Report of the Auditor General of Alberta

FEBRUARY 2014

Mr. Wayne Cao, MLA
Chair
Standing Committee on Legislative Offices

I am honoured to send my *Report of the Auditor General of Alberta—February 2014* to Members of the Legislative Assembly of Alberta, as required by Section 20(1) of the *Auditor General Act*.

[Original signed by Merwan N. Saher]

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Auditor General

Edmonton, Alberta
February 5, 2014

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REPORT OF THE AUDITOR GENERAL OF ALBERTA

February 2014

Auditor General's Message

Our work and why it is important

As an independent legislative audit office, our work assists the Legislative Assembly, and in particular the Standing Committee on Public Accounts, in holding the government accountable. We provide opinions on whether the consolidated financial statements of the province, and the financial statements of every ministry, department, fund and provincial agency, are presented appropriately. Our audits of financial statements and performance measures often lead to recommendations to improve performance reports and the processes the government follows to produce them.

An important part of our mandate is to examine and report on the government's management control systems. Through systems audits, we identify opportunities and propose solutions to improve the use of public resources. The following findings and recommendations to the Legislative Assembly are the focus of our February 2014 report.

This report makes public our audits of the oversight systems for public sector pension plans, and of the financial systems and controls within Alberta's public post-secondary institutions. We also report on several follow-up audits, where we determine if the government has implemented prior recommendations.

Report highlights—New audit

Treasury Board and Finance—The Department's Oversight Systems for Alberta's Public Sector Pension Plans (page 15)

The financial health and design of Alberta's public sector pension plans can affect the government's and other plan employers' ability to cost effectively deliver public services, attract and retain quality employees and provide a level of benefit security for plan members. Albertans need to know if Alberta's public sector pension plans are sustainable. The plans face retirees who are living longer and low interest rates that result in large unfunded liabilities. The minister and department need performance measurement systems to help them assess if the plans are continuing to meet their objectives.

Our recommendations are intended to help ensure that each plan's objectives and tolerances for its cost and funding components are clearly articulated. Clear objectives and risk tolerances will help the minister and department monitor plan performance. They will also help all stakeholders reach a consensus about what to do when a plan exceeds its tolerances. This should prompt timely responses to such risks as they arise. Furthermore, an improved approach to pension risk management should make it clear in advance who will bear which risks and costs when plans exceed their tolerances.

During this new systems audit, we identified that better tools and strategies are currently in use by other defined benefit pension plans to assess and mitigate risk. With proper standards and guidance, Alberta's public sector pension plans can use these risk management techniques to increase the likelihood that the plans are sufficiently funded to meet their obligations and that costs do not become more than plan sponsors can afford.

We found that pension plan boards have, to varying degrees, implemented risk management systems. However, no one organization has clear responsibility for coordinating and monitoring the performance of the plans or taking a consolidated approach to managing risk. The department has managed risk to some extent by providing policy support to the minister, who is the trustee and administrator of the plans. We recommend the department establish an Alberta public sector pension plan risk management system to support the minister in fulfilling his responsibilities for Alberta's public sector pension plans.

The department completed significant research and analysis on plan design, governance and sustainability risks, which supported the advice it provided to the minister. However, this analysis was constrained by time limits for the review and the existence of significant unfunded liabilities for past service that need to be funded. We make recommendations for improvement to this ongoing sustainability review.

Report highlights—Follow-up audits

We are pleased to report that all of the 13 outstanding recommendations we followed up in these audits have been implemented.

Education—School Board Budgeting (page 47)

We followed up on our October 2005 recommendation to the Department of Education regarding improving the school board budgeting process and working with key stakeholder associations to provide guidance on the standards and best practices for financial reporting. We found the department has implemented our recommendation.

Human Services—Administrative Support Systems for Child Intervention Services (page 51)

The 2007 audit that we conducted and this follow-up examine administrative systems the department has to support child intervention services, such as agency accreditation and case file review. We did not evaluate the work done by caseworkers or the department's external reporting system. The original recommendations are primarily centered on the monitoring systems that provide assurance that child intervention standards are adhered to consistently. These administrative systems are important since they provide oversight, identify trends and provide feedback to frontline caseworkers. In 2007 we made five recommendations to the then Department of Children Services and Child and Family Services Authorities, to improve administrative systems that support child intervention services. In 2010 we found the department had implemented one of the recommendations. In this audit we conducted further follow-up work and found the four remaining recommendations have been implemented by the Department of Human Services.

Human Services—PDD Service Provider Monitoring (page 57)

We followed up on our 2004 and 2009 audits of the systems used to monitor and evaluate the performance of service providers to the Persons with Development Disabilities Community Boards. Of the three original recommendations made in 2004, one remained outstanding—the department should work with the boards to strengthen the monitoring and evaluation of the performance of service providers through the provision of adequate financial reporting from service providers, by obtaining annual financial statements, implementing a risk-based internal audit plan, developing and implementing standard communications procedures, and evaluating service provider performance. This recommendation has been implemented by the Department of Human Services.

Human Services—Systems to Monitor Training Provider Compliance (page 59)

In 2008 we audited the former Department of Employment and Immigration's systems for delivering training to Albertans who need to improve their employment skills. We made three recommendations. In 2012 we reported the department had implemented two of three recommendations. We found that the Department of Human Services has fully implemented the final outstanding recommendation. Systems for monitoring training providers have been improved by implementing a detailed monitoring, auditing and remedial action policy that requires the department to perform regular audits of training providers and perform follow-up procedures on post-audit action plans. Reports have been developed to monitor whether training providers are meeting performance outcomes and expectations.

Infrastructure—Alberta Schools Alternative Procurement (page 61)
In 2010 we audited systems the Department of Infrastructure used in applying the private–public partnership framework to the Alberta Schools Alternative Procurement project. The P3 framework identifies an alternative approach to building and paying for public facilities such as schools and hospitals. Our objective was to determine whether the department had effective systems to assess the potential value for money of the ASAP project, and ensure procurement activities were fair and transparent. We made two recommendations in our April 2010 report, to improve the processes the department uses to challenge and support maintenance costs and risk valuations and to publish value for money reports upon entering into P3 agreements. In this audit we found the Department of Infrastructure has implemented both recommendations.

Innovation and Advanced Education—Post-secondary Institution Non-Credit Programs (page 65)
In 2008 we recommended that the Department of Innovation and Advanced Education clarify its standards and expectations, and improve monitoring of non-credit programs at post-secondary institutions. The department has implemented our recommendations by annually communicating its expectation that institutions recover at least the total direct cost of delivering their non-credit programs, allowing the rate of cost recovery to vary for each program. It also obtains financial reports approved by each institution's vice president of finance, performs improved reconciliation processes and analysis of this information, and follows up with institutions when they do not recover the total direct costs for non-credit programs.

Service Alberta—Information Technology Control Framework (page 67)
An information technology framework is an efficient way to ensure that there are sufficient and effective controls over an organization's information and the systems and processes that create, store, manipulate and retrieve important data.

A framework can mitigate risks and:
- provide secure programs and services to employees and Albertans
- protect the confidentiality and security of information
- ensure that systems work as expected and are available when needed

In 2008 we recommended that Service Alberta, in conjunction with all ministries and through the Chief Information Officer Council, develop and promote a comprehensive information technology control framework and guidance for implementing it, and well-designed and cost-effective IT control processes and activities. We revisited Service Alberta in 2010 and 2012 but the department was not ready for a follow-up. This year we conducted a follow-up audit and found that Service Alberta had implemented our recommendation.

Report highlights—Other audit work

Innovation and Advanced Education—Report on Post-secondary Institutions (page 71)
This report card on internal controls over financial reporting highlights our observations on financial statement preparation and outstanding recommendations from our audits of colleges, technical institutions, MacEwan University and Mount Royal University. Our October 2013 report provided our observations on Athabasca University, University of Alberta, University of Calgary and University of Lethbridge.

AUDITOR GENERAL'S MESSAGE

We found three institutions have improved their preparation of accurate and timely financial statements—NorQuest College, MacEwan University and Mount Royal University—and three continue to struggle—Olds College, Northern Lakes College and Alberta College of Art + Design—because of weaknesses within institutional internal controls and processes.

Sustaining a strong internal control environment is difficult for any organization. Post-secondary institutions must continuously re-assess if their control environment is operating effectively as their operations change and evolve. An institution's ability to prepare timely, accurate financial reporting may be temporarily impacted by the institution's inability to adjust to unexpected changes in its operations or staffing.

A number of institutions faced various obstacles in maintaining the effectiveness of their financial reporting processes in the past year. In particular, Keyano College did not prepare timely, accurate financial reporting this year, due to challenges in staffing and unexpected events impacting their operations. These obstacles appear to be temporary. We expect all institutions that have been unable to maintain their prior year ranking will re-establish the effectiveness of their processes and make further improvements where required in the next fiscal year.

We issued unqualified audit opinions on the financial statements of the 14 institutions where our audit is complete.

We followed up on outstanding recommendations made in our February 2013 report. Overall, institutions either improved or maintained their ranking on the number and nature of outstanding recommendations. NorQuest College significantly improved its internal control environment by implementing eight of our prior years' recommendations. Lethbridge College, Mount Royal University and Keyano College also implemented recommendations to improve their control environments. MacEwan University implemented a number of recommendations to continue its process of strengthening its overall internal controls.

The boards of governors of Alberta College of Art + Design, Northern Lakes College and Olds College must hold management accountable to implement recommendations that will establish and sustain a strong internal control environment. Institutions with strong internal control environments have demonstrated that effective processes can be implemented and sustained in periods of economic and operational change.

While Medicine Hat College's financial reporting process was effective, the college must make significant improvements to some of its operating activities. In our July 2013 report we recommended significant improvements to the college's international education activities.

Portage College also has adequate processes to prepare its financial reporting. However, we followed up on the college's implementation of our prior year's recommendation on improving the accuracy of bookstore inventory. We conclude not all necessary improvements have been made and repeat our recommendation.

February 2014 Recommendations

We conducted our audits in accordance with the *Auditor General Act* and the standards for assurance engagements set by the Canadian Institute of Chartered Accountants.

This report contains five new and five repeated recommendations to government. The repeated recommendations have been made because we do not believe there has been sufficient action taken to implement our previous recommendations.

As part of the audit process, we provide recommendations to government in documents called management letters. We use public reporting to bring recommendations to the attention of Members of the Legislative Assembly. For example, members of the all-party Standing Committee on Public Accounts refer to the recommendations in our public reports during their meetings with representatives of government departments and agencies.

We believe all of the recommendations in this report require a formal public response from the government. In instances where a recommendation has been made to a board-governed organization, we expect the organization to implement the recommendation and report back to its respective government ministry as part of proper oversight of the organization. By implementing our recommendations, the government will significantly improve the safety and welfare of Albertans, the security and use of the province's resources, or the governance and ethics with which government operations are managed.

Reporting the status of recommendations

We follow up on all recommendations. The timing of our follow-up audits depends on the nature of our recommendations. To encourage timely implementation and assist with the planning of our follow-up audits, we require a reasonable implementation timeline on all recommendations accepted by the government or the entities we audit that report to the government. We recognize some recommendations will take longer to fully implement than others, but we encourage full implementation within three years. Typically, we do not report on the progress of an outstanding recommendation until management has had sufficient time to implement the recommendation and we have completed our follow-up audit work.

We repeat a recommendation if we find that the implementation progress has been insufficient.

We report the status of our recommendations as:

- **Implemented**—We explain how the government implemented the recommendation.
- **Satisfactory progress**—We may state that progress is satisfactory based on the results of a follow-up audit.
- **Progress report**—Although the recommendation is not fully implemented, we provide information when we consider it useful for MLAs to understand management's actions.
- **Repeated**—We explain why we are repeating the recommendation and what the government must still do to implement it.
- **Changed circumstances**—If the recommendation is no longer valid, we explain why and remove the recommendation from our outstanding recommendation list.

STAND-ALONE SYSTEMS AUDITING—NEW AUDIT

Treasury Board and Finance—The Department's Oversight Systems for Alberta's Public Sector Pension Plans

Page 24

RECOMMENDATION 1: POLICIES DESIGNED TO ACHIEVE PLAN OBJECTIVES

We recommend that the Department of Treasury Board and Finance set standards for the public sector pension plan boards to establish funding and benefit policies with:

- tolerances for the cost and funding components
- alignment between plan objectives and benefit, investment and funding policies
- pre-defined responses when tolerances are exceeded or objectives are not met

Implications and risks if recommendation not implemented

Without explicitly linking measures to the plans' objectives, the department cannot ensure that it is evident to stakeholders and decision makers whether Alberta's plans are meeting their objectives. Decisions about funding and benefits have a significant impact on plan stakeholders. Unclear disclosure of the circumstances that could lead to future reviews of benefit design could create a lack of stakeholder understanding about the decision making process.

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RECOMMENDATION 2: RISK MANAGEMENT SYSTEM

We recommend that the Department of Treasury Board and Finance establish an Alberta public sector pension plan risk management system to support the minister in fulfilling his responsibilities for those plans.

Implications and risks if recommendation not implemented

Pension plans with informal risk management processes are less likely to identify risks and implement risk management activities effectively. Because the system has been designed with multiple parties, a consolidated approach to risk management is necessary. Otherwise, plan boards, AIMCo, APS and the department are more likely to duplicate efforts, fail to identify and manage risks and fail to manage risks outside of the plans' and stakeholders' risk tolerances.

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RECOMMENDATION 3: SUSTAINABILITY SUPPORT PROCESSES

We recommend that the Department of Treasury Board and Finance:

- validate the objectives for the pension plan sustainability review with stakeholders
- evaluate and report on how each proposed change meets the objectives for the review
- cost and stress-test all proposed changes to assess the likely and possible future impacts on Alberta's public sector pension plans
- conduct or obtain further analysis of the impact of proposed pension plan design changes on employee attraction and retention
- prepare a detailed implementation plan for the changes

Implications and risks if recommendation not implemented

Without clear alignment between proposed plan changes and the government's objectives for the review, adequate financial analysis and consideration of human resource objectives, the department may not achieve its sustainability review objectives.

OTHER AUDIT WORK

Innovation and Advanced Education—Report on Post-secondary Institutions

ALBERTA COLLEGE OF ART + DESIGN

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RECOMMENDATION 4: IMPROVE CONTROLS OVER EXPENSE CLAIMS AND PURCHASE CARD TRANSACTIONS

We recommend that Alberta College of Art + Design strengthen its controls over expense claims and purchase card transactions by:
- improving documentation to support the business reason for and cost effectiveness of expenses
- improving staff training on their responsibilities for complying with policies
- monitoring expenses and reporting results to the board

Implications and risks if recommendation not implemented

Without adequate policies and controls related to the review, approval and payment of expenses, the college increases its risk that employees may spend inappropriately, including expensing items of a personal nature. An effective control framework over its expenses will help the college reduce its reputational risk and promote an overall healthy control environment.

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RECOMMENDATION 5: IMPROVE FINANCIAL REPORTING—REPEATED

We again recommend that Alberta College of Art + Design improve its processes and internal controls to increase the accuracy and efficiency in its financial reporting.

Implications and risks if recommendation not implemented

Without efficient and effective processes, the college may not produce timely, accurate and complete financial reporting at a reasonable cost. This may also result in the board and senior management making decisions based on inaccurate information.

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RECOMMENDATION 6: IMPLEMENT AND ENFORCE PROCEDURES FOR CODES OF CONDUCT AND CONFLICT OF INTEREST—REPEATED

We again recommend that Alberta College of Art + Design develop, implement and enforce procedures for code of conduct and conflict of interest.

Implications and risks if recommendation not implemented

If the college does not have well-functioning systems to enforce compliance with its conflict of interest and code of conduct procedures, the college may be exposed to economic or reputational risk if employees do not comply.

FEBRUARY 2014 RECOMMENDATIONS

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RECOMMENDATION 7: IMPROVE INTERNAL CONTROLS AT THE BOOKSTORE—REPEATED

We again recommend that Alberta College of Art + Design improve its internal control systems for its bookstore operations by:

- properly segregating incompatible job duties
- improving its inventory count procedures and investigating discrepancies between inventory counts and inventory records
- resolving software deficiencies in its inventory management computer application

Implications and risks if recommendation not implemented

Without good controls over inventory counts and reliable software, the risk of undetected fraud and error increases as does the misstatement of inventory balances in the financial statements.

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RECOMMENDATION 8: IMPLEMENT PROPER PURCHASE CONTROLS—REPEATED

We again recommend that Alberta College of Art + Design ensure purchases are appropriately supported by purchase requisitions and purchase orders, in accordance with its policies and procedures.

Implications and risks if recommendation not implemented

If the college does not have controls to make sure staff comply with its purchasing procedure, the college may pay for inappropriate purchases.

NORTHERN LAKES COLLEGE

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RECOMMENDATION 9: IMPROVE PROCESSES FOR FINANCIAL REPORTING

We recommend that Northern Lakes College review the adequacy of its financial statements closing process and improve its ability to produce timely and accurate financial statements.

Implications and risks if recommendation not implemented

Without processes to ensure its financial statements are complete and accurate, the college may fail to identify material errors or omissions. As a result, there is a higher risk management and the board may make decisions based on inaccurate financial information.

PORTAGE COLLEGE

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RECOMMENDATION 10: IMPROVE ACCURACY OF BOOKSTORE INVENTORY—REPEATED

We again recommend that Portage College improve the accuracy of its perpetual inventory system at the bookstore.

Implications and risks if recommendation not implemented

Without effective systems in place to track inventory, the college has a higher risk of undetected fraud and misappropriation occurring as well as inaccurate financial information at the bookstore.

AUDITOR GENERAL
Alberta

Stand-alone Systems Auditing—New Audit

REPORT OF THE AUDITOR GENERAL OF ALBERTA

February 2014

Treasury Board and Finance—The Department's Oversight Systems for Alberta's Public Sector Pension Plans

SUMMARY

Why we did this audit

We started this project in 2011 because of concerns expressed by elected officials, the media and the public about the financial health of Alberta's public sector pension plans. As part of our audit planning, we met with those involved in Alberta's public sector pension system, including plan board members, officials from the department and others. We needed to understand:

- the roles and responsibilities of the various entities within Alberta's public sector pension plan system
- the risk management systems used

During our audit planning, we decided to focus the scope of our audit on assessing the adequacy of systems used to manage risks within Alberta's public sector pension plans. We did this because the sector did not appear to have well functioning risk management processes that made use of clearly articulated objectives for the plans, with clear targets and tolerances for the costs of the plans. We also chose to focus our audit on the department's systems because of its role of supporting the Minister of Finance, who is the trustee and administrator of the plans. The department supports the minister through the development of public sector pension legislation and policy.

