies of the audit report, including management’s response, to the Finance and Audit Committee.*”
- 3.67 Our review of the Finance and Audit Committee minutes indicated the Director of Internal Audit reported on the results of audits. We did not ensure the results of all audits during our testing period were provided to the Finance and Audit Committee and therefore we cannot comment whether, in fact, discretion was used in reporting results. We noted two of the five audits we tested were specifically referenced in the minutes.
- 3.68 Recommended practice on the reporting relationship between the chief audit executive and an audit committee are noted in the CICA publication *20 Questions Directors Should Ask About Internal Audit*. It notes the chief audit executive should “*...report the results of major activities and key findings and issues to the Audit Committee.*” The Internal Audit Charter at the College should be revised to reflect this best practice.

Recommendation 3.9

The Internal Audit Charter should be revised by the College to remove discretion in the reporting of audit results by the Director of Internal Audit to the Finance and Audit Committee.

- 3.69 *Follow-up* – With respect to follow-up, the Director tracks all recommendations and follows up with clients until the recommendations have been implemented.

Nova Scotia Liquor Corporation

- 3.70 *Conclusions and summary of observations* – The internal audit group at the Nova Scotia Liquor Corporation (NSLC) operates in accordance with its mandate. The significant activity of the group is store audits and the importance of this activity reflects corporate goals of the NSLC. We recommended the Internal Audit Charter be updated to reflect current Institute of Internal Auditors Standards. We selected audit files at NSLC and tested against IIA Standards. We found the work in the files was in compliance with those attribute and performance standards applicable to the conduct of audits.

- 3.71 *Risk management, controls and governance* – The Corporation is in the process of an enterprise risk management (ERM) exercise. We noted the Internal Audit Charter does not address risk management and the role of internal audit in its evaluation and improvement. The Charter should be revised to reflect this role. The Manager of Internal Audit provided us with a presentation he made to the Board of Directors at the Corporation in which he expanded on the importance of ERM and included the results of a control self-assessment survey he conducted.
- 3.72 With respect to controls, we noted these are addressed in the objectives of the store audits. We further noted the control self-assessment included aspects of governance such as ethical values and the role of the Board of Directors and the Audit Committee. While not fully in compliance with IIA Standards, the internal audit group actively promotes strong controls and governance.
- 3.73 *Independence* – The Manager of Internal Audit reports to the Corporate Secretary of the NSLC for administrative matters, and functionally to the Audit Committee. The Internal Audit Charter does not reflect the current reporting relationship of Internal Audit within the organization, and should be updated.
- 3.74 Until recently, the Manager of Internal Audit prepared an annual audit plan. This plan reflected the results of risk assessments prepared for stores, operations and manufacturers. The risk assessments ranked each assessed area based on various criteria – for example, stores were ranked based on factors such as the class (size) of the store, breakage, cash shortages and audit history. Divisional management was asked for input, but the Manager indicated he was responsible for the preparation of the plan and the selection of the audits.
- 3.75 Neither the Terms of Reference for the Audit Committee nor the Internal Audit Charter requires the audit plan be approved. We saw the audit plan was discussed in certain minutes of Audit Committee meetings, but did not see any specific approval. Recommended practice on the approval of audit plans is noted in the CICA publication *20 Questions Directors Should Ask About Internal Audit*. It notes the Audit Committee should “...approve the *Internal Audit plan annually.*”

GOVERNMENT-WIDE:
INTERNAL AUDIT

Recommendation 3.10

The Corporation’s Internal Audit Charter and the Terms of Reference for the Audit Committee should be revised to indicate the Committee is to approve the audit plan.



NOVA SCOTIA

GOVERNMENT-WIDE:
INTERNAL AUDIT

- 3.76 The Manager indicated one result of the enterprise risk management exercise was the completion of a five year audit plan. We noted one change in the five year plan compared to the annual plan was a more specific schedule for store audits, based on the class of the store. This reflects the legislative responsibility of the NSLC which includes attaining suitable financial revenue for the Province. We suggest the five year plan should have an annual operational plan and this should be approved by the Audit Committee.
- 3.77 *Audit charter* – The Internal Audit Charter is included in a policy and procedure manual for financial management. In order to promote the independence of the internal audit function, related policies and procedures should be documented in a separate manual for the internal audit group. Senior management at NSLC indicated the Corporation is aware its manuals require updating.
- 3.78 The Charter includes the purpose, objective and scope of the work of the internal audit group. The responsibility and authority is noted in the manual, but outside the Charter. Also, as discussed previously, the evaluation of the Corporation's risk management system is not included in the Charter. In general, the Charter should be reviewed and updated to ensure it reflects current IIA Standards. This is consistent with recommended practice which suggests a review at least every three years. The existing Charter was approved by senior management of the former Nova Scotia Liquor Commission, but not by the current Audit Committee.