In September 2012 the minister asked plan boards to consult with stakeholders about the sustainability of the plans and to submit proposals to ensure the plans continue to be affordable, sustainable and offer secure benefits. The department asked us to consider adding a second objective to our audit, which focused on assessing the adequacy of the department's sustainability review support processes. We agreed to the department's request.

We knew the sustainability review would not be complete by the time we had finished our audit. However, we wanted to provide the department with timely recommendations on areas where its sustainability review support processes could be improved. This would allow the department time to evaluate our recommendations and consider necessary actions to enhance its processes. We examined the department's sustainability review support processes up to July 2013. We formally provided our report to the department in December 2013.

What we examined

We audited the Department of Treasury Board and Finance's systems to monitor and evaluate the performance and sustainability of the following Alberta public sector pension plans:

- Local Authorities Pension Plan (LAPP)
- Management Employees Pension Plan (MEPP)
- Public Service Pension Plan (PSPP)
- Special Forces Pension Plan (SFPP)

We focused on the department because it monitors the plans and provides policy support to the minister, who is the trustee and administrator of these pension plans and oversees the entities shown in the governance chart in Appendix A.

Our objective was to assess if the department has adequate processes to:

- monitor and evaluate whether the plans are meeting their objectives, considering risks, costs and benefits
- evaluate proposed plan design and governance changes and the likelihood they will improve the plans' sustainability and their ability to meet their objectives

An overview of the plans is included in Appendix B.

What we found

Pension plans are facing funding challenges—Alberta's public sector pension plans have significant unfunded liabilities and contribution rates that have risen to levels where some employers and employees do not want to pay more. At December 31, 2012 those unfunded liabilities totalled $7.4 billion. Unfunded liabilities, simply put, are the amount of money needed to be put into the plans today to fully support promises made to retirees and current employees for services already provided. Unfunded liabilities do not include amounts required to pay for benefits related to future service.

To fix the plans—The minister needs to ensure plan benefits are secure and commensurate with an affordable and available amount of funding from both employees and employers.

Alberta pension plans not unique—These plans are not unique. Many other defined benefit plans face the same problem: they have significant unfunded liabilities and they risk having insufficient assets to meet their obligations unless they change something. Recent experience has shown that actual plan costs are much higher than the estimated costs originally used to set contribution levels.

The plans' objectives and tolerances for risk have not been clearly articulated by the plans' sponsor. Therefore, it is unclear whether the plans are meeting their objectives or operating within sustainable tolerances for risk. The plans are facing significant funding challenges and these plans are a significant cost to employers and employees. Therefore, a process to review the risks and costs facing the plans is necessary.

Better tools available to manage risk—The plans have used traditional pension industry methods to manage risk, primarily by spreading the effects of bad experience across contribution rates over a long time. But these methods allow the risks and costs of defined benefit plans to accumulate and be less transparent to stakeholders.

Defined benefit pension plans are starting to use better tools and strategies to assess and mitigate their risks. With proper standards and guidance, Alberta's public sector pension plans can use these risk management techniques to increase the likelihood that the plans are sufficiently funded to meet their obligations and costs do not become more than plan sponsors can afford.

Who should pay to fix the plans—This is a key question and the options are limited. Employers, funded typically by taxpayers, can pay higher contributions to the plans. In exceptional circumstances former employees may be asked to receive reduced benefits. Current and future employees can pay higher contributions and take lower benefits. It's hard to reform pension plans that owe a lot of money to former and current employees. Current and future employees help pay these costs, but they likely won't want to contribute more to plans that will pay them less benefits than their predecessors receive when they retire.

Inconsistent monitoring and evaluation—To varying degrees, the pension plan boards have implemented risk management systems. However, no one organization has clear responsibility to coordinate and monitor the performance of the plans or take a consolidated approach to managing risk. The department has managed risk to some extent by providing policy support to the minister, who is the trustee and administrator of the plans. Our audit focused on the department's processes, which are designed for its primary role in providing policy support and advice to the minister.

Sustainability review—The department has completed significant research and analysis on plan design, governance and sustainability risks as part of its review. This analysis supported the advice it provided to the minister. The department's review covered a sufficient range of the relevant issues but the depth of analysis on some issues was constrained by the time limits for the review.

The department's options for reform were also constrained by the existence of significant unfunded liabilities for past service that need to be funded. An option used in the private sector to manage pension risk is the conversion of defined benefit pension plans to defined contribution pension plans. This option was considered by the department in its analysis but was not pursued because of the existence of significant unfunded liabilities that are being paid for jointly by the contributions of employers and current employees. If the defined benefit plans were changed to defined contribution plans, it would be more likely that employers would have to pay a much larger share of the current unfunded liabilities than they are currently paying under the existing joint funding model.

What needs to be done

We recommend that the department:

- set standards for the plan boards to establish funding and benefit policies with:
  - tolerances for the cost and funding components
  - alignment between plan objectives and benefit, investment and funding policies
  - pre-defined responses when tolerances are exceeded or objectives are not met
- establish an Alberta public sector pension plan risk management system to support the minister in fulfilling his responsibilities for Alberta's public sector pension plans
- as part of its ongoing sustainability review:
  - validate the objectives for the review with stakeholders
  - evaluate and report on how each proposed change meets the objectives of the review
  - cost and stress-test all proposed changes to assess the likely and possible future impacts on the plans
  - conduct or obtain further analysis of what effect the proposed changes might have on employee recruitment and retention
  - prepare a detailed plan for implementing the proposed changes

We have based these recommendations on the department's current responsibilities within the public sector pension system. These recommendations will continue to be relevant even if responsibility for implementing them needs to shift if the current governance structure of the plans changes.

Why this is important to Albertans

The financial health and design of Alberta's public sector pension plans can affect the government's and other plan employers' ability to cost effectively deliver public services, attract and retain quality employees and provide a level of benefit security for plan members. Albertans need to know if Alberta's public sector pension plans are sustainable. The plans face retirees who are living longer and low interest rates resulting in large unfunded liabilities. The minister and department need performance measurement systems to help them assess whether the plans are continuing to meet their objectives.

The promissory relationship between employers and employees created by defined benefit pension plans makes it difficult to change plan benefits once established. Therefore, it is important to properly cost plan benefits and assess the likelihood that they can be funded at a contribution rate acceptable to the sponsors while withstanding risks. Otherwise, the sponsors may bear a higher cost than intended or beneficiaries may receive less than promised. The first and most important step in managing risk in defined benefit pension plans is to only make promises that have a high probability of being able to be kept. Even so, not all risks can reasonably be foreseen and there will be times when plans experience circumstances that take them beyond the tolerances they were designed to withstand.

Our recommendations are intended to help ensure that each plan's objectives and tolerances for its cost and funding components are clearly articulated. Clear objectives and risk tolerances will help the minister and department monitor plan performance. They will also help all stakeholders reach a consensus about what to do when a plan exceeds its tolerances. This should prompt timely responses to such risks as they arise. Furthermore, an improved approach to pension risk management should make it clear in advance who will bear which risks and costs when plans exceed their tolerances.

AUDIT OBJECTIVES AND SCOPE

Our objectives were to assess whether the Department of Treasury Board and Finance has adequate systems to:

- monitor and evaluate whether the plans are meeting their objectives, considering risks, costs and benefits
- evaluate proposed plan design and governance changes and the likelihood they will improve the plans' sustainability and their ability to meet their objectives

We included reporting from the plan boards[1] to the minister in our audit of the department's monitoring processes. We focused our audit on Alberta's public sector plans for which the minister is the trustee and administrator and which were included in the scope of the sustainability review.

This audit did not examine the investment management systems at Alberta Investment Management Corporation (AIMCo), which is responsible for investment of the plan assets, or the pension plan administration systems at Alberta Pensions Services Corporation (APS). APS has been delegated all functions in relation to administration of benefits of the pension plans.

[1] We focused our audit on the department's monitoring of LAPP, MEPP, PSPP and SFPP.

The scope of our audit included the department's systems to conduct its sustainability review and advise the minister. We conducted our audit while the review was ongoing, so that we could provide our audit findings to the department in a timely manner, prior to the completion of its review.

We conducted our field work from January 2013 to July 2013. We substantially completed our audit on the exit conference date in December 2013. Our audit was conducted in accordance with the *Auditor General Act* and the standards for assurance engagements set by the Canadian Institute of Chartered Accountants.

Prior to commencing our audit, we interviewed public sector pension plan stakeholders, including board members from each plan. We took into account feedback from these interviews in planning the scope of our audit work.

Disclosure of potential conflict of interest in our audit work
The Auditor General and employees of the Office of the Auditor General participate in one or more of the following Alberta public sector pension plans: MEPP, PSPP and the Supplementary Retirement Plan for Public Service Managers. We believe we have managed any potential conflict of interest with respect to this audit by ensuring that our report and recommendations do not express a view on the existing, proposed, or potential form or level of retirement benefits the plans provide to public sector employees.

THE DEPARTMENT'S ROLE AND PROCESSES

The criteria we used for our audit were developed from existing risk management frameworks. While the department accepted these criteria, it drew our attention to the fact that it views itself as a "policy shop" responsible for advising the minister with respect to his various roles in the pension system. As such, the branch of the department responsible for the public sector pension plans was forthright with us that their processes focused on policy development as opposed to risk management. We examined the policy setting process to reconcile our criteria with the branch's processes.

We compare an overview of the two processes as follows.

POLICY DEVELOPMENT PROCESS[2]	RISK MANAGEMENT PROCESS[3]
Issue identification—identify issues through environmental scanning, stakeholder questions/concerns, elected officials and questions and concerns from the public	**Establish context**—define objectives, define the external and internal environment, define criteria to evaluate the significance of risk and define the scope of risk management activities to be carried out
	Risk identification—identify sources of risk, events and their causes and potential consequences
Research and analysis—develop an accurate picture of the issue, who it is an issue for and how it can be best resolved	**Risk analysis**—determine the likelihood that positive and negative consequences can occur
	Risk evaluation—compare the level of risk in the risk analysis with criteria to evaluate the significance of risk

[2] Adapted from the Government of Alberta's Policy Development Process: Guidance for Alberta's Public Service, December 2011.
[3] Adapted from ISO 31000 Risk management–Principles and guidelines

POLICY DEVELOPMENT PROCESS	RISK MANAGEMENT PROCESS
Options development—identify options reflecting the research, but identify options that are consistent with economic and social realities	**Risk treatment**—select one or more options for modifying risks, decide whether risk remaining is tolerable and assess the effectiveness of the risk treatment
Decision making—various steps followed depending on the type of policy decision; documents used in decision making include the issue, background, options and recommended courses of action	
Implementation—plan for implementation including consideration of operational elements to implement policy, action plans and legislative development, if necessary	
Evaluation/performance measurement—evaluation and monitoring of the success of a policy	**Communication and consultation**—should take place during all stages of the process and **monitoring and review**—should encompass all aspects of the risk management process, noted on the previous page

At a glance the two processes are similar. Risk management seeks to identify potential risks and put in place strategies to mitigate them before they happen. Good policy development processes should do the same.

In 2012 and the years leading up to the sustainability review, the department continued its ongoing research into and analysis of whether public sector pension plans are sustainable. The outputs of the department's analysis included:

- identification of trends in governance and plan design in other jurisdictions
- evaluating concerns that plan stakeholders brought to the minister or department
- some modeling of each plan's ability to withstand further adverse experience

The department briefed the minister based on its analysis, concluding that all four plans face high, volatile costs. The boards of each plan also informed the minister of various risks as part of their annual risk reporting. In September 2012 the minister asked the plan boards to consult with stakeholders about the sustainability of the plans and submit proposals to ensure the plans continue to be affordable, sustainable and offer secure benefits. The minister requested proposals from the boards of LAPP, MEPP, PSPP and SFPP.

In March 2013 the four boards reported the results of their consultations and analysis to the minister. Their report included such items as consulting with stakeholders about potential plan design changes, obtaining legal interpretations and opinions, reporting issues with the current governance structure, costing potential plan design options and highlighting issues that are unique to their specific plans. A consistent theme in these reports to the minister was that governance needed to be reviewed or changed. However, LAPP and PSPP did not make recommendations for plan design changes. MEPP and SFPP essentially requested more time to further consider and consult on plan design changes. The minister then directed the department to come up with proposals.

In June 2013 the department researched options for governance and plan design changes and briefed the minister on the options. Within this briefing, the department developed a set of principles for sustainability and governance of the plans. These principles were shared with the plan boards in

August 2013 and were subsequently shared with the public on the Government of Alberta's website in September 2013. The briefing set out a process to review proposals for reforming governance, funding and benefit design.

On September 16, 2013 the minister announced proposed changes to all four plans. These proposals can be found at http://pensionsustainability.alberta.ca.

Proposed design changes to LAPP, MEPP and PSPP include:
- removing early retirement subsidies
- shifting from guaranteed cost of living adjustments (COLA) at 60 per cent of Alberta inflation to targeted COLA at 50 per cent of Alberta inflation for future service
- immediate vesting in the plans
- removing the limit of 35 years for pension accrual

Proposed design changes unique to MEPP include:
- closing the plan to new members with new managers—Managers hired by MEPP employers after the changeover date will participate in PSPP.
- changing the normal form pension for future service to be a pension paid for the life of the member, guaranteed for five years after pension commencement
- setting employee contribution rates to be the same as the employee rate under PSPP for the two per cent unit of benefit, with employers being responsible for the remaining cost of MEPP

Proposed changes to SFPP would be based on SFPP stakeholder recommendations to be implemented by the government before the plan would become exempt from being governed by the *Public Sector Pension Plans Act*.

Proposed governance structures for PSPP, LAPP and SFPP would also allow their sponsors to establish new plans outside of the statutes that currently govern all three plans. The proposed governance structures would also separate the roles of the sponsors[4] from those of its board of trustees.[5] A legislated cap on contribution rates is also proposed. Funding and benefit policies would set out how benefits will be reduced if this cap is reached and how benefit improvements or contribution adjustments will be made when the plan's funding improves. Proposed governance changes for MEPP would include discontinuing the MEPP board and replacing it with an advisory committee to provide advice to the minister.

A review of these plan design changes is complicated by the fact that the plans have unique characteristics and have many stakeholders: hundreds of employers, multiple unions and thousands of plan members (see Appendix B: Overview of pension plans). The Government of Alberta and its public agencies, along with Alberta's municipalities and police forces, are the large employers in these pension plans.

[4] Sponsors are responsible for designing the pension plan and determining benefits. Sponsors bear costs and risks of the plans.
[5] Board of trustee responsibilities include selecting the fund holder, providing investment direction to the fund holder, and executing the fund holder agreement and other services agreements. The board of trustees has a fiduciary responsibility to the plan's beneficiaries.

ELEMENTS OF A PENSION SYSTEM

To prepare our audit plan we first obtained an understanding of Alberta's pension plan system, the broad issues facing defined benefit pension plans and the processes to deal with them. A well functioning pension system comprises complex, interrelated components, risks and processes. To establish a context for our audit we found it useful to classify the system into three main elements:

- cost
- funding
- governance and administration

Each of these elements has sub-components or dependencies that significantly impact pension plan sustainability. In the diagram that follows, we map these elements and their related risks and processes. A glossary of pension terms is included in Appendix C, and a fuller description of the elements is in Appendix D: Elements of a pension system.

The processes with green framing are the ones we included in the scope of our audit. In the right-hand column the diagram illustrates the interrelatedness of the processes and who is responsible for them in Alberta. In some cases responsibility is clear and in others it is not.

Our work to obtain our understanding of the Alberta's pension system led us to focus on risk management. What we found as most lacking in the system was a well functioning risk management system. One that made use of clearly articulated objectives for plan design and clear targets and tolerances for the cost of these plans.

We did not see the risk management system implemented by way of the use of the analytical tools that estimate these parameters and integrate them with the components of the funding element. If these risk management tools were used to make risks and costs more transparent, stakeholders would understand that past promises and practices cannot be used as the benchmarks for a sustainable future. We therefore focused our audit on determining the extent to which these risk management tools have been implemented in the Alberta public sector pension plan system.

Based on our research, a root cause of unsustainable defined benefit pension plans has been a systematic underassessment of their risks. These risks are associated with funding stable benefits with variable investment returns and an associated lack of discipline in setting contribution rates that align with the level of benefits promised and security level desired. Stated another way, historically, pension promises were made without a full understanding of the risk adjusted cost of funding them securely.

ALBERTA'S PUBLIC SECTOR PENSION PLAN SYSTEM

Components | **Risks** | **Processes**

Cost

COST is dependent on:

- Level of benefits
- Inflation
- Longevity
- HR inducements
- Discount rate
- Benefit security level

Key risks from cost are:

- Level of benefits, too high/low
- Inflation higher than expected
- Longevity improving faster than expected
- HR inducements improperly costed, not meeting current HR needs
- Benefit security level not clearly articulated and not managed to
- Contribution rates used as proxy for cost do not reflect risk adjusted cost
- Risk adjusted cost unclear resulting in benefits higher than intended

Funding

FUNDING is dependent on:

- Contributions
- Stabilization mechanisms
- Investment returns and risk appetite
- Plan maturity
- Integration of funding policy with benefit cost

Key risks from funding are:

- Contributions are not set in relation to specific level of benefit security and benefit cost
- Joint funding limits availability of solvency funding mechanisms
- Reserves used for benefits improvement rather than risk management
- Mature plans can't rely on contributions to manage solvency
- Investment portfolio and contribution rates not coordinated to manage volatility tolerance

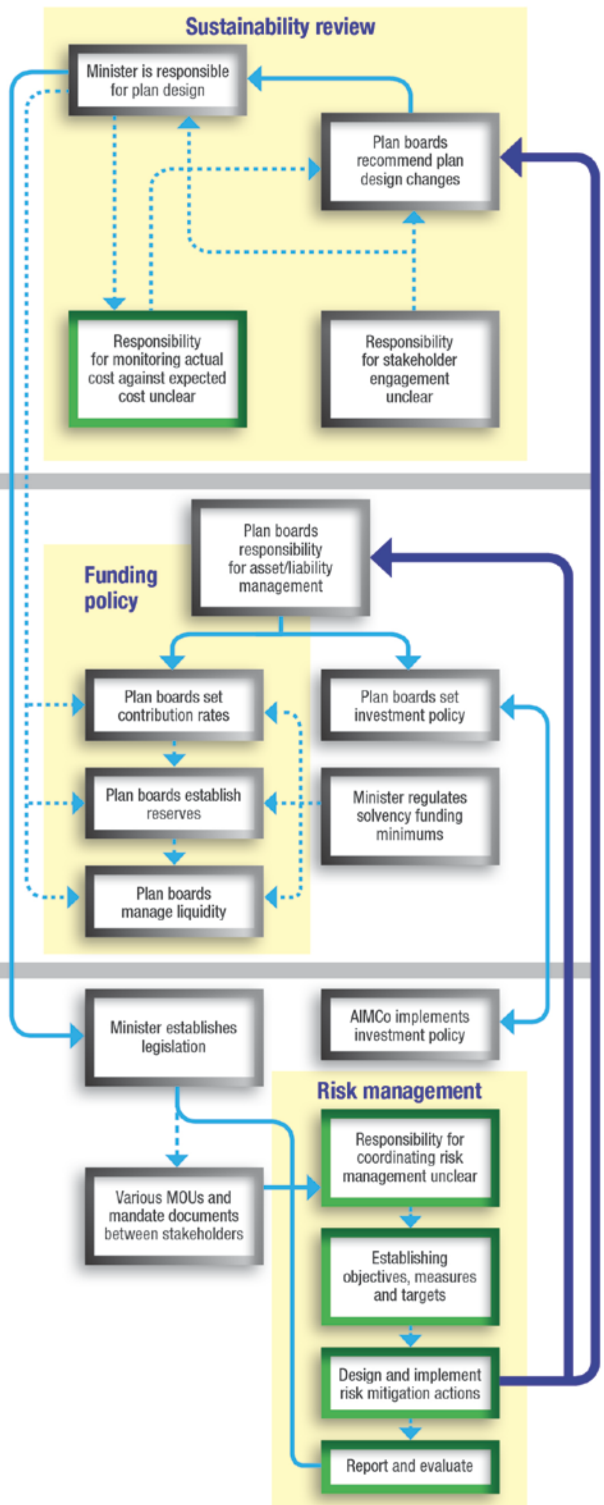
Governance and administration

GOVERNANCE AND ADMINISTRATION is dependent on:

- Clearly defined roles, responsibilities and structure
- Communication
- Risk management
- Investment management

Key risks from governance and administration are:

- Unclear roles and responsibilities results in inaction
- Objectives, measures and targets for plan design attributes are not clearly defined, communicated or managed against
- Process and risk inter dependencies not coordinated because systems not interconnected
- Risk tolerances and funding objectives unclear resulting in disconnect between investment policy and implementation



LEGEND: Inside audit scope | Outside audit scope

FINDINGS AND RECOMMENDATIONS—PENSION RISK MANAGEMENT SYSTEMS

Performance measures and funding policies

Background

Alberta's public sector defined benefit pension plans face significant decisions when determining how the plans will be funded. These decisions impact employees, employers, pensioners and taxpayers because they impact current contribution rates and the risk of contribution rate increases in the future.

Funding policies support the decision making process for funding defined benefit pension plans and they improve transparency of funding decisions for stakeholders. A funding policy formalizes the decision making process and is integrated with the plans' funding objectives.

RECOMMENDATION 1: POLICIES DESIGNED TO ACHIEVE PLAN OBJECTIVES

We recommend that the Department of Treasury Board and Finance set standards for the public sector pension plan boards to establish funding and benefit policies with:

- tolerances for the cost and funding components
- alignment between plan objectives and benefit, investment and funding policies
- pre-defined responses when tolerances are exceeded or objectives are not met

Criteria: the standards for our audit

- The department should have systems to monitor and evaluate whether the plans continue to meet their objectives and should report on pre-defined measures to the minister and plan stakeholders.
- Each plan should establish a funding and benefits policy that includes, for example, thresholds for the plan's funded ratio and contribution rates, and associated risk tolerances for variances in those measures.
- A plan design review should be initiated in accordance with the funding and benefits policy.

KEY FINDINGS

- The department monitored various measures and risks related to the plans. However, the measures of performance were not consistently integrated with objectives and targets for the pension plans.
- All four plans had funding policies that included thresholds for the plan's funded ratio. However, the policies did not specify tolerance levels for volatility in investment returns or contribution rates.
- Three of four plan funding policies were not clear on the circumstances that could lead to a plan design review.

Our audit findings

We reviewed the plans' funding policies, business plans, annual reports and annual risk reporting from the boards to the minister, to determine how the plans reported to stakeholders whether they were meeting their objectives.

Integration of performance measures with plan objectives and targets

The department's analysis of this information included various measures of risk and performance as well as environmental scanning in the public and private pension sectors. This analysis included looking at benefits provided, governance structures, plan liabilities, cost trends, longevity risks and other analyses. The department's analysis of sustainability and performance of the plans was not explicitly linked to objectives at the time the analysis was performed.

The plans' annual reports and annual risk reports to the minister included various measures of performance. The measures in the annual reports and annual risk reports were not integrated with each plan's goals or objectives. The plans also did not consistently report on whether they were meeting targets for these measures.

Plan objectives and their associated measures and targets were not stated clearly enough to guide plan monitoring and oversight. The department has not required the plans to articulate the tolerances for plan attributes and their interrelationships. Key attributes and their tolerances include:
- contribution rate maximums, minimums and volatility
- investment portfolio risk thresholds stated in terms of portfolio volatility
- maximum economic cost of benefits
- longevity
- inflation
- level of benefit security

It is therefore unclear what probability of benefit security the contribution rate and investment policies of the plans are designed to achieve and over what period. Furthermore, the alignment of this objective with others such as fairness to taxpayers and intergenerational equity amongst plan participants is unclear.

In September 2013 the government announced that it planned to put caps on the contribution rates. This is an example of a threshold that could be used to achieve clarity. However, the department also needs to ensure the plans determine how these contribution rate caps will align with other plan attributes. For example, the plans will need to determine how these caps align with the objective of benefit security and investment policy.

Contribution rates are currently determined in relation to the expected rate of return on invested assets. The plans could increase the risk of their investment portfolios, for example, to offset the contribution rate cap. The increased risk on benefit security that would result from this change may not be aligned with beneficiary or taxpayer expectations. One way the department could manage this risk is to require use of a proxy for the risk-free rate to set contribution rates, in combination with a requirement to maintain a fully funded plan. Another would be to specify the probability that a fully funded plan will be maintained by the combination of the plan's contribution rates and investment returns.

Other pension plan managers are using financial modeling to estimate the probability that contribution rate and investment policies in combination will ensure benefits can be funded. Some of the Alberta plans are beginning to use these models as part of making funding policy decisions, but could make better use of them by linking them with measures and targets for plan performance.

Plan funding policies

In some instances the plans' funding policies did contain measures, targets and tolerances for the plans' funded ratio. All four of the plans' funding policies we reviewed indicated that contribution rate stability was a funding objective. However, none of the plans reported measures or targets for contribution rate stability. Volatile investment returns can lead to unstable contribution rates; however, plan funding policies did not specify tolerances for investment volatility.

The four boards implemented their funding policies between 2011 and 2013. However, they did not integrate measures in the funding policies with objectives and targets in their business plans. Measures of targets and tolerances in funding policies were not consistently reported to stakeholders.

Circumstances that could lead to a plan design review

Only one plan funding policy we reviewed was clear on the circumstances that could lead to consultations about benefit design or sustainability. Based on the measures, targets and tolerances in the funding policies, if the funding policies had been in place during and immediately after the 2008 financial crisis, there would be no indication in the funding policy that plan design or sustainability consultations with stakeholders would need to be considered.

Implications and risks if recommendation not implemented

Without explicitly linking measures to the plans' objectives, the department cannot ensure that it is evident to stakeholders and decision makers whether Alberta's plans are meeting their objectives. Decisions about funding and benefits have a significant impact on plan stakeholders. Unclear disclosure of the circumstances that could lead to future reviews of benefit design could create a lack of stakeholder understanding about the decision making process.

Risk management system

Background

The department's pension policy branch is responsible for monitoring the public sector pension plan system and advising the minister, who is both the trustee and administrator of the plans.

We reviewed the plan boards' risk reporting to the minister and operating protocols between the plan boards, the department and the service providers—APS and AIMCo. We reviewed these items to determine to what extent the risk management processes for the plans are integrated with the department's monitoring and evaluation of whether the plans are meeting their objectives.

Risk management reporting is a tool to help management make informed decisions and prioritize activities. Managing risk includes avoiding or minimizing risk; however, it can also include risk taking to take advantage of opportunities. A plan's tolerance for risk can be impacted by several factors including its objectives and its stakeholders' appetite for risk. One plan might have more or less of an appetite for risk compared with another plan, so each plan's response to a given risk will vary based on a plan's unique circumstances. For example, a plan with a higher proportion of young, active members may be willing to take on more investment risk than a plan that has a higher proportion of members near or in retirement. The younger plan may decide it can absorb investment losses because it has a higher proportion of members and employers making contributions to the plan to make up for potential losses.

The plan boards, the service providers and the department are responsible for managing risks within their mandate for each pension plan. With several parties involved in managing and governing the plans, there is a risk that management activities will not be aligned with the tolerances and plan-specific objectives for each plan. By viewing and reporting risk management activities at an enterprise level, the various parties can improve coordination and the plans' ability to manage risk appropriately.

RECOMMENDATION 2: RISK MANAGEMENT SYSTEM

We recommend that the Department of Treasury Board and Finance establish an Alberta public sector pension plan risk management system to support the minister in fulfilling his responsibilities for those plans.

Criteria: the standards for our audit

- In supporting the minister in his roles of trustee and administrator, the department should have a risk management system that identifies the significant risks to achieving the plans' objectives; who owns each risk; the risk tolerance for each risk; the risk mitigation strategy; and risk measurement techniques to be applied. The department's system should take into account the risks and strategies identified by the plan boards, employers, AIMCo and APS.
- Risks should be communicated and responsibility for managing them should be accepted and acted upon.

KEY FINDINGS

- There is no one organization within the public sector pension system with clear responsibility for coordinating and monitoring the performance of the public sector pension plans.
- A practical means of moving from analyzing concerns and issues shared by the department, boards and stakeholders, to implementing responses has been missing.

Our audit findings

There is no one organization within Alberta's public sector pension plan system with clear responsibility for coordinating and monitoring the performance of the public sector pension plans and therefore able to take a sector-wide view of the system's risks. Because of the number of organizations and the integration of the system, risks need to be monitored for the individual organizations as well as for the system as a whole.

Risk management systems and reporting

We reviewed the annual risk reporting from the plan boards of LAPP, MEPP, PSPP and SFPP to the minister for the eight months ending in August of 2012 as well as the briefings to the minister by the department about the risk reports. We used this review to assess whether:

- the risk reporting to the minister linked the risks to plan objectives
- the risk reporting identified risk owners, risk tolerances for each risk, risk mitigation strategies and risk metrics
- risk owners accepted and communicated their responsibility for managing each risk to the minister

LAPP's risk report to the minister included a register of risks, including measures of risk and risk mitigation strategies. LAPP's risk register took an enterprise-wide view of risk, including a view of the risks that the service providers (AIMCo and APS) manage. While LAPP's risk reporting was formalized, the minister delegated the responsibility to LAPP to identify risks and have policies in place to mitigate risks. In contrast, the MEPP, PSPP and SFPP boards have mandates that are set out in operating protocols. These protocols indicate the board's responsibility to report risks to the minister but do not specify that the boards must ensure that policies are in place to mitigate the risks.

The risk reports did not consistently include:

- risk registers
- objectives at risk
- a risk owner who has both the accountability and authority to manage each risk and who has accepted responsibility for managing the risk
- who bears the risk, to what extent and the risk bearers' tolerance levels for each risk
- measurement for monitoring and reporting likelihood of consequences and severity of each risk
- quantitative measures as well as narrative descriptions of risk mitigation strategies

- risk mitigation strategies that are consistent with tolerance levels
- risks managed by all management groups including plan boards, advisory committees, service providers and the department

The department prepared considerable research and analysis with respect to the sustainability of the pension plans including risk identification

The department's pension policy branch has processes for policy analysis and development but it does not have a formal risk management system. From our many discussions with the branch's staff and our review of many of the documents they prepared, analyzing the pension sustainability issue in the last few years, it was evident that the branch is knowledgeable about the various risks and possible solutions to pension sustainability.

Similarly, the plan boards and their advisors have identified various sustainability issues and have implemented risk management systems to varying degrees. However, there is no risk management system for the public sector pension plan system as a whole. Despite the department, boards and stakeholders sharing many of the same concerns and having the same knowledge of risks facing the system, the response to these risks has mainly been limited to increasing contribution rates to a point that both employers and employees are questioning whether they can be practically raised further. A practical means of moving from analyzing these issues to implementing responses to them has been missing.

Implications and risks if recommendation not implemented

Pension plans with informal risk management processes are less likely to identify risks and implement risk management activities effectively. Because the system has been designed with multiple parties, a consolidated approach to risk management is necessary. Otherwise, plan boards, AIMCo, APS and the department are more likely to duplicate efforts, fail to identify and manage risks and fail to manage risks outside of the plans' and stakeholders' risk tolerances.

FINDINGS AND RECOMMENDATION

Sustainability support processes

Background

At the time of our audit, the sustainability review process was ongoing and not yet finalized. We considered whether the department had adequate processes to assess proposed plan design and governance changes.

RECOMMENDATION 3: SUSTAINABILITY SUPPORT PROCESSES

We recommend that the Department of Treasury Board and Finance:
- validate the objectives for the pension plan sustainability review with stakeholders
- evaluate and report on how each proposed change meets the objectives for the review
- cost and stress-test all proposed changes to assess the likely and possible future impacts on Alberta's public sector pension plans
- conduct or obtain further analysis of the impact of proposed pension plan design changes on employee attraction and retention
- prepare a detailed implementation plan for the changes

Criteria: the standards for our audit

The department's plan design review should:

- include consultation with stakeholders to validate the plan objectives and obtain feedback about the proposed changes throughout the process
- evaluate proposed plan design and governance changes thoroughly for alignment and likelihood of meeting the government's principles for reforms
- evaluate the costs and benefits of each alternative and should use analytical tools that consider a range of potential outcomes—The quantitative analysis should include expected or most likely outcomes as well as reasonably foreseeable adverse outcomes for key variables related to investment, longevity, inflation, interest rate risks or other variables.
- evaluate the impact of proposed plan design changes on total compensation costs and employee recruitment and retention
- conclude with an implementation plan that clearly considers necessary changes to regulatory, governance and administrative structures and how to deal with legacy issues and risks

KEY FINDINGS

- The department's principles for the reform of the pension plans have been developed without a specified process to validate them with stakeholders' objectives.
- Analysis of the proposed changes has not yet been evaluated thoroughly for alignment with and likelihood of meeting the government's principles for reforms, incorporating feedback from stakeholders in the analysis.
- The department has performed some costing and stress testing for the proposed changes; however, a comparative analysis of each option and stress testing of all combined changes has not been completed.
- The department has not completed a detailed implementation plan; however, we note that the department was still working out the details of its processes during our audit.

Our audit findings

We found that the department has undertaken a significant amount of analysis covering a wide breadth of issues related to plan sustainability. Their review included the three key components that affect the pension plan's sustainability: cost, funding, and governance and administration.

ELEMENTS	COMPONENTS	EVALUATED BY THE DEPARTMENT (Yes/No)	COMMENTS
Cost	Level of benefit	Yes	
	Inflation	No	Targeted indexing established as overall risk mitigation tool
	Longevity	Yes	Changes to benefits when retiring before 65
	HR inducements	Yes	Changes to benefits when retiring before 65
	Discount rate	No	Unclear whether return on plan assets is consistent with benefit security level
	Benefit security level	Yes	Evaluated managed defined benefit plan vs. target benefit plan vs. defined contribution plan
Funding	Contribution rate setting	Yes	Anecdotal consensus that contribution rates have reached practical ceiling
	Stabilization mechanisms	Yes	Targeted indexing for inflation proposed. Contribution rate caps proposed.
	Investment returns & risk appetite	No	
	Plan maturity	Yes	Target indexing for inflation proposed. Contribution rate caps proposed.
	Integration of funding policy & benefit cost	No	
Governance & Administration	Roles, responsibilities & structure	Yes	Department has proposed new structure
	Communication	No	
	Risk management	Yes	Targeted indexing for inflation and contribution rate cap proposed
	Investment management	No	Proposed that plans can choose an investment manager other than AIMCo

Further analysis is needed in the following key areas, to help ensure the department's sustainability review achieves its intended long-term results.

Principles for the reform of the pension plans

The department identified proposed principles for reforms of the pension plans and made them available to the public on September 16, 2013.

The department's plan for reviewing governance, funding and benefit design reform proposals includes obtaining feedback from employee and employer stakeholders. However, the purpose, content and necessary resources for the planned consultations were not specified at the time of our audit.

Analysis of the proposed changes

The department's comparison of options considered how some options for reform aligned with the government's principles. However, that analysis was not thorough. For example, the vision for reform indicated that the plans would be adaptable in changing circumstances in good times or bad; however, the plans had not yet been stress-tested with all options incorporated into the testing to support this conclusion. Stress testing means modeling how the plan would perform if significant risks were to occur.

Furthermore, one of the objectives was to ensure there was intergenerational fairness for members and taxpayers; however, we did not see how the analysis compared options considered against this principle.

Finally, the department's comparative analysis of proposed changes did not include feedback from stakeholders.

Costing and stress testing for the proposed changes

The department indicated to us that it had capacity to analyze costs as well as a range of potential outcomes resulting from proposed plan design changes. Its processes do not indicate whether it will quantify the costs of each option or whether it will assess a range of potential outcomes for all combined proposed plan design changes. It is therefore unclear whether the proposed reforms significantly increase the likelihood of the plans' sustainability.

Human resource risks

The department has not assessed the impact of the proposed plan changes on employee recruitment and retention. A difficulty for the department is that responsibility for assessing compensation strategies of public sector employees is spread across public sector employers. This makes it difficult for the department to obtain the information needed to assess the potential unintended consequences of plan changes on employers' ability to achieve their human resource objectives. Some of the plan boards have gathered qualitative survey data about the value of the pension plans to employees and their relative competitiveness with other public sector employers. However, we did not identify a coordinated process amongst public sector employers that would enable the department to assess the impact of proposed changes to the pension plans on employee recruitment and retention.

Implementation plan

At the time of our review, the department had developed the main steps to review governance, funding and benefit design reform proposals. This plan included an overall timeline for the review, consultations, announcements and approvals. The department also shared educational material with stakeholders on its website. However, we did not identify plans for continuous education as the review progresses and concludes.

The department had not developed a detailed implementation plan at the time of our review. We note that our review of their processes was underway while the department was still working out the details for this process.