Recommendation 3.11

The Internal Audit Charter should be reviewed by the Corporation and updated to ensure it complies with IIA Standards. The Charter should be approved by the Audit Committee.

- 3.79 *Results of testing* – We tested five files prepared by the NSLC Internal Audit group. All files indicated the scope and objectives of each audit, and conclusions were drawn for all objectives tested. We did not note any instance of non-compliance with IIA Standards in the files we tested.
- 3.80 *Quality assurance and continuous improvement* – Quality assurance is implemented through the policies and procedures detailed in the Internal Audit section of the Financial Management manual. It includes a description of the components of the audit plan, the preliminary survey, the process for examining and evaluating information, and related working paper preparation, and the requirement for working paper review. The focus of the section on examining and evaluating information is on internal controls; this should be expanded to include the current broad range of internal audit activity contemplated in the IIA Standards.

3.81 The manual indicated the internal auditors are bound to comply with IIA Standards and Code of Ethics. As noted previously, these include monitoring the effectiveness of the function through both internal and external assessments. The Internal Audit group at NSLC has not been subject to an external assessment by the IIA and this should be done to ensure compliance with the Standards. The manual was also deficient in identifying a process to monitor the effectiveness of the internal audit function.

Recommendation 3.12

The Finance Management manual should be revised by the Corporation to indicate how the internal audit function will evaluate its results and improve its performance. An external assessment to ensure compliance with IIA Standards should be performed.

GOVERNMENT-WIDE:
INTERNAL AUDIT

3.82 Although an external assessment has not been performed, the Manager of Internal Audit has completed a GAIN (Global Auditing Information Network) Survey which is a tool provided by the IIA providing benchmarks to users of the Survey on successful internal audit practices. While the Survey was completed by the Manager and therefore is not an objective assessment of NSLC's internal audit function, it provided feedback to the Manager in numerous areas. He indicated as a result of the Survey, it was recognized NSLC internal auditors required increased training, were lagging in the use of data extraction techniques during audits, and were not conducting customer satisfaction surveys. The Manager noted these changes have been made and are an indication of continuous improvement. We did not verify these comments.

3.83 *Reporting* – Although the policy and procedure manual does not specify the reporting requirements of the Manager of Internal Audit, other than with respect to individual audit results, the relationship is clearly explained in a June 2003 memo from the (then) Chair of the Audit Committee noting the Manager reports administratively to the Manager of Finance and that “*On all audit business impacting the corporation, (the Manager) will report to the Audit Committee. This will ensure that (the Manager) has full independence of action when completing his various Audit responsibilities.*”

3.84 Until 2007, the Manager of Internal Audit provided an annual report to the Audit Committee noting the overall results of audit activity against the audit plan, and provided details of store audit results. In November, 2006, the minutes indicated the Audit Committee requested quarterly reports be provided. More frequent reporting to the Audit Committee, including the results of audits, began in 2007. The update to the Charter should note this reporting relationship.



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GOVERNMENT-WIDE:
INTERNAL AUDIT

3.85 *Follow-up* – Written reports were provided as a result of all the audit files we tested. The Manager of Internal Audit maintains a spreadsheet indicating the disposition of recommendations. The Manager indicated he enquires of the respective divisional staff as to whether the recommendations have been implemented but does not verify responses. He noted most recommendations resulting from store audits are implemented immediately. We suggest a more formal follow-up system be developed to track the status of all recommendations, and the results be reported to the Audit Committee.

Workers' Compensation Board

3.86 *Conclusions and summary of observations* – The internal audit function at the Workers' Compensation Board (WCB) is outsourced to a third party service provider. Based on discussions with WCB management and review of documentation, the internal audit function is considering risk management, internal controls and governance in its audit plans. The internal audit function at the Worker's Compensation Board is in compliance with policies established by the Audit Committee.

3.87 *Audit activities* – The Internal Audit Charter establishes the mission, authority, responsibility of the service provider, and notes the internal auditor will comply with the standards and codes of ethics of the IIA. The Charter also notes the independence of the internal auditor; specifically, the service provider auditor reports to the Chair of the Audit Committee and to the Board's Chief Executive Officer. An engagement letter between the service provider and the Board further summarizes the terms of the engagement and the services to be provided. The Internal Audit Charter was not formally approved by the Audit Committee but was recommended by that Committee to the Board of Directors.