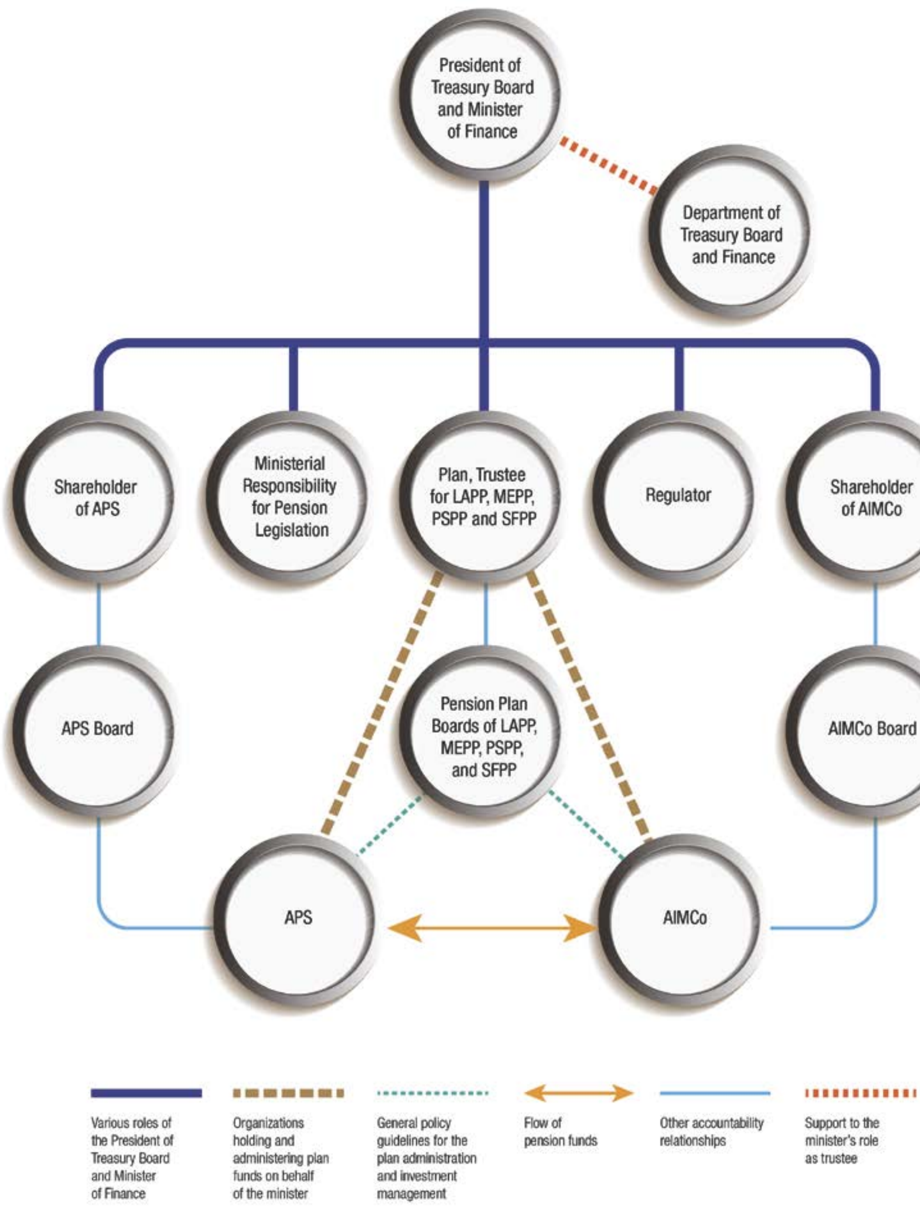
Implications and risks if recommendation not implemented

Without clear alignment between proposed plan changes and the government's objectives for the review, adequate financial analysis and consideration of human resource objectives, the department may not achieve its sustainability review objectives.

Appendix A

GOVERNANCE CHART

This diagram is applicable to LAPP, MEPP, PSPP and SFPP.



Appendix B

OVERVIEW OF PLANS

	LAPP	MEPP	PSPP	SFPP
Net assets available for benefits[1]	$22.86 Billion	$2.99 Billion	$7.30 Billion	$1.75 Billion
Pension obligation in financial statements[1]	$27.84 Billion	$3.29 Billion	$8.94 Billion	$2.25 Billion
Deficiency in financial statements[1]	$4.98 Billion	$0.3 Billion	$1.64 Billion	$0.5 Billion
Funded ratio in financial statements[1]	82%	91%	82%	78%
Solvency deficiency	$14.72 Billion[2]	$2.18 Billion[2]	$6.37 Billion[2]	$1.16 Billion[3]
Solvency funded ratio	61%[2]	58%[2]	53%[2]	57%[3]
Discount rate to value the pension obligation in financial statements[1]	5.8%	6.3%	6.4%	6.2%
Current service cost[4]	16.76%[3]	22.35%[2]	16.28%[3]	19.54%[3]
Contribution rate to pay for unfunded liabilities[4]	7.40%[3]	12.30%[2]	9.34%[3]	8.46%[3]
Employee contribution rate[4,5]	11.58%	12.80%	12.81%	13.45%
Employer contribution rate[4,5]	12.58%	21.85%	12.81%	14.55%
Separate AB Gov't contribution rate towards pre-1992 liablities[4,5]	-	-	-	1.25%
Total contribution rate[4,5]	24.16%	34.65%	25.62%	29.25%
Active members[6]	147,153	5,330	41,234	4,129
Deferred members[6]	27,831	1,044	15,677	185
Retirees receiving benefits[6]	49,767	3,957	22,178	2,278
Number of employers[7]	428	21	31	7
Retirement benefit	1.4% for each year of service based on the average salary of the highest 5 consecutive years up to the average YMPE[8] and 2% on excess	2% for each year of service based on the average salary of the highest 5 consecutive years	1.4% for each year of service based on the average salary of the highest 5 consecutive years up to the average YMPE and 2% on excess	1.4% for each year of service based on the average salary of the highest 5 consecutive years plus a bridge benefit of 0.6% for each year of service paid until age 65
Cost of living benefits	60% of Alberta CPI[9]	60% of Alberta CPI	60% of Alberta CPI	See footnote[10]
Unreduced pension available	At age 55 and when the sum of age and years of service is 85	See footnote[11]	At age 55 and when sum of age and years of service is 85	Age is 55 with 5 years' service or any age with 25 years of service

1 Amounts are based on the financial statements contained in the plans' 2012 annual reports.
2 Based on the plan's 2012 actuarial valuation.
3 Based on the plan's 2011 actuarial valuation.
4 Expressed as a percentage of salary.
5 2014 contribution rates.
6 Information obtained from the Government of Alberta's 2012–2013 Annual Report, page 59.
7 Information obtained from the plans' 2012 annual reports.
8 The year's maximum amount of pensionable earnings (YMPE) used to calculate contributions and benefits determined by the Canada Pension Plan.
9 CPI or consumer price index is an indicator of changes in consumer prices or the rate of inflation experienced by Albertans.
10 Cost of living adjustments are made at 60% of Alberta CPI for pre-2001 service. Effective January 1, 2013, a target of 30% of CPI will be applied for service after December 31, 2000.
11 For service before 1992, an unreduced pension is available if a participant is age 55 and has accrued five years of service. For service after 1991 if the participant's age and service is at least 80 or the participant is at least 60 years old, no reduction is applied.

Appendix C

GLOSSARY

Beneficiary A person who receives or will receive benefits from the pension plan.

Defined benefit pension plan A pension plan with benefits determined by a formula. Key factors that determine the benefit include the employees' historical salaries and number of years of service, among other factors.

Early retirement A retirement before the age set by the pension plan as the normal retirement age.

Economic cost of pension benefits The actuarially determined value of pension benefits discounted into today's dollars using a discount rate that reflects the risk in the cost of benefits.

Governance The structure and processes for overseeing, managing and administering a pension plan to ensure the fiduciary duties and other obligations of the plan are met.

Insolvent A pension plan can be considered insolvent when the present assets and expected contributions to the plan are insufficient to pay the benefits promised in full.

Mandate and roles document A document that includes the mandate, roles and responsibilities of a public agency, its members, the responsible minister, the accountability relationships of the agency and its duty to account to the responsible minister, among other items required by the *Alberta Public Agencies Governance Act*.

Normal form pension The default form of pension benefit is its normal form. An example is a pension paid for a member's lifetime, but guaranteed to continue to make payments for at least 10 years. Alternative forms of pension could include changing the guaranteed term of a pension or options to pay a spouse.

Risk adjusted cost A measure of pension benefits that considers the level of risk that the benefits will be paid.

Solvency deficiency The estimated liabilities of the pension plan minus the market value of plan assets if the plan were wound up and settled on the date of the actuarial valuation.

Sponsor Those responsible for setting the rules of the pension plan, arranging for the plan's administration and bearing the costs and risks of a pension plan.

Stress test A calculation of the impact of different scenarios on the assets and liabilities of a pension plan. An example would be measuring the impact of lower than expected investment returns.

Tolerance A predefined limit for an agreed upon measure that would not willingly be exceeded.

Trustee A person or entity who manages, administers and holds the investments of the plan.

Unfunded liability The amount by which the plan's pension obligations exceeds plan assets on a going concern basis.

Vested Pension plan members vested in a pension plan are entitled to benefits upon retirement.

Appendix D

ELEMENTS OF A PENSION SYSTEM

Cost

The cost of a defined benefit plan mainly depends on:

- **level of benefits**—The pension benefit that employees earn with units of service.
- **inflation**—Benefits may be increased with the rate of inflation. Extended periods of high inflation can have a significant impact on cost and therefore plan sustainability and can be difficult to mitigate with funding strategies.
- **longevity**—The average length of time people live has increased with each generation. If longevity improvements are underestimated cost can be significantly underestimated and therefore contributions rates set too low relative to the cost of benefits.
- **human resource inducements**—Benefits built into the plan design to achieve human resource objectives such as attraction, retention, or workforce downsizing (e.g., early retirement subsidies). Once built into the plan and established in employees' expectations, they can be difficult to reverse if human resources' objectives change.
- **discount rate**—The rate used to calculate the present value of the expected future benefit payments. The discount rate does not change the cash flows of the plan. However, selection of the discount rate can change the present value of future benefit payments significantly and, therefore, the current perceived cost of the plan. The discount rate, which incorporates the risk associated with the cash flows being discounted, is not always set commensurately with the benefit security level of the plan.
- **benefit security level**—The probability that the plan will deliver on the benefits promised. This depends on the level of contributions in relation to benefits and investment portfolio risk.

Plan design—The key process related to costing the plan is the plan design process. Here the sponsor(s) establish what the pension deal is and in doing so allocate the costs and risks of the plan between employers and employees. Effective consultation between employers and employees is important to ensure costs and risks are allocated in a clear manner that results in a win/win arrangement for the sponsors and beneficiaries. An ineffective consultation process on plan design can result in a sub-optimal outcome for the sponsor(s) and/or beneficiaries.

Each cost component in the above list must be estimated at the time a defined benefit plan is designed, to assess if the costs are reasonable in the circumstances. The estimate must then be used to set a funding policy commensurate with the cost. Since estimation is involved, it is certain that actuals will differ from these estimates. When actual costs differ significantly from the estimated cost, a defined benefit pension plan may prove unsustainable.

Ideally, during the initial plan design the tolerances for variance for each of these items from their estimate would be explicitly defined so that if they exceed those tolerances the sponsors and beneficiaries would have a common understanding that the plan's sustainability and design would be re-evaluated. Explicitly analyzing each of these components of cost also allows risks to be allocated amongst stakeholders (i.e., employers, current employees and pensioners) more granularly if so desired and agreed to.

In practice defined benefit pension plans do not usually define such tolerances at the outset and variances have been managed mainly through funding mechanisms described further on in the report. Alberta is not significantly different from others with defined benefit pension plans in this regard.

One potential reason for this is the belief by many that defined benefit pension plans include enduring promises to beneficiaries and that the sponsors have to fulfill those promises through the funding of the plan. These cost dependencies underlie both the feasibility and willingness of the sponsor to fulfill the promise, whether they are explicitly recognized by the stakeholders at the outset or not. It is therefore always possible that a sponsor's continuing commitment to the existing level of benefits may change if these components of cost differ significantly from those expected when the promise was made. Plan stakeholders may have difficulty accepting when the assumptions underlying the plan design have changed to such a degree that the promise is no longer affordable and sustainable.

In the worst possible scenario, sponsors and beneficiaries can only agree that the plan has become unsustainable after it has become insolvent. Whether these tolerances are defined explicitly at the outset or not, regularly monitoring actual costs against those estimated when the plan was designed is necessary to identify emerging risks to plan sustainability early on so that risk mitigation strategies can be evaluated and implemented to avoid reaching this worst case scenario.

Level of benefit – Plan benefits are usually defined by the proportion of pre-retirement income that will be replaced by post-retirement benefits per unit of service. Employers are not obliged to ensure that plans are designed to meet the retirement needs of their employees. However, doing so is a part of the value proposition of a defined benefit plan. At the same time the employer is interested in ensuring that employee salaries and other benefits are sufficient to attract and retain staff while being cost efficient.

Inflation – Because of a recent period of relatively low levels of inflation, inflation has not been identified as a large issue for defined benefit pension plans. The cost of Alberta's pension plans is dependent on inflation because benefits are partially indexed to inflation. The cost and contribution rates include the expectation of moderate amounts of inflation. However, if extended periods of high inflation were to occur the cost of such inflation could be difficult to manage through the funding system alone.

Longevity – During our knowledge gathering project and subsequent audit we observed stakeholders identified issues related to longevity and some of the human resource inducements related to early retirement.

When defined benefit pension plans initially were offered, employees typically worked for 40 or more years until turning 65, and had a life expectancy of 75. Alberta's more recent experience has been for employees to retire closer to 60 while living until their early to mid-80s, resulting in a retirement period that has doubled or tripled. In turn the ratio of contributing years to benefitting years has decreased significantly from the time when these plans were first established. This change in the proportion of time spent in pre- and post-employment is a result of increased longevity and early retirement.

The impact of increasing longevity is difficult to monitor because it occurs slowly over many decades. The cost of increased longevity is therefore also slowly built into contribution rates. Depending on the time lag between recognizing the impact of the change in longevity and funding for it this can have a significant impact on plan sustainability and intergenerational equity.

Potential technological improvements to health care, such as a cure for cancer, that dramatically increase the life spans of beneficiaries could have a much more sudden impact on expected longevity. Similar to high inflation, funding mechanisms may not be sufficient to mitigate a sudden significant improvement in longevity.

Human resource inducements – Some of the plan stakeholders we met with identified the issue of subsidized early retirements. Under current Alberta public sector pension plan rules an employee may retire several years before the age of 65, the age that has been traditionally considered the normal retirement age. The cost of being able to retire before 65 was subsidized in the plan's design to meet past human resource objectives. This led some to question the fairness of this arrangement in relation to taxpayers and whether or not it was consistent with the present human resource needs of the public service.

Discount rate – The discount rate does not change the cost of the plan but it does change the contribution rates and therefore the perceived cost of the plan. It also impacts which group of employees bears the costs of the plan. We observed that employers and employees frequently use contribution rates as a proxy for plan cost presumably since contributions are the direct in-year cash cost to them and are therefore transparent. Canadian public sector accounting standards permit pension obligations to be determined using the expected return on plan assets. However, by determining pension obligations using expected returns on assets and smoothing the impact of volatility on contribution rates through various actuarial and accounting techniques, the full risk and inherent volatility is not reflected in the accounting costs or contribution rates. The full economic cost can be significantly understated by these methods.

One method that can be used to reflect the risk in the cost of benefits (at least for the employer portion) is to use a risk-free discount rate. One proxy for the risk-free rate would be the Government of Alberta's own incremental borrowing rate since it has a AAA credit rating. In doing so, it demonstrates that the full economic cost of pension benefits can be significantly more than what the contribution rates derived from expected returns on plan assets imply. Private sector accounting standards require the use of yields on high quality bonds to be used in valuing pension plan liabilities for financial reporting purposes.

The department's analysis found that the economic cost is significantly more than the current service cost used to set contribution rates when a risk-free rate (2.66 per cent at the time of the analysis) is used. For example, while MEPP and SFPP have current service costs of about 20 per cent of salary when using the expected return on plan assets, the economic cost is approximately 35 per cent using the risk-free rate. Similarly LAPP and PSPP have a current service cost of about 15 per cent of salary when the expected rate of return on plan assets is used versus 25 per cent of salary when the risk-free rate is used. More tangible evidence that the full economic cost of benefits exceeds the current service cost can be determined by assessing what it would cost to transfer the public sector pension obligations to a financial institution by way of annuity purchases. This comparison would show that the current service contribution rates derived from expected returns on plan investments significantly understate the full economic cost of benefits.

By not recognizing the full economic cost of benefits, the risks that benefits result in an overly generous total compensation package or that pension benefits are not as securely funded as stakeholders might think, are not well understood. Those risks are therefore not as likely to be efficiently allocated, managed and monitored.

An example demonstrates the confusion that can be caused by discounting pension liabilities using expected returns on plan assets. Assume an employer proposes to give an employee $1 million in 10 years in respect of past service and this amount will be funded presently with a mix of investments expected to yield 6.5 per cent per year on average. The employer therefore contributes $530,000 to the plan today as determined by the plan's actuary.

Under present public sector accounting standards the employer will show no liability on its balance sheet since the plan's obligation is also discounted using the expected return on plan assets.

Plan assets of $530,000 less present value of obligation of $530,000
= balance sheet liability of $0

In contrast, if a risk-free interest rate is used to separate out the effect of risk resulting from funding the plan with risky assets, assumed in this case to be 4 per cent, then the liability is valued at $675,000 and the employer has to record a $145,000 liability on its balance sheet.

Plan assets of $530,000 less present value of obligation of $675,000
= balance sheet liability of $145,000

It is important to note that changing the discount rate does not change the amount—$1 million that the employer will pay to the employee—and therefore using the lower discount rate does not worsen the employer's financial position or further enrich the employee. Rather it simply makes the risk of relying on future investment returns to fund the benefits transparent.

Put another way, the present shortfall is real in both methods. Unfortunately, the first presentation and resulting funded ratio leaves the employer and employee with a sense that all is well while the latter seems to cause a sense of concern. It should not be a surprise to either party that the plan is presently underfunded since the essence of the business opportunity was to defer a portion of the employee's compensation and to try and fund part of the cost with investment returns. Instead, it should lead to important questions clarifying the terms of the arrangement between the two parties.

These questions include:
- Who bears the risk if the plan is still underfunded in 10 years if the investment returns are less than expected?
- What is one party willing to give up in exchange for transferring risk (e.g., investment, longevity, inflation) to the other party?
- What is the risk tolerance of both parties for that scenario?
- How can the risks be allocated, contributions set and investment portfolio be aligned to that risk tolerance?
- In light of the answers to these questions does the agreement to defer compensation and fund the cost with investment returns still align with both the employer's and employee's interests?

Benefit security level – The benefit security level is another significant issue. Beneficiaries of defined benefit plans have typically believed that benefits are guaranteed even though this is not always the case. The combination of a plan design and funding strategies will yield a certain unquantifiable probability of success. The variance in each of the cost and funding components can be modeled to yield a probability distribution of outcomes. Depending on the combination of plan design and funding strategy the expected probability of success may be considerably lower than the guaranteed level of security expected.

The security of plan benefits can be estimated using modeled ranges of variances and combinations of cost and funding dependencies. The models can estimate the probability that a particular contribution rate will be sufficient to pay the benefits promised. These estimated results are based on the model's inputs and assumptions, and could differ significantly from actual results. However, the models can illustrate, based on foreseeable ranges of outcomes, when there is a gap between a targeted security level and the estimated security level of a particular funding strategy.

These modeling techniques originated in the financial industry. Banks and insurance companies manage similar risks to those of pension plans, where the cash flows associated with assets on one side of their balance sheet vary from those associated with liabilities on the other side. In the financial industry, regulations and industry frameworks are in place establishing the use of these models to manage risk within targeted parameters. The Dutch pension system has been a leader in applying these techniques to the regulation of defined benefit and target pension plans.

The application of these modeling techniques together with establishing tolerances and targets is a significant improvement in pension risk management. While the use of these techniques does not guarantee pension plan sustainability, they do provide better insight into plan sustainability and what can be done to manage it. It is also an emerging area of practice in the management of pension plans. Alberta is not presently behind the norm in regulating and utilizing these techniques but risks falling behind as other jurisdictions look to these techniques to improve the management of pension risks.

Relationship to compensation – Lastly, a process that is not exclusive to and therefore not considered part of the pension system, but nevertheless bears on plan design, is determining whether the cost is reasonable or "fair."

For the plan design to represent a win/win arrangement it must be perceived as "fair" by taxpayers who typically fund the employers that pay a portion of the costs of these the plans. A widespread perception that the plans are unfair to taxpayers could prove to make the plans unsustainable even if employers and employees can otherwise agree on an arrangement that fully funds the plans. Employees both accept the employer's contribution as a component of their compensation and also fund the plan out of their salaries through employee contributions and expect that compensation practices will not be tested for fairness solely by what is politically saleable at a given point in time. A process is therefore necessary to demonstrate the plans are fair to taxpayers and employees.

The lesser prevalence of defined benefit pension plans in the private sector compared with the public sector is often cited as evidence that the public sector defined benefit plans are unfair. Others have gone as far as calculating the risk adjusted cost of the plans as evidence that they are too rich and therefore unfair.

These observations raise concerns but do not recognize the interrelationship of pension benefits with an employee's total compensation package. The form or cost of the pension plan is not so much the risk to taxpayers but rather how the other components of total compensation are balanced with that cost to ensure total compensation is in line with labour market value.

Salary + pension benefits + other benefits = total compensation

Starting from the assumption that total compensation is in line with labour market value then reductions to the pension component, without adjustment to the rest of the equation, could create false economies. The other components of compensation would be expected to increase to bring total compensation into equilibrium with the labour market value.

On the other hand, if total compensation exceeds labour market value focusing on one component of the equation unnecessarily limits the options of stakeholders to restore the balance.

In practice, a significant amount of analysis would need to be done to weigh total compensation against labour market value and measure the effects of changes in one component on another especially in a system with hundreds of employers and employee groups. At best, only estimates can be made. The risk of not attempting to do so during a plan design review increases the risk of unintended consequences following from plan design on the other components or human resources attraction and retention objectives. Perhaps more importantly the risk that changes cannot be demonstrated as fair to taxpayers or employees is also a risk and ultimately a risk to plan sustainability.

Funding

Funding is dependent on:

- **contributions**—Money put into the plan by employers and employees that is invested and that, in combination with investment returns, is expected to pay for the benefits of the plan. Contribution rates depend directly on the discount rate chosen and stabilization mechanisms used. Often contributions are perceived as the cost of the plan although they are not a conceptually sound measure of such.
- **stabilization mechanisms**—Comprise various techniques used to manage the volatility of contribution rates and plan funded ratio arising from investment volatility and variances in other component variances.
- **investment returns and risk appetite**—These are related. The more risk taken the higher the expected return but also the greater the variance in return.
- **plan maturity**—The proportion of working employees contributing to the funding of the plan in comparison to retired employees drawing benefits from the plan.
- **integrating the funding policy with benefit cost**—This helps ensure the benefit security level is achieved and it necessitates understanding the constraints on the other funding dependencies.

All pension plans rely on two sources to fund retirement benefits—contributions and returns on the invested contributions. In defined benefit plans the contribution levels are directly set in relation to the proportion of funding that is anticipated to come steadily from investment returns that can be uncertain and highly variable. Contribution rates have historically been determined as the residual of plan costs minus expected returns.

Since both investment returns and plan costs vary, so must contribution rates; but various stabilization mechanisms are used to dampen the effect of investment and cost volatility on contribution rates. Traditional pension funding strategies use combinations of margins on estimates and smoothing of losses and gains on assets to stabilize contribution rates with the expectation that these smoothing techniques can cope with investment and cost volatility over time. To a lesser extent some plans establish reserves to stabilize the plan by targeting a funded ratio in excess of 100 per cent. More sophisticated systems use complex models to establish the amount of the margins or reserves in relation to defined tolerances for key cost and funding components.

Solvency funding is another stabilization mechanism that pre-defines an accelerated increase in contributions to cover plan deficits in certain circumstances. Alberta's public sector pension plans are not subject to solvency funding requirements that are typical in the regulation of private sector defined benefit pension plans. The rationale for this difference between the private sector and public sector plans has not been formally communicated by the Government of Alberta.

Investment returns can and often usually do fund a significant portion of the pension cost. Pursuing higher returns through a plan's investment mix comes with greater risk and volatility in the returns. Because the traditional method of establishing contribution rates lowers the contribution rate when expected investment returns are increased without recognizing the associated risk from these higher expected returns, and because contribution rates are often perceived as the plan's cost, there is a risk that investment risk levels are not aligned with the expected or targeted benefit security level. This is because plan sponsors may increase the expected returns to lower or maintain the perceived cost. In the public sector the expected return is also used to value the plan's liabilities without consideration of the benefit security level. Increasing investment risk can be used to decrease the value of the liabilities to balance the funded ratio without recognizing the risk it places on maintaining the funded ratio.

Plans can also manage solvency risk by using current contributions to pay for past accrued benefits in years when investment returns are insufficient to do so. When this occurs the plans operate more akin to a pay-as-you-go plan than a funded plan. This works as long as the proportion of active employees to retirees is stable. However, when plans mature and the amount of contributions decreases in proportion to benefit payments, this method of managing solvency risk becomes less effective adding to sustainability risk.

This makes the process of integrating the funding components with the plan cost as opposed to the desired contribution rate critically important. A high or ill-defined investment risk appetite combined with a low tolerance for contribution rate volatility or increases, and inadequate stabilization mechanisms, creates a significant risk to plan sustainability particularly for mature plans.

The quality of a plan's funding policy and the rigour of its implementation through asset liability management, the system by which contribution rates and investment strategies are set consistently with the objective of funding desired benefit levels with a defined degree of certainty, is a key determinant of plan sustainability.

Governance and administration

This element is composed of:

- clearly defining roles, responsibilities and structure
- communication
- risk management
- investment management

In describing the cost and funding elements we have drawn attention to the interrelated components, risks and processes of a pension plan system. Clearly defining roles and responsibilities is part of the mechanism for joining these processes at their seams and ensuring effective communication occurs between the many stakeholders involved in the system. Good structure empowers process owners to act when necessary in a timely manner. However, structure does not ensure that empowered process owners will act when necessary.

Throughout the audit we observed a lack of confidence amongst stakeholders and some of the organizations responsible for the plans in each others' abilities to fulfill their responsibilities and a sense that responsibilities for certain functions were not appropriately allocated. This lack of confidence has impacted the ability of these groups to work together co-operatively despite sharing responsibility for achieving the same objectives.

Many we spoke with attribute this to the public sector pension plans' legislated governance framework, which was put in place two decades ago. Reviewing the governance structure has been cited by three of the plan boards as being a necessary part of reviewing the sustainability of the plans.

Through our research at the outset of this project, we noted numerous defined benefit pension plans, both in the private and public sectors, across the globe have experienced significant deterioration in their funded status. Amongst these many plans, mostly experiencing the same funding deterioration, are many different governance structures. So while alternative governance structures can be implemented, changes to the governance structure alone would not be the sole solution to plan sustainability.

The minister has several roles with respect to the governance of LAPP, MEPP, PSPP and SFPP. The roles are summarized at a high level in a diagram in Appendix A. The minister is the trustee of the plans and has delegated pension administration and investment management of the plans to APS and AIMCo, respectively. The minister is also the sole shareholder of the two service providers—APS and AIMCo.

Operating protocols between the plan boards, the department and APS require that the plan boards report to the minister an annual summary of the boards' activities in relation to their mandates and business plans. As required by the operating protocols, the boards, APS and the department also report risks, opportunities and strategic considerations related to the plans that should be dealt with by each other. The operating protocols also set out general guidelines for the content of the pension plan annual reports.

The plan boards of LAPP, MEPP, PSPP and SFPP have legislated powers, which differ amongst them, with respect to setting contribution rates, amending plan benefits and setting general policy guidelines on the investment and management of the plans' assets. Given the plan boards' legislated mandate, the boards have developed funding policies to support their decision making process. The funding policies of the plans were developed between 2011 and 2013 by the pension plan boards. Under the *Public Sector Pension Plans Act*, with the exception of MEPP, the contribution rates and benefits can only be changed on the boards' recommendation. The MEPP board must only be consulted with prior to amending contributions or benefits. Regulations establish plan rules with respect to contribution rates and benefit changes.

The department assists the minister with ongoing monitoring of the pension plans by briefing the minister on the risk reporting from the plan boards. The department monitors the sustainability of the plans and conducts research and analysis as part of that monitoring process. The department also plays a significant role in clarifying the roles and responsibilities by collaborating with the plan boards, APS and AIMCo with respect to the governance of the plans. The department has collaborated with various parties on operating protocols and, more recently, on the drafting of mandate and roles documents.

It is clear from any view of the structure that the Minister of Finance fills the leadership role in the existing system. The minister is responsible for making significant timely decisions as trustee, administrator, policy maker and the individual with ministerial responsibility for the *Public Sector Pension Plans Act* and regulations. The minister also has a responsibility to look out for the interests of Alberta taxpayers as joint funders of the plans. Inherent in all of these roles are a number of conflicting stakeholder interests that have to be balanced. How these conflicts in stakeholder interests can be effectively managed is a significant issue for policy makers to consider.

Another typical leadership function is to build consensus amongst followers so that change can be implemented when necessary. From the year 2000 onwards, the period in which the plans funded status deteriorated; there were 10 different ministers of finance who had responsibilities to deal with other than just Alberta's public sector pension system. In this complex system with multiple stakeholders, the lack of continuity in this leadership role poses a significant risk in the ability of the system to respond to adverse experience in a timely manner. A system to establish consensus for when and how to implement change without continuity in leadership is necessary to make the plans sustainable.

Another significant attribute of the Alberta public sector pension plan structure is that both the employer and employees are responsible for funding the plans. In the private sector, typically only the employer is responsible for funding deficits. This shared funding structure is thought to provide a medium of "fairness" in that employees share the risk and cost of plans.

When a plan deficit occurs, only current and future employees can fund the employee share over an extended period of time (e.g., 15 years). This can create inequities between past, current and future employees. Practically speaking, current and future employees will not likely pay for benefits accruing to past employees if current employees' contribution rates are significantly more than the value of their own expected pension benefits. If current and future employees will not support the plan, then the options are limited to: the employer is left to assume more of the past liability; retired employees will receive benefits that are less than promised; or the plan risks insolvency. This means changing the pension promise for current or future employees is difficult while they bear the cost and risks of benefits given to past employees.

The use of the pension funding methodology and resulting contribution rates to define the cost of benefits and the incorporation of various margin and smoothing techniques reduces the transparency of the risks associated with the defined benefit pension plans. As noted above, contribution rates are set in relation to the expected investment returns on the plan's assets. The returns vary in accordance with the relative risk of the asset portfolio. A riskier portfolio will lead to a higher expected return and therefore lower cash contribution rates. However, higher expected investment return rates come with more volatility in the returns resulting in greater risk that these returns will be insufficient to fund pension benefits.

Many believe that this risk is to be controlled by oversight of the investment manager's performance in achieving the expected rate of return. While an investment manager should be evaluated on the degree to which they maximize the return of a portfolio given a particular risk tolerance, the decision about investment risk appetite is the responsibility of the sponsors. In Alberta, the pension plan boards have had the responsibility for operationalizing the risk tolerance through investment and contribution rate policies.

AUDITOR GENERAL
Alberta

Stand-alone Systems Auditing—Follow-up Audits

REPORT OF THE AUDITOR GENERAL OF ALBERTA

February 2014

Education—School Board Budgeting Follow-up

SUMMARY

In our October 2006 report,[1] we recommended that the Department of Education:

- improve the school board budget process
- work with key stakeholder associations to provide guidance to school board trustees on minimum standards for interim financial reporting and best practices for fulfilling financial monitoring responsibilities, including having strong budgetary control systems

The department implemented our recommendations by:

- providing information to help school boards prepare budgets on time
- examining whether school boards are applying and disclosing realistic assumptions when preparing their budgets
- reviewing whether school boards' budget update reports are reasonable and are submitted on time
- monitoring the financial health of school boards by annually assessing the reasonableness of accumulated operating surplus or deficit balances and examining financial trends over a five-year period
- developing minimum standards for interim financial reporting and providing information on controls and best practices to encourage further improvements in financial monitoring

Why this is important to Albertans

In 2013 the department paid $6.3 billion in grants to Alberta school boards.[2] Albertans want assurance that the department and school boards have appropriate systems to ensure that school boards are operating within the resources allocated to them. Failure to do so may result in certain education programs not being provided if current funding must be used to eliminate accumulated operating deficits.

AUDIT OBJECTIVE AND SCOPE

Our audit objective was to determine if the department has implemented two recommendations from our October 2006 report. In performing our audit, we:

- interviewed department management and staff and representatives from stakeholder associations
- tested the department's systems and processes for monitoring the financial condition of school boards
- examined on a sample basis school board budget reports, budget updates, the department review of school board audited financial statements for fiscal 2011 and 2012, and deficit elimination plans
- obtained information from a sample of school boards through a questionnaire
- reviewed applicable internal and publicly available documentation, including legislation

We conducted our field work from June to September 2013. We substantially completed our audit on December 2, 2013. Our audit was conducted in accordance with the *Auditor General Act* and the standards for assurance engagements set by the Canadian Institute of Chartered Accountants.

[1] *Annual Report of the Auditor General of Alberta: 2005–2006*, Vol. 2, pages 63-70.

[2] School boards for this audit comprise 62 school board jurisdictions and 13 chartered schools.

BACKGROUND

The minister requires school boards to submit budget reports to the department by May 31 each year. Since the department is the major source of funding to school boards, the department must provide them with information on grant rates, changes to grant allocations and funding for specific initiatives by mid-February each year. School boards must submit a budget update report and their audited financial statements by November 30 each year.

The minister has authority, under the *School Act*, to prescribe reporting and accountability systems for school boards.[3] The minister can also inquire into the financial condition of school boards and make any order he or she considers appropriate.[4] A school board may budget for or incur an operating deficit in a given fiscal year, which would reduce its accumulated operating surplus. However, a deficit elimination plan is required when a board budgets for or incurs an accumulated operating deficit. School boards are expected to work with the department to eliminate the accumulated operating deficit within three to five years. For the year ended March 31, 2013, four of 75 school boards had an accumulated operating deficit. These numbers are relatively consistent with each of the past five years.

In 2006 the Association of School Business Officials of Alberta formed a financial monitoring and accountability committee of key stakeholders. This ad hoc committee issued a report in May 2007.[5] In 2010 a task force reported[6] on developing and implementing processes for three priority areas: budget systems and processes; financial monitoring; and capacity building for school board trustees and superintendents.

FINDINGS

School board budget process—implemented

Background

In 2006 we recommended[7] that the department improve the school board budget process by:

- providing school boards with timely information needed to prepare their budgets
- requiring school boards to use realistic assumptions and to disclose key budget assumptions to their trustees and the department
- establishing a date to give the department a trustee-approved revised budget based on actual enrollment and prior year actual results
- re-assessing when and how the department should take action to help school boards avoid incurring an accumulated operating deficit

Audit findings

Budget information

For the school boards' 2012 and 2013 fiscal years, all sampled school boards confirmed the department provided the information needed to prepare timely budgets. The department provided a manual that details the funding available and grant rates and the estimated amount of provincial funding by grant type based on enrollment projections, by mid-February. The budget report template and guidelines for preparing the budget report were also provided sufficiently in advance for the school boards to prepare budget reports by the department's submission deadline.

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[3] Chapter S-3, RSA 2000, Section 78.
[4] Chapter S-3, RSA 2000, Section 41.
[5] Financial Monitoring and Accountability Ad Hoc Committee. Part 1—Budget Process, Interim Reporting and Financial Monitoring, May 2007.
[6] Alberta Education. Building Financial Capacity for School Board Trustees and Superintendents—Report of the Advisory Task Force, 2010.
[7] *Annual Report of the Auditor General of Alberta: 2005–2006*, Vol. 2, no. 25, page 65.

Use and disclosure of assumptions

The department requires that school boards prepare their budget reports based on realistic assumptions on enrollment and staffing, planned activities, anticipated revenues and the completeness of costs. The school board budget report must also disclose all key assumptions and business and financial risks and be approved by the board chair.

From a sample of board-approved budget submissions, we observed that all disclosed details of significant assumptions applied in their budget. Our samples included school boards that varied in both size and location in the province. The department reviewed these budget reports for reasonableness using a standard checklist and followed up with the school boards, if necessary, for clarification on assumptions and risks.

Budget update reports

For the school boards' 2012 and 2013 fiscal years, all sampled school boards submitted their budget update reports on time. The department requires that variances greater than five percent from the original budget in enrollment, staffing, revenues or expenses be explained. The department reviews these explanations and follows up with the individual school boards if necessary.

We originally recommended that revised budgets should be approved by the board of trustees. The department, in collaboration with key stakeholders, concluded that this is not always necessary. Instead, the department requires the board of trustees to at least formally receive budget updates and indicate this on the budget update form. As the board of trustees would ensure the department is notified of any further adjustments required to a budget update received, we agree this approach provides the same control as a formal approval. For all school boards sampled, we observed an attestation by the secretary-treasurer that the budget update information was formally received by the board of trustees.