3.88 The service provider prepares an Internal Audit Plan for the Audit Committee. Based on discussions with the Chair of the Audit Committee, and supported by a review of the minutes, the Committee challenges the Plan and changes are made. The mandate of the Committee indicated it recommends the Plan to the Board of Directors. We noted through a review of the Audit Committee minutes, the Plan is fluid and changes are made during the year at the request of the Committee. The Audit Plan is risk-based and reflects a mature internal audit function, indicating "... *new initiatives have also been included in the audit plan, where the objective of the Internal Auditor's involvement would be to provide proactive risk identification and control advisory services.*"

3.89 The results of each audit are provided to the appropriate manager, and the Audit Committee receives a draft of the individual reports as well. The



service provider presents an update on the status of audits in the annual Plan to the Audit Committee on a regular basis. A formal system for tracking the implementation of recommendations was developed by the service provider in 2007. We were informed each recommendation is rated as high, medium or low in terms of its necessity for implementation, and that the service provider tracks each recommendation to ensure it is implemented. We did not audit the tracking system or its results.

3.90 The Internal Audit Charter and the Internal Audit Plan at WCB reflect IIA Standards. We did not audit for compliance with IIA Standards in individual audit files. Our criterion was to determine how an audit oversight body – the Audit Committee at the WCB – evaluates the work of the service provider, including the implementation of recommendations. Through review of documentation and discussions with management, we determined this criterion was met.

GOVERNMENT-WIDE:
INTERNAL AUDIT

RESPONSE:
NOVA SCOTIA
COMMUNITY
COLLEGE

Response: Nova Scotia Community College

Recommendation 3.6

The Finance and Audit Committee should approve the annual audit plan.

The Director of Internal Audit will ensure the approval of the audit plan is documented in the minutes.

Recommendation 3.7

The Internal Audit Charter should be approved by the Finance and Audit Committee.

The Director of Internal Audit will ensure the approval of the updated Audit Charter is documented in the minutes.

Recommendation 3.8

The policy and procedure manual should be revised to indicate how the internal audit function will evaluate its results and improve its performance. An external assessment to ensure compliance with IIA Standards should be performed.

The Director of Internal Audit will amend the manual to include information on the procedures used by the internal audit group to monitor its activities and to continue to add value.

Recommendation 3.9

The Internal Audit Charter should be revised to remove discretion in the reporting of audit results by the Director of Internal Audit to the Finance and Audit Committee.

The Director of Internal Audit will amend the Charter to clarify the meaning of discretionary reporting. All significant findings / issues are currently reported to the Audit Committee.

Response: Nova Scotia Liquor Corporation

The NSLC welcomes the review by the Office of the Auditor General of the Internal Audit function at the NSLC. Our response to each of the recommendations made by the OAG is below. These recommendations have been reviewed and accepted by the Audit Committee of the NSLC Board. It should be noted that the Internal Audit function at the NSLC reports to the Audit Committee, and that the Committee has authority to either accept or reject the recommendations forwarded by management.

Recommendation - Internal Audit Charter

The Internal Audit Department agrees that there is a need to update the Corporation's Internal Audit Charter. The Internal Audit Department will review and update its charter by December 31, 2008 and present the revised Charter and recommendations to the Audit Committee for their consideration in early 2009.

Recommendation - Policy & Procedure Manual

The Internal Audit Department agrees that there is a need to update the Policy & Procedure Manual. The Internal Audit Department will review and update the Policy & Procedure Manual by December 31, 2008 and present the revised manual and recommendations to the Audit Committee for their consideration in early 2009.

Recommendation - External Assessment

The requirement for an external assessment will be included in the revised Internal Audit Charter. The Audit Committee has agreed with the recommendation and will ensure that an external assessment is carried out.

RESPONSE:
NOVA SCOTIA
LIQUOR
CORPORATION

Response: Worker's Compensation Board

Good governance is a cornerstone of good business performance and we take our responsibility for safeguarding the WCBs assets seriously to ensure the sustainability of the WCB over the long-term. We are committed to transparency in our operations and to the independence of the internal audit function. We are proud and extremely pleased with the Auditor General's positive comments about our internal audit process.

RESPONSE:
WORKER'S
COMPENSATION
BOARD