Monitoring of school board's financial health

As recommended by the Advisory Task Force, the department monitors whether a school board's accumulated operating surplus, as a percentage of total operating expenses, is within a reasonable range. The department generally makes additional inquiries of a school board's secretary-treasurer when the school board falls below the minimum amount in the range to assess the potential for an accumulated operating deficit.

While this indicator is important to assess the financial health of the school board, the department continues to consider other indicators that may assist in mitigating financial and business risk. The department plans to communicate these indicators to the school boards so that they are aware of the department's expectations and monitoring processes. We will assess the department's progress in improving this process during our fiscal 2014 financial statement audit.

The department prepares financial reporting profiles to monitor the financial condition of school boards. The profile is prepared annually based on the school board's audited financial statements and other data, such as enrollment numbers. The profile consists of trend analysis for each school board over the past five years relating to accumulated operating surplus, capital reserves, liquidity and capital asset replacement data. School boards are compared to the average for all school boards and the average for school boards with similar enrollment. As this analysis is provided to school boards, board management may use it to perform further compare itself to its peer group.

Further required improvements

While the department has improved its monitoring processes, it has the following opportunities to further improve its processes to assist school boards in avoiding or eliminating an accumulated operating deficit. We will confirm the department has made these improvements during our fiscal 2014 financial statement audit.

Deficit elimination plans should be submitted by school boards when they budget for or incur an accumulated operating deficit. In 2012 the department obtained these plans when they performed a review of the fiscal 2011 school board audited financial statements in February or when the minister requested information relating to the school boards with an accumulated operating deficit. In 2013 the department did not complete the review process of the fiscal 2012 school board audited financial statements by the February targeted timeline. As a result, the department did not request a plan for two school boards until June 2013. These deficit elimination plans remained outstanding at the completion of our audit field work. The department acknowledged it must improve the timeliness of its review process.

We observed no set format for deficit elimination plans. As a result, the consistency of information varied by plan. To mitigate this weakness, the department in 2012 implemented a checklist to help staff be consistent in their review of deficit elimination plans for reasonableness and achievability within five years. Management can continue to improve this process by approving the reviews completed by their staff.

The funding manual requires that deficit elimination plans receive ministry approval. However, it does not specify what that approval is or by whom. The department management has asserted that their role is not to approve the plan specifically, but to determine if it is reasonable and achievable. While senior management review deficit elimination plans, they do not evidence their review. In addition, we found no formal documentation of management's regular communication with school boards that have an accumulated operating deficit and monitoring of their plans. Management intends to clarify the funding manual and improve the evidence of reviews and monitoring of deficit elimination plans.

School board interim reporting and guidance to trustees—implemented

Background

In 2006 we recommended[8] that the department work with key stakeholder associations to set minimum standards for the financial monitoring information provided to school board trustees and provide trustees information about:

- the characteristics of a strong budgetary control system
- best practices in fulfilling financial monitoring responsibilities

Audit findings

The department implemented our recommendation, through collaboration with key stakeholders, by:

- identifying and communicating to school boards minimum standards for interim financial reporting by school board management to trustees
- providing guidance to school boards about characteristics of strong budgetary controls
- identifying best practices for fulfilling financial monitoring responsibilities through training courses and publications that are available to school board management and trustees

[8] *Annual Report of the Auditor General of Alberta: 2005–2006*, Vol. 2, no. 26, page 68.

Human Services—Administrative Support Systems for Child Intervention Services Follow-up

SUMMARY

Our 2007 audit and this follow-up examine administrative systems the department has to support child intervention services, such as agency accreditation and case file review. We did not evaluate the work done by caseworkers or the department's external reporting system. The original recommendations are centered on the monitoring systems that provide assurance that child intervention standards are adhered to consistently. These administrative systems are important since they provide oversight, identify trends and provide feedback to frontline caseworkers.

In 2007 we made five recommendations to the then Department of Children Services[1] and Child and Family Services Authorities to improve administrative systems that support child intervention services.[2] In 2010 we found the department had implemented one of the recommendations.[3]

In this audit we conducted further follow-up work and found the four remaining recommendations have been implemented. The Department of Human Services:

- has implemented a new process to approve accrediting bodies and will be directly contracting with, and receiving written results reports from, them
- reviews targeted case files of strategic interest to it and sends the results to caseworkers and their immediate supervisors, to provide them with feedback. It has improved how it shares information about contracted agencies.
- has trained staff on the new provincial casework practice standards
- enters licensing, contract and other information needed to monitor and evaluate agencies' adherence to contract provisions and their facilities in its new electronic information system

AUDIT OBJECTIVE AND SCOPE

Our objective was to determine if the department had implemented four recommendations that remained outstanding since 2007. All four recommendations deal with administrative systems that support child intervention services through accreditation, contract monitoring and case file reviews.

Neither the original audit nor this follow-up examined programs used to deliver services to children through family enhancement services or protective services—including family intervention, kinship care, foster care or residential care.

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[1] Now Child and Family Services, part of the Department of Human Services.

[2] *Annual Report of the Auditor General of Alberta: 2006–2007,* pages 63–89. Three recommendations were directed to the department and two to the authorities.

[3] *Report of the Auditor General of Alberta—April 2010,* pages 135–136.

At the time of the original audit in 2007 there were 10 Child and Family Services Authorities. The *Building Families and Communities Act*[4] dissolved these authorities on January 1, 2014. Program delivery responsibilities and our original audit findings remain relevant in the new organizational structure.

In performing the audit, we:
- examined documentation, policies and processes at the department and in the regions[5]
- examined and tested the system the department uses for monitoring and reporting results of case file reviews
- examined the department's systems to evaluate contracted agencies and share these results internally
- interviewed management and staff at Child and Family Services and in the 10 regions
- examined a sample of agency contract files

We carried out our work between July and October 2013. We examined policies and processes in place from January 2012 to June 2013. Our audit was conducted in accordance with the *Auditor General Act* and the standards for assurance engagements set by the Canadian Institute of Chartered Accountants.

BACKGROUND

If the department determines that a child's security or development is at risk, it places them into one of two intervention streams—family enhancement services or protective services.

Under family enhancement services, children remain in their family setting. The department works with the child and family to provide the required support services.

Under protective services, the child is cared for by the Crown and placed in a setting external to their immediate family. The placement depends on the child's age and needs, and the availability of services. These arrangements can include kinship care,[6] foster care,[7] group homes and treatment facilities.

A department caseworker is assigned to each child receiving intervention services. The worker develops a plan for the child, assists with getting them the services they need, maintains regular contact and ensures they are placed in a safe environment.

Typically the programs and residential supports for children in either intervention stream are delivered by contracted agencies, which for the most part are not-for-profit agencies or organizations. Some of these agencies operate in multiple regions and provide a variety of services and programs at a number of different facilities using their own staff. Regions enter into separate contracts with the agencies for each type of service and program. Each agency must be accredited by a recognized third-party accrediting agency before it can be contracted. Each facility operated by an agency to deliver a particular program or support such as a group home or treatment facility must be individually licensed by the region in which it is located.

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[4] Royal Assent given December 11, 2013 and came into force January 1, 2014.

[5] We visited five of the 10 regions, which accounted for 87 per cent of total intervention services expenses in 2012–2013: Region 6 (Edmonton); Region 7 (North Central); Region 3 (Calgary); Region 1 (Southwest); Region 4 (Central).

[6] A family home approved to provide care because of a family connection or significant relationship to the child.

[7] Foster parents can either contract directly with a region for their services or be affiliated with a specific agency that has the contract with a region to provide foster care services. They are individually licensed by the region in which they are located.

FINDINGS

Standardize accreditation process for agencies providing child intervention services—implemented

Background

The department requires an agency to be accredited by an approved accrediting body before it can be contracted to provide child intervention services. In 2007[8] we found the department did not have a process to ensure that accrediting bodies' standards aligned with its expectations for child intervention services or have agreements to access the accrediting bodies' findings and reports.

Our audit findings

In 2013 the department developed a selection process to evaluate and recognize accrediting bodies and contract with them to accredit agencies. Its request for proposals[9] set out 17 organizational and program standards[10] for which an accrediting body would need to demonstrate having equivalent standards in assessing an agency. The request for proposal also required a contracted accrediting body to provide to the department a quarterly written summary of accreditations completed and in progress, and a synopsis of concerns and risks identified with any specific agency. Three accrediting bodies were selected through this process.

Improve compliance monitoring processes—implemented

Background

As part of its compliance monitoring, the department conducts twice yearly case file reviews. A sample of active files for children receiving services in both intervention streams from each region are assessed for adherence by caseworkers to child intervention standards,[11] using standardized checklists. In 2007[12] we found no indication that the department used risk-based sampling to select files. Frontline staff in the regions received minimal feedback from this review process. We also found the department did not receive full and consistent information from the regions on their monitoring of contracted agencies.[13]

Our audit findings

Targeted file reviews

The department continues to use a statistically random method to select active files from the population of children receiving services in both intervention streams for its compliance monitoring. It also conducts additional targeted file reviews regarding:

- areas of strategic interest to the department
- trends noticed from an analysis of the regular file review process or other data sources, either occurring province-wide or within a specific region

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[8] *Annual Report of the Auditor General of Alberta: 2006–2007*, Vol. 1, no. 7, page 82.

[9] RFP Number AB-2013-00743. Issue date: February 11, 2013. Closing date: March 4, 2013. http://vendor.purchasingconnection.ca/Opportunity.aspx?Guid=2F373362-48A6-4016-B9B7-EB66F030A4A0

[10] These are core/organizational standards (5); program/service area standards (5) and standards in priority areas (6).

[11] The standards are 1) emergency response and safety; 2) initial client contact; 3) planning and permanency; 4) caseworker contact; 5) cultural connectedness for aboriginal children and youth; and 6) placement.

[12] *Annual Report of the Auditor General of Alberta: 2006–2007*, Vol. 1, no. 8, page 83.

[13] Licensing, monitoring and contract management of individual agencies is the responsibility of the regions. The department acts in a coordinating or oversight role.

These targeted reviews are conducted either in conjunction with the regular file review process, as supplemental questions to the checklists or as a separate, stand-alone review using additional risk-specific file samples and a separate checklist with specifically focused questions. For example, a recent review added questions specific to family violence to the checklists used during 2011 and 2012. The impetus for this review came from a 2008 study[14] that listed family violence as one of the top two reasons for individuals being involved in the child welfare system. The department felt this review would help it gain a better understanding of the dynamics concerning family violence and demographics in families it was involved with.

Providing feedback from case file reviews

Reviewers are now required to email completed review checklists to the caseworkers associated with a particular file, as well as to the caseworkers' immediate supervisors. This gives front line workers the ability to know what the reviewers' findings and comments were (both positive and in areas for development) and an opportunity to challenge or explain any noted areas of non-compliance. It also gives supervisors an opportunity to identify and work with their subordinates to improve case file practices. We spoke with caseworkers and supervisors at the five regions visited about this process. Their comments were overwhelmingly positive. Copies of checklists and emails are saved in a separate, restricted-access provincial standards monitoring database. They are not placed in case files.

Sharing of information between department and regions

One of the primary means the department has to regularly obtain and share information with the regions about contracted agencies is through its participation in the CFSD Contracting Group,[15] which meets every two months. The senior contract managers from each region are members of this group, as is a senior manager from the department. The meeting provides a forum where information relevant to the provision of child intervention services can be made available, shared and discussed. As well, each regional manager can discuss challenges they face regarding the contracting, monitoring or service delivery of agencies in their region—some which may have contracts with other regions. This is intended to create a collaborative process to identify solutions for these concerns and identify if they are shared by other regions.

The department recently created an online site where the regional senior contract managers can post summaries of the annual contract monitoring and evaluation reviews they compile on each contracted agency. A template developed by the department is used. The senior manager from the department reviews these summaries to identify any trends or concerns to take back to the contracting group for additional analysis and discussion.

The department also uses the contracting group as a means to solicit feedback and discussion on matters relevant to all regions. A recent example is the workforce alliance funding process. This impacted all regions since it required them to amend existing contracts with agencies to ensure they used any additional money for staff wages. The senior contract managers at the regions we visited all agreed the contracting group is an important vehicle for facilitating two-way communication between themselves and the department.

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[14] Public Health Agency of Canada. *Canadian Incidence Study of Reported Child Abuse and Neglect,* 2008. *http://cwrp.ca/sites/default/files/publications/en/CIS-2008-rprt-eng.pdf*

[15] This group was previously known as the Provincial Contract Managers Committee. The new group was formed in 2012 with new terms of reference, after Child and Family Services became part of Alberta Human Services.

Improve training processes and feedback to caseworkers on file preparation and case file monitoring reviews—implemented

Background

In our original audit[16] caseworkers told us policies and standards about how files should be managed and documented were not always easy to follow and it was not always clear how they should document their work. Caseworkers also felt there needed to be improvements in how the results of case file reviews were communicated back to them.

Our audit findings

Casework Practice Model

In 2008 the department implemented a new province-wide standardized approach to casework practice, the Casework Practice Model.[17] CPM consists of four successive stages—intake, assessment, intervention and closure. Each stage has prescribed timelines and decision points designed to require ongoing assessment if the child still needs intervention services. Supervisors monitor the status and progress of each caseworker's assigned files through the department's information system, which identifies when a file is overdue on the timeline or decision point for the particular stage it is at.

Case file preparation and maintenance training

All new caseworkers receive delegation training, a six-part training program delivered by the department. It comprises both online self-learning and three to four days of classroom instruction taught in Edmonton and Calgary. One module covers casework practice considerations and includes simulations and scenarios around the CPM regarding intake, case assessments and case planning. The regions we visited also provide supplemental staff training on file management and documentation, including how and when to do contact notes (which now must be entered into the information system).

All staff can access the online Enhancement Policy Manual,[18] which sets out policy and procedural requirements for delivering intervention services. The manual sets out expectations on when, how and where information should be recorded, including what information is expected to be included in contact notes. A chapter on casework practice incorporates the principles and timelines of the CPM.

Improve evaluation of agencies by coordinating monitoring activities and sharing the results with the department—implemented

Background

Contract management, and licensing of contracted agencies and their facilities, is the responsibility of regions. This work is done by the regions' various licensing and contract officers. In 2007[19] we found that the department's staff working in 10 decentralized functions had a problem with the timely sharing of information. We also found that the regions did not provide consistent information on agency performance to the department.

Our audit findings

Sharing of information

Licensing information for each facility that provides child intervention services is now entered into the department's information system. This includes date of issue and expiry of the licence, any associated restrictions or conditions, which agency operates it, confirmation of background checks and other

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[16] *Annual Report of the Auditor General of Alberta: 2006–2007*, Vol. 1, page 87.

[17] http://www.calgaryandareacfsa.gov.ab.ca/home/documents/ProgramsServices/The_Casework_Practice_Model.pdf

[18] www.humanservices.alberta.ca/documents/Enhancement-Act-Policy-Manual.pdf (revised as of July 1, 2013)

[19] *Annual Report of the Auditor General of Alberta: 2006–2007*, Vol. 1, page 88.

required assessments being done. This information can be accessed by any authorized employee and is not isolated within a paper file at a specific location.

Other information entered into the database includes:
- copies of investigation reports into serious incidents involving children in care (filed by facility)
- contact notes from any onsite facility visits conducted by regions' licensing and contract officers
- summary details of contracts with agencies

All regions we visited have established processes to ensure licensing and contracting officers and other staff responsible for ensuring the safety of children in care meet on an ongoing basis to share information.

Sharing results with the department
Department staff share information through participation in the CFSD Contracting Group and use of an online document sharing site.

Human Services—PDD Service Provider Monitoring Follow-up

SUMMARY

In 2004[1] we audited systems the then Department of Community Development[2] and the Persons with Developmental Disabilities community boards used to monitor and evaluate the performance of service providers. We made three recommendations and followed up in 2009.[3] At that time two recommendations had been implemented. This year we conducted follow-up work to assess the boards' and department's progress in implementing our remaining recommendation that they strengthen their monitoring and evaluation of the performance of service providers by:

- requiring service providers to provide adequate financial reporting
- obtaining annual financial statements from service providers
- implementing a risk-based internal audit plan
- developing and implementing standard procedures for communication with service providers
- implementing a method to evaluate service providers' performance

The boards provide services to adults with developmental disabilities. The *Persons with Developmental Disabilities Community Governance Act* describes a developmental disability as a state of functioning that began in childhood and is characterized by a significant limitation, in both intellectual capacity and adaptive skills. One of the goals of the department and community boards is to ensure that these individuals are living as full citizens in their communities.

What we found

We found that the department has developed, and the boards have implemented, criteria to assess the financial health of the service providers; monitor the service providers; and report this monitoring to the department. The department developed guidelines to assist the boards in developing a process to prioritize service provider audits.

Why this is important to Albertans

If service provider contracts are not effectively monitored and are not audited periodically, vulnerable individuals may experience a reduced standard of care and cost for these services may be excessive.

AUDIT OBJECTIVE AND SCOPE

Our audit objective was to determine if the Department of Human Services and the boards had implemented our recommendation to monitor and evaluate the performance of service providers.

[1] *Annual Report of the Auditor General of Alberta: 2003–2004*, pages 106-115.
[2] Now the Department of Human Services.
[3] *Report of the Auditor General of Alberta—October 2009*, pages 305-309.

In performing the audit, we:
- examined policies, roles and responsibilities of contract management staff at the PDD boards
- tested systems the boards used to evaluate service providers' financial health and performance
- interviewed department management and staff

We conducted our field work from January 2013 to May 2013. Our audit was conducted in accordance with the *Auditor General Act* and the standards for assurance engagements set by the Canadian Institute of Chartered Accountants.

BACKGROUND

The PDD community boards have a mandate to promote the inclusion of adults with developmental disabilities in community life. They fulfill this mandate primarily by providing funding to service providers who in turn provide services directly to the individuals. This occurs through service provider program agreements and family managed service agreements. Under the service provider program, the community board contracts directly with a service provider to provide services to individuals. Under family managed program, the individual can choose their own service provider, and the agreement is between the board and the family of the disabled individual.

FINDINGS

Monitoring and evaluation of service providers—implemented

Background

In 2004[4] we recommended that the department and the boards strengthen the monitoring and evaluation of the performance of service providers

Our audit findings

The department worked with the boards to create and implement new monitoring standards and procedures for contracts. The boards have implemented these by:
- evaluating service provider financial health using a template developed by the department
- performing service provider assessments and maintaining records of these assessments
- completing risk assessments and reporting the results to the department
- meeting with the department to discuss common issues and a common approach to auditing providers across the province

In early 2013 the chairs of all the board audit committees met with the department to discuss common issues. This is a step towards developing a common approach to auditing across the province. During our audit of financial statements in 2014, we will follow the development of these plans.

[4] *Annual Report of the Auditor General of Alberta: 2003–2004*, no. 9, page 111.

Human Services—Systems to Monitor Training Provider Compliance Follow-up

SUMMARY

In 2008 we audited the former Department of Employment and Immigration's systems for delivering training to Albertans who need to improve their employment skills. We made three recommendations.[1] In 2012 we reported the department had implemented two of three recommendations. In the current year we conducted follow-up work to assess the department's progress in implementing the final outstanding recommendation regarding implementing policies, procedures and outcome reports for monitoring training provider compliance.

BACKGROUND

The department provides funding that allows eligible learners to upgrade their employment skills or prepare for further training. The department's delivery model allows learners to select a training provider. If the program is approved and the learner is eligible, the department pays tuition directly to the training provider.

The department pays for training through four main types of providers—private vocational schools, accredited schools, private providers and public post-secondary institutions.

The Department of Human Services has a process to follow up with training providers to review monitoring results and develop action plans to deal with non-compliance matters. However, we found the processes for follow-up on non-compliance were inconsistently applied and enforced. The department's processes were not clear in the steps that need to be followed in non-compliance matters. In 2012 we found the department had made progress in implementing this recommendation.

What we found

We found that the department has fully implemented our final recommendation. Systems for monitoring training providers have been improved by implementing a detailed monitoring, auditing and remedial action policy that requires the department to perform regular audits of training providers and perform follow-up procedures on post-audit action plans. Reports have been developed to monitor whether training providers are meeting performance outcomes and expectations.

Why this is important to Albertans

We did the original audit because the department provides funding to training providers to provide training to learners. Training providers with poor performance may continue to receive funding from the department and provide training to learners that do not improve employment and training program outcomes.

[1] *Report of the Auditor General of Alberta—October 2008*, pages 243-253.

AUDIT OBJECTIVE AND SCOPE

The scope of our audit was to determine if the department had implemented the outstanding recommendation that we had made in 2008,[2] dealing with monitoring of tuition-based training providers.

FINDINGS

Improve monitoring of tuition-based training providers—implemented

The department implemented our recommendation[3] by:

- implementing the monitoring, auditing and remedial action policy that requires:
  - regional offices to perform, at minimum, annual monitoring procedures on training providers
  - internal audit to assess every training provider's compliance with policies and regulations at least once every three years
  - training providers to implement post-audit action plans to deal with non-compliance issues, or face remedial action
  - regional offices to monitor the training providers' implementation of the post-audit action plans
  - the internal audit unit, regional representatives and delivery partnerships unit to review results at the end of the monitoring period, to ensure that post-audit action plans are implemented
- developing outcome and indicator reports that are used to monitor whether training providers are meeting the performance outcomes

[2] Ibid.

[3] *Report of the Auditor General of Alberta—October 2008*, no. 24, page 245.

Infrastructure—Alberta Schools Alternative Procurement Follow-up

SUMMARY

In 2010 we audited systems the Department of Infrastructure[1] used in applying the P3 (private-public partnership) framework to the Alberta Schools Alternative Procurement project. The P3 framework identifies an alternative approach to building and paying for public facilities like schools and hospitals. Our objective was to determine whether the department had effective systems to:

- assess the potential value for money of the ASAP project
- ensure procurement activities were fair and transparent

We made two recommendations in April 2010.[2] This year, we assessed the department's progress in implementing our recommendations to:

- improve the processes it uses to challenge and support maintenance costs and risk valuations
- publish value for money reports upon entering into P3 agreements

The department implemented our recommendations by using its historical data on school costs to support its assumptions on maintenance costs and to validate its risk valuation. The department also published value for money reports for its ASAP P3 projects.

Why this is important to Albertans

Albertans need to know if the government's processes to deliver P3 projects are open and transparent, and can demonstrate that value for money will be achieved.

AUDIT OBJECTIVE AND SCOPE

Our audit objective was to determine if the department implemented the two recommendations from our 2010 report.

Our audit was not an assessment of whether value for money was achieved, but rather an audit of the systems management implemented in response to our recommendations. The assessment of whether value for money will be achieved is the responsibility of the department's management.

We conducted our field work from June 2013 to November 2013 and focused on the department's actions since our April 2010 report. We substantially completed our audit on December 5, 2013. Our audit was conducted in accordance with the *Auditor General Act* and the Canadian Institute of Chartered Accountants' standards for assurance engagements.

[1] In 2006 the Department of Infrastructure developed frameworks for assessing and procuring P3 projects. In 2011 the Department of Treasury Board and Finance replaced these frameworks with the *Alberta Public–Private Partnership Framework and Guideline*. We made our original recommendations to both departments. The Department of Infrastructure is currently responsible for the framework and for overseeing P3 projects. Therefore, our follow-up audit focused on steps it has taken to implement our recommendations.

[2] *Report of the Auditor General of Alberta—April 2010*, starting at page 13.

BACKGROUND

Traditional procurement

In the traditional procurement model, approval and funding for building a new school follows capital planning processes of the school jurisdictions and the provincial government. The Department of Treasury Board and Finance approves the use of public funds to build schools. Each school jurisdiction manages the design and construction, as well as routine and major maintenance of its schools.

School jurisdictions enter into contracts with third parties for design, construction and maintenance activities over the lifetime of schools. The Department of Education provides annual maintenance funding and school jurisdictions allocate these funds to individual schools. Routine maintenance may be provided by school jurisdiction staff or by contractors.

Public–private partnership procurement

A P3 is a procurement approach in which a private contractor provides some or all of the financing for the project; designs and builds the project; operates and maintains the project; and receives payments from government over an extended period of time, subject to deductions for failing to meet contractually defined performance standards.[3]

The P3 framework provides guidance for assessing potential P3 projects and delivering them in Alberta. It defines terms that have specific meaning in financial analysis and in the evaluation of P3 proposals. Value for money is an assessment of the quantitative cost of a project in relation to the qualitative benefits expected to be received. A procurement option that provides the same benefits but at a lower cost than another alternative provides greater value for money.

The department assesses a P3 project's potential value for money by comparing the net present value of the contractors' bids received to its own estimates of the project's costs. Called the public sector comparator, this number is an estimate of the risk-adjusted cost of a project financed, owned and implemented by the government through a traditional procurement model. The PSC serves as a benchmark against which to evaluate the procurement alternatives. The department develops a shadow bid by modeling the project as if it were delivered through P3 procurement. In a business case, the department compares its shadow bid to the public sector comparator to decide whether the project should proceed as a P3.

Alberta Schools Alternative Procurement

In June 2007 the Minister of Education announced phase one of the Alberta Schools Alternative Procurement project. Called ASAP 1, its goal was to build 18 schools using a design-build-finance-maintain procurement approach. Unlike traditional procurement, the DBFM approach:

- uses standard core modular school designs to reduce design costs
- requires contractors to design a structure that could be built to required standards
- bundles more schools into one contract to achieve economies of scale
- requires contractors to finance the construction of the schools
- commits public funds to pay contractors to carry out maintenance and renewal activities for these schools
- makes contractors responsible for ongoing maintenance and renewal of the structure

The 18 schools were completed one month earlier than the contracted completion date of June 30, 2010. Since then, the department has used the P3 model to build more schools. Phase two,

[3] Alberta Public–Private Partnership Framework and Guideline, page 9.

ASAP 2,[4] has been completed: 10 new schools opened in 2012. ASAP 3 is under construction and 12 schools are expected to open in the 2014–2015 school year. The department has obtained the Department of Treasury Board and Finance's approval for phase four to provide 19 additional schools.

FINDINGS

Challenging and supporting assumptions—implemented

Background

In 2010 we recommended that the department improve its processes, including performing a sensitivity analysis, to challenge and support maintenance costs and risk valuations.[5] The P3 framework requires management to document its assumptions for the PSC and shadow bid and, where possible, to base PSC costs on actual costs from prior projects. It also suggests a sensitivity analysis to show the effects of different assumptions on the value for money of the procurement options.

However, in 2010 we found that the department:

- did not retain evidence to support maintenance costs
- estimated maintenance costs using government owned office space costs rather than schools
- developed risk valuations based on anecdotal evidence rather than actual costs from prior school construction projects
- did not include a sensitivity analysis or provide an explanation why a sensitivity analysis was not included in the business case

Our audit findings

For ASAPs 2 and 3, the department retained supporting information for maintenance costs and based its risk valuation on actual costs from prior school construction projects. It also included sensitivity analyses in its business cases.

The department based its maintenance costs for ASAP 2 and 3 on school facilities. It engaged a cost advisor with experience in cost–benefit analyses of many Alberta schools. The cost advisor determined the average maintenance costs of these school facilities. The department then used this average cost in its public sector comparator and applied a labour efficiency rate on the maintenance costs for its shadow bid.

We obtained consolidated information from the Department of Education for Edmonton and Calgary Catholic and public schools, and calculated the maintenance costs per square metre. The maintenance costs the department used in ASAPs 2 and 3 were comparable to the information from the Department of Education.

For risk valuation, the department conducted workshops with representatives from several ministries and external consultants to identify risks. Through the workshops, the department identified various risks. It quantified the risks that were material to the project and different between the delivery alternatives. Participants in the workshop provided input based on their technical expertise, professional experience and judgement, and reached consensus on the probability and impact of risks based on worst case, typical case and best case scenarios.

[4] The project procured an additional four schools traditionally.
[5] *Report of the Auditor General of Alberta—April 2010*, no. 1, page 22.

To quantify the cost of these risks, the department multiplied the project base cost by a value assigned to the probability and impact of each risk. The department demonstrated that the significant estimated risk costs were comparable to actual costs from prior school construction projects.

The department conducted sensitivity analyses to assess what effect the level of provincial financial contribution and the interest rate spread would have on the project's value for money. The department determined the amount of provincial contribution based on industry feedback and contribution levels in previous projects. Interest rate spreads were based on current financial market conditions. It established a range for the inputs and assessed how different values of the inputs would impact the potential value for money.

Transparency—implemented

Background

In 2010 we recommended that the department follow its own guidance to publish a value for money report upon entering into a P3 agreement.[6] To ensure the process is timely and transparent, a report should be prepared within six months of entering into a P3 agreement to inform Albertans about how value for money will be achieved. We found that a report was not published as required by the department's P3 framework.

Our audit findings

The department published the value for money reports according to the requirements of its P3 framework. The department published the ASAP 1 value for money report after our original audit and more than a year after the required disclosure deadline. However, it published the reports for ASAPs 2 and 3 within six months of signing the P3 agreements.

The reports describe, as required, the P3 project goals, outcomes and procurement process, and explain the value for money assessment process, including quantitative and qualitative measures of value. They also show how major project risks were allocated between the government and the P3 contractor. The reports also describe the P3 selection process, summarize key terms of the project agreement and indicate the amount of money the government estimates it will potentially save through the P3 approach.

[6] *Report of the Auditor General of Alberta—April 2010*, no. 2, page 24.

Innovation and Advanced Education—Post-secondary Institution Non-credit Programs Follow-up

SUMMARY

In 2008 we recommended that the Department of Innovation and Advanced Education clarify its standards and expectations, and monitoring of non-credit programs at post-secondary institutions.[1]

The department has implemented our recommendations by:
- annually communicating its expectation that institutions recover at least the total direct cost of delivering their non-credit programs, allowing the rate of cost recovery to vary for each program
- obtaining financial reports approved by each institution's vice president of finance, performing improved reconciliation processes and analysis of this information, and following up with institutions when they do not recover the total direct costs for non-credit programs

Why this is important to Albertans

The department provides operating grants for credit programs. A lack of clear policies and guidelines for institutions for non-credit programs may result in them using department operating grants to support non-credit programs.

AUDIT OBJECTIVES AND SCOPE

Our objective was to determine if the department had implemented the recommendations we made in 2008. To perform the audit, we:
- interviewed management and staff to learn what actions they took in response to our recommendations
- tested the department's policies, systems and processes to monitor institutions' delivery of non-credit programs
- examined samples of the department's monitoring processes

Our field work was completed in November 2013. We substantially completed our audit on December 17, 2013. We conducted our audit in accordance with the *Auditor General Act* and the Canadian Institute of Chartered Accountants' standards for assurance engagements.

BACKGROUND

Institutions offering credit programs that can lead to a degree or diploma may also offer non-credit programs that are open to the public or specific organizations. The department does not fund non-credit programs and expects institutions to recover the direct costs of delivery from user fees.

[1] *Report of the Auditor General of Alberta—April 2008,* pages 22 and 23.

FINDINGS

Clarify standards and expectations—implemented

Background

In 2008 we recommended that the Department of Innovation and Advanced Education:

- clarify its standards and expectations for non-credit programs and clearly communicate them to public post-secondary institutions
- work with institutions to improve the consistency of information that institutions report to the department[2]

Our audit findings

The department communicates annually in operating grant letters its expectation that institutions recover all direct instructional costs and variable indirect costs of non-credit programs from user fees. Any net surplus revenue from non-credit programs must be applied to offset the institution's overhead costs. The department also clarified this extends to non-credit programs delivered off-campus, including international operations.

Institutions report information about non-credit programs as a subset of financial and non-financial information reported to the department. The department's manual for financial reporting now defines costs, including direct and indirect overhead costs, and reporting requirements for allocation of overhead costs. The department and institutions have recently formed a committee to standardize presentation and disclosure of annual financial reporting among institutions that includes classification of expenses and non-credit program information. This committee will have an ongoing role in ensuring future reporting consistency.

Monitoring Institution's non-credit programs—implemented

Background

In 2008 we recommended that the department implement effective processes to:

- monitor whether institutions report information consistent with its expectations
- investigate and resolve cases where an institution's program delivery is inconsistent with the department's standards and expectations[3]

Our audit findings

The department implemented our recommendation by updating the review checklists staff use in reconciling and analyzing information that institutions provide for the department's financial information reporting system. We examined information submitted by a sample of institutions and found evidence that the department:

- reviewed the information for instances where institutions were not recovering direct costs
- where applicable, investigated the reason for the variance
- resolved the issue before obtaining the final approval from the institution's vice president of finance

Processes at institutions

The department's improvements to clarifying standards and expectations of non-credit programs and reporting consistency have mitigated the risk that department operating grants fund non-credit programs. However, a sample of institutions we examined as part of our audit still require improvements to non-credit program policies, processes and controls to make them more effective. We plan to follow up on improvements at these institutions in our 2014 financial statement audits.

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[2] *Report of the Auditor General of Alberta—April 2008*, no. 1, page 22.
[3] *Report of the Auditor General of Alberta—April 2008*, no. 2, page 23.

Service Alberta—Information Technology Control Framework Follow-up

SUMMARY

In 2008 we recommended that the Ministry of Service Alberta, in conjunction with all ministries and through CIO Council, develop and promote:

- a comprehensive IT control framework and guidance for implementing it
- well-designed and effective IT control processes and activities[1]

An IT control framework is a set of policies, processes, standards and controls that help an organization identify risks to its IT strategy and then help eliminate or reduce those risks to an acceptable level.

We assessed Service Alberta's progress to implement this recommendation in 2010 and 2012 and found that, although its progress continued, the department was not ready for a final assessment. In October 2012 Service Alberta reiterated its commitment to finish implementing this recommendation. We conducted our follow-up audit in June and July 2013.

FINDINGS

Information technology control framework—implemented

Service Alberta has implemented this recommendation by working with the CIO Council to create an IT governance and control working group with members and subject matter experts from all ministries that chose to participate. This working group developed and continues to improve and implement a comprehensive IT control framework.

We also initiated a survey of the IT control framework's core stakeholders to assess the IT control framework and the guidance Service Alberta provided. We contracted with an independent third party to survey all of the ministries' CIOs and other persons that the CIOs and Service Alberta identified as being significantly involved in development or as users of the framework. Overall, the survey indicated that the project is well received and is meeting the needs of CIOs and other stakeholders.

Through this survey we found that the majority of respondents are familiar with the project and are implementing an IT control framework. A large majority also think that the policy instruments (directives, standards and guidelines) and practices are applicable to their department and useful as guidance to implement an IT control framework. However, the survey also identified areas for improvement, such as project governance, roles and responsibilities, and communication within the project and between Service Alberta and the ministries.

Based on what the department and CIO Council have accomplished, we consider this recommendation to Service Alberta implemented. However, there is room to improve the IT control framework project. We will continue to work with Service Alberta and the CIO Council to ensure that the IT control framework and the guidance to implement it continues to improve to help remediate risks to IT strategies.

[1] *Report of the Auditor General of Alberta—April 2008, no. 7,* page 170.

Other Audit Work

REPORT OF THE AUDITOR GENERAL OF ALBERTA

February 2014

Innovation and Advanced Education—Report on Post-secondary Institutions

Post-secondary institutions must spend considerable time and effort to establish and then sustain strong internal controls and processes over financial reporting. A number of institutions examined in this report experienced difficulty in sustaining these processes this year, due to unexpected challenges in their operations. Three institutions have not established strong internal control environments. The Minister of Innovation and Advanced Education, through the department, must ensure the boards of governors of these institutions are holding management accountable to improve these control environments so that all post-secondary institutions are promptly reporting reliable financial information to Albertans.

INTERNAL CONTROLS—A REPORT CARD

This report card on internal controls over financial reporting highlights our observations on financial statement preparation and outstanding recommendations from our audits of colleges, technical institutions, MacEwan University and Mount Royal University. Our October 2013 report provided our observations on Athabasca University, University of Alberta, University of Calgary and University of Lethbridge.[1]

We evaluated the following key indicators of effective financial processes and internal controls:

- the time it took institutions to prepare complete and accurate year-end financial statements
- the quality of draft financial statements we received, including the number of errors our audit found
- the number and type of current and outstanding recommendations

To govern effectively, boards need accurate and timely financial information throughout the year, not just at year-end. To manage effectively, management needs the same information. We see a direct correlation between a strong year-end process to prepare financial statements and the ability to prepare quality financial information throughout the year.

A post-secondary institution could have a yellow or red status yet still receive an unqualified audit opinion on its financial statements as management can correct errors and financial statement disclosure deficiencies during the audit process. The number of errors and disclosure deficiencies we find in the draft financial statements indicates how effective financial controls are for preparing accurate financial statements.

Effective control environments include clear policies, well-designed processes and controls to implement and monitor compliance with policies and secure information systems to provide timely and accurate financial and non-financial information to manage and govern the institutions. Recommendations that are not implemented promptly erode the effectiveness of the institution's control environment. Weak control environments impact the quality of decisions made by management and the board of governors and can result in an institution not achieving its goals by operating in a cost-effective manner and managing operating risks.

[1] *Report of the Auditor General of Alberta—October 2013*, pages 92-101.

It is critical that the boards of governors of post-secondary institutions hold management accountable for improving identified control weaknesses in a reasonable period of time. The Minister of Innovation and Advanced Education and the Lieutenant Governor in Council appoint the boards. The minister, through the department, must also hold the boards accountable for their effective oversight of the institutions.

The report card

◆ Significant improvements are needed.

▲ Improvement is required, but not to the same extent as the red items. Yellow items may or may not be associated with a management letter recommendation. They represent areas where an institution can improve, as opposed to areas that require significant, immediate attention.

● We have not identified significant weaknesses in the control environment.

Institutions where significant improvements are needed (by significance)

Institution	Financial statements preparation		Outstanding recommendations
	Accuracy	Timeliness	
Olds College			
2013	n/a[2]	◆	◆[2]
2012	◆	●	◆
2011	◆	▲	◆
Northern Lakes College			
2013	n/a[2]	◆	◆[2]
2012	◆	◆	◆
2011	◆	◆	◆
Alberta College of Art + Design			
2013	◆	▲	◆
2012	◆	▲	◆
2011	◆	◆	◆
Medicine Hat College			
2013	●	●	◆
2012	●	●	▲
2011	●	●	▲
Portage College			
2013	●	●	◆
2012	●	●	▲
2011	▲	▲	▲
Keyano College			
2013	▲	◆	●
2012	●	▲	▲
2011	●	▲	▲

[2] We have not completed our 2013 financial statement audit to the date of this report as the institutions did not prepare timely, accurate financial statements. We will again recommend these institutions improve financial reporting processes at the conclusion of the audits.

Institutions where significant improvements are not needed (alphabetical)

Institution	Financial statements preparation		Outstanding recommendations
	Accuracy	Timeliness	
Bow Valley College			
2013	▲	●	●
2012	▲	●	●
2011	●	▲	●
Grande Prairie Regional College			
2013	▲	●	●
2012	●	●	●
2011	●	●	●
MacEwan University			
2013	●	●	▲
2012	●	●	▲
2011	◆	◆	◆
Northern Alberta Institute of Technology			
2013	●	▲	●
2012	●	●	●
2011	●	●	●
Red Deer College			
2013	●	●	▲
2012	●	●	▲
2011	●	▲	●
Lakeland College			
2013	●	●	●
2012	●	●	●
2011	▲	▲	●
Lethbridge College			
2013	●	●	●
2012	●	●	▲
2011	▲	▲	●
Mount Royal University			
2013	●	●	●
2012	▲	▲	▲
2011	▲	▲	●
NorQuest College			
2013	●	●	●
2012	◆	▲	◆
2011	◆	◆	◆
Southern Alberta Institute of Technology			
2013	●	●	●
2012	●	●	●
2011	●	●	●

In concluding on our report card, we note the following:

Financial statement preparation

Post-secondary institutions prepared their first financial statements under Canadian public sector accounting standards for fiscal 2013. All institutions had to resolve financial reporting differences to varying degrees from the complete change in accounting standards. We generally excluded the one-time nature of these transition differences in our assessments of financial statement accuracy. Institutions should apply lessons learned from this transition to their financial reporting processes when changes to individual accounting standards occur in the future.

Institutions must have strong internal controls and processes to promptly prepare reliable financial statements. Olds College and Northern Lakes College did not prepare timely, accurate financial statements this year. We have not completed our audits of these institutions as a result. While more timely, Alberta College of Art + Design must also improve the accuracy of its financial reporting and the underlying internal controls and processes. We either have or will repeat our recommendation to improve financial reporting processes at each of these institutions.

These three institutions should emulate NorQuest College, MacEwan University and Mount Royal University, which recently have significantly improved the accuracy and timeliness of their financial reporting. The boards of governors of these institutions held management accountable for implementing outstanding recommendations and significantly improved financial reporting processes as a result.

Sustaining a strong internal control environment is difficult for any organization. Post-secondary institutions must continuously re-assess if their control environment is operating effectively as their operations change and evolve. An institution's ability to prepare timely, accurate financial reporting may be temporarily impacted by the institution's inability to adjust to unexpected changes in its operations or staffing.

A number of institutions faced various obstacles in maintaining the effectiveness of their financial reporting processes in the past year. In particular, Keyano College did not prepare timely, accurate financial reporting this year, due to challenges in staffing and unexpected events impacting their operations. These obstacles appear to be temporary. We expect all institutions that have been unable to maintain their prior year status will re-establish the effectiveness of their processes and make further improvements where required in the next fiscal year.

We issued unqualified audit opinions on the financial statements of the 14 institutions where our audit is complete.

Outstanding recommendations

Most institutions either improved or maintained their status on the number and nature of outstanding recommendations. NorQuest College significantly improved its internal control environment by implementing eight of our prior years' recommendations. Lethbridge College, Mount Royal University and Keyano College also implemented recommendations to improve their control environments. MacEwan University implemented a number of recommendations to continue strengthening its overall internal controls.

The boards of governors of Alberta College of Art + Design, Northern Lakes College and Olds College must hold management accountable to implement recommendations that will establish and sustain a strong internal control environment. Institutions with strong internal control environments have demonstrated that effective processes can be implemented and sustained in periods of economic and operational change.

While Medicine Hat College's financial reporting process was effective, the college must make significant improvements to some of the college's operating activities. In our July 2013 report we recommended significant improvements to the college's international education activities.[3] Portage College also has adequate processes to prepare its financial reporting. However, we followed up on the college's implementation of our prior year's recommendation on improving the accuracy of bookstore inventory. We conclude not all necessary improvements have been made and repeat our recommendation—see page 88.

FINDINGS AND RECOMMENDATIONS

POST-SECONDARY INSTITUTIONS

Matter from current audit

Compliance with legislation

We recommend that, similar to our recommendation to other post-secondary institutions in February 2013[4] and October 2013,[5] Grande Prairie Regional College and Northern Lakes College improve systems to ensure they comply with legislation.

ALBERTA COLLEGE OF ART + DESIGN

SUMMARY

We recommend that the college improve controls over expense claims and purchase card transactions—see page 76.

We again recommend that the college:

- improve financial reporting—see page 78
- implement codes of conduct, conflict of interest and fraud policies—see page 79
- improve internal controls at the bookstore—see page 80
- implement proper purchase controls—see page 81

The college implemented our prior year's recommendation by implementing a change management policy and controls—see page 82.

FINDINGS AND RECOMMENDATIONS

Matter from current audit

Controls over expense claims and purchase card transactions

Background

The college's business requires expenditures for hosting, hospitality and travel. These expenditures inherently have a higher risk of including items of a personal nature rather than

[3] *Report of the Auditor General of Alberta—July 2013*, pages 55-80.
[4] *Report of the Auditor General of Alberta—February 2013*, page 59.
[5] *Report of the Auditor General of Alberta—October 2013*, page 94.

strictly a business purpose. In September 2012, the Government of Alberta implemented a new policy for travel, meals and hospitality expenses. The policy is designed to increase the transparency of and accountability for publicly funded expenditures. The Department of Innovation and Advanced Education asked post-secondary institutions to adhere to the new policy and disclosure requirements.

In 2013[6] we recommended that the college strengthen controls over procurement card transactions, as we identified a larger than expected number of expense claim and purchase card transactions that had supporting information deficiencies. In the current year we expanded our examination of purchase transactions to examine the college's systems to review and approve expense claims and purchase card transactions of the college's staff, executive and contractors from July 1, 2011 to June 30, 2013.

RECOMMENDATION 4: IMPROVE CONTROLS OVER EXPENSE CLAIMS AND PURCHASE CARD TRANSACTIONS

We recommend that Alberta College of Art + Design strengthen its controls over expense claims and purchase card transactions by:

- improving documentation to support the business reason for and cost effectiveness of expenses
- improving staff training on their responsibilities for complying with policies
- monitoring expenses and reporting results to the board

Criteria: the standards for our audit

The college should have:

- clearly documented policies and processes for the payment of expenses
- effective processes to independently review and approve purchase card, expense claim and other purchasing transactions before making payments
- periodic reporting of expense report activity of senior management to the board
- controls to recover the cost of transactions that do not comply with college policies

Our audit findings

KEY FINDINGS

- The college's policies do not require staff to state the business reason for expenses on reconciliations or supporting documentation for purchase card transactions.
- Employees do not consistently follow policies for employee travel, hosting and group business meals.
- The college has not implemented corporate processes to ensure expense decisions consider the lowest cost alternative or to assess the results of spending by staff.
- The college does not report to the board on senior employees' expenses.

We reviewed the college's policies related to purchasing and expense transactions. Compared to standards in the Government of Alberta's travel, meals and hospitality policy, the college's policies do not:

- require clear, detailed documentation of a business purpose for the expense
- clearly define working sessions, hospitality expenses and corporate events
- provide clear guidance or limitation on purchases of alcohol by employees

[6] *Report of the Auditor General of Alberta—February 2013*, no. 11, page 66.

Documentation of the business purpose

The college's purchase card guidelines do not require staff to document the business purpose for purchases but rather only require cardholders to submit reconciliations and supporting documents for purchase transactions However, the business purpose of many expenses is not evident from the detailed receipt alone. For example, items purchased for research include movie and event tickets, books and other supplies. Other expenses for meals, groceries, snacks and expenses incurred for hosting artists also lacked clarity. Many of these expenses were submitted with either no indication of the business purpose or a vague business purpose.

The college has professional services contracts where, although payment of some expenses is clearly defined, we were unable to determine the business purpose of some contractors' expense claims. In addition, we identified where one contractor approved the expenses of another contractor.

The college has a liquor policy that outlines the licensing requirements for special events. Other policies, however, such as those for hosting and travel expenses, are silent on the purchase of alcohol for hosted events and in general. We identified instances where alcohol was purchased with meals and where only alcohol was purchased from restaurants and liquor stores, for gifts and for hosted events at private residences. The college should have policies and approval processes for such purchases.

Non-compliance with policy

Travel expenses

Travel expenses may be incurred on corporate purchase cards or staff may claim per diem allowances on expense claims. Processes to review these expenses are insufficient, as there is no review or reconciliation to ensure that:

- an expense claim and purchase card transaction do not claim the same expense
- travel-related receipts and per diems are not duplicated

We found one instance where the same travel expenses were submitted on two separate expense claims. Both claims were paid because the submissions were made months apart. We also identified instances where there was insufficient detail to determine whether meals claimed as per diem expenses and meals paid on purchase cards for the same trip were paid twice.

The college's travel and expense policy states that before incurring any expenses, employees must complete a professional development/travel authorization (PD/TA) form indicating the destination, purpose, estimated total expenses and portion of expenses that the college will pay. The college president or vice-president/director must approve this form before employees incur expenses. We found instances of non-compliance with this requirement including where forms were never submitted, forms were approved after travel costs were incurred, multiple copies of the same PD/TA form were submitted, and forms where the preparation date was later than the approval date.

Approval and purpose for hosting and business meals

The college's policy requires itemized receipts for hosting activities and requires documentation of the business purpose, name of approver and list of attendees. For a sample of hosted meals examined, the majority did not have sufficient detail regarding the purpose of the event and the names and affiliations of the guests.

The college must improve staff understanding of policies through better training and through prompt action by management when instances of non-compliance are identified.

Cost-effective travel

Travelers are required to estimate costs of travel on PD/TA forms; however, the college has no formal process to compare actual to estimated costs. This reduces the college's ability to assess the appropriateness of travel costs and ensure costs are incurred at the lowest cost alternative.

Monitoring processes

The college does not measure the effectiveness of its expenditures on fundraising or hosting to assess the success of its strategies and partnerships. Measuring the results of these activities would confirm that the college is using public funds effectively to meet its needs.

Implications and risks if recommendation not implemented

Without adequate policies and controls related to the review, approval and payment of expenses, the college increases its risk that employees may spend inappropriately, including expensing items of a personal nature. An effective control framework over its expenses will help the college reduce its reputational risk and promote an overall healthy control environment.

Matters from prior audits

Periodic financial reporting—recommendation repeated

Background

In 2008 we recommended that the college improve its processes and internal controls to increase the accuracy and efficiency in its financial reporting.[7] We repeated this recommendation in 2010,[8] as while the college took steps to improve its year-end financial reporting processes, it was still unable to produce accurate year-end financial statements.

We again repeat the recommendation, as the college has not prepared accurate financial statements.

RECOMMENDATION 5: IMPROVE FINANCIAL REPORTING—REPEATED

We again recommend that Alberta College of Art + Design improve its processes and internal controls to increase the accuracy and efficiency in its financial reporting.

Criteria: the standards for our audit

The college should have effective processes for and controls over preparing accurate and complete financial statements.

Our audit findings

KEY FINDINGS

- The college's financial statements contained a number of accounting errors.
- Deficiencies in presentation or disclosures were significant to the college's overall financial statements.

We identified in the draft financial statements a number of accounting errors and disclosure deficiencies. These included a significant amount presented in internally restricted funds not yet approved by the board of governors and incomplete note disclosure of salaries and benefits. Management agreed with the differences and adjusted the financial statements.

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[7] *Report of the Auditor General of Alberta—April 2008*, page 180.
[8] *Report of the Auditor General of Alberta—April 2010*, page 160.

Implications and risks if recommendation not implemented
Without efficient and effective processes, the college may not produce timely, accurate and complete financial reporting at a reasonable cost. This may also result in the board and senior management making decisions based on inaccurate information.

Code of conduct, conflict of interest and fraud policies—recommendation repeated

Background
In 2011 we recommended[9] that the college

- develop, implement and enforce procedures for code of conduct and conflict of interest
- develop and implement a fraud policy that clearly defines actions, responsibilities, authority levels and reporting lines in case of fraud allegations

Management has developed, and the president approved, procedures for a code of conduct, conflict of interest and policies and procedures related to fraud risk identification and mitigation.

We repeat this recommendation as the college has not consistently enforced code of conduct and conflict of interest procedures, resulting in a continued risk of employee non-compliance.

RECOMMENDATION 6: IMPLEMENT AND ENFORCE PROCEDURES FOR CODES OF CONDUCT AND CONFLICT OF INTEREST—REPEATED

We again recommend that Alberta College of Art + Design develop, implement and enforce procedures for code of conduct and conflict of interest.

Criteria: the standards for our audit
The college should define, communicate and enforce codes for acceptable business practices, to ensure a sound control environment. Specifically, the college should enforce procedures for managing codes of conduct and conflicts of interest.

Our audit findings

KEY FINDINGS

- The college still cannot demonstrate that staff comply with procedures.
- The Confirmation of Understanding form signed by staff does not clearly state who is responsible or accountable for their compliance.
- Twenty-five college employees did not confirm their compliance.

The college cannot consistently demonstrate enforcement of its policies and procedures. Letters of employment do not consistently require new employees to confirm they understand and will comply. The college requires all employees to annually sign a Confirmation of Understanding form acknowledging their awareness of and compliance with college policies and procedures. College management has not followed up with the 25 staff members who in fiscal 2013 have yet to supply any documentation supporting their compliance. This form also incorrectly states that the auditor general requires them to comply with the college's procedures rather than college management and the board of governors.

[9] *Report of the Auditor General of Alberta—April 2011,* page 72.

Implications and risks if recommendation not implemented
If the college does not have well-functioning systems to enforce compliance with its conflict of interest and code of conduct procedures, the college may be exposed to economic or reputational risk if employees do not comply.

Improve internal controls at the bookstore—recommendation repeated

Background
In 2013 we recommended[10] that the college improve its internal control systems for its bookstore operations. The college's director of facility and ancillary services manages the bookstore, which sells art supplies and textbooks.

We repeat our recommendation because control deficiencies still exist.

RECOMMENDATION 7: IMPROVE INTERNAL CONTROLS AT THE BOOKSTORE—REPEATED

We again recommend that Alberta College of Art + Design improve its internal control systems for its bookstore operations by:
- properly segregating incompatible job duties
- improving its inventory count procedures and investigating discrepancies between inventory counts and inventory records
- resolving software deficiencies in its inventory management computer application

Criteria: the standards for our audit
The college should have effective internal controls systems at its bookstore. Specifically, it should:
- properly segregate responsibilities of employees to avoid potential for undetected fraud or error
- apply basic procedures including independent verification of counts, to accurately and completely account for inventory
- use operating software that provides reliable management information

Our audit findings

KEY FINDINGS
- Bookstore management duties of the director of facilities and ancillary services are still not properly segregated.
- The college's finance department does not check inventory during the year.
- Deficiencies persist in the bookstore's inventory software.

The college has not assessed the risks associated with the director of facility and ancillary services maintaining the incompatible job duties of bookstore management. The director can still authorize and process transactions, perform reconciliations and approve write-offs on discrepancies in the inventory system. We found no effective compensating controls to mitigate the risks of all these tasks being completed by the same individual.

The college's finance group performed some test counts of inventory at year-end. However, no independent checks are performed during the year on the reliability of counts and the costing of inventory reported in the software application. The group does not follow up on any discrepancies identified during the inventory counts.

[10] *Report of the Auditor General of Alberta—February 2013,* no. 8, page 62.

Limitations relating to the inventory computer application have not been resolved by management. Management is still unable to print key reports such as exception reports and count sheets. Functional knowledge of the software is also still limited. As a result, there is a higher risk that the application may not be working as efficiently or effectively as it could.

Implications and risks if recommendation not implemented

Without good controls over inventory counts and reliable software, the risk of undetected fraud and error increases as does the misstatement of inventory balances in the financial statements.

Implement proper purchase controls—recommendation repeated

Background

In 2013 we recommended[11] that the college ensure purchases are appropriately supported by purchase requisitions and purchase orders, in accordance with its policies and procedures. These weaknesses were first reported to management in 2009. However, the number of non-compliance issues continued to increase over time.

We again repeat this recommendation due to continued compliance issues with policies and procedures.

RECOMMENDATION 8: IMPLEMENT PROPER PURCHASE CONTROLS—REPEATED

We again recommend that Alberta College of Art + Design ensure purchases are appropriately supported by purchase requisitions and purchase orders, in accordance with its policies and procedures.

Criteria: the standards for our audit

The college should have effective controls to ensure that purchases made by staff are supported with authorized purchase requisitions and purchase orders, in accordance with the purchasing procedure.

Our audit findings

KEY FINDINGS

- Some purchase orders were issued after the invoice had been received for payment.
- Some purchase requisitions had a date after the purchase order date.

Similar to the prior year, a sample of purchase transactions tested revealed:

- purchase orders dated after the invoice date, indicating a control deficiency that allowed staff to make purchases before management approved them
- purchase requisitions dated after the purchase order date, indicating a control deficiency that allowed staff to issue purchase orders before management approved the purchase

The college's staff is still able to make purchases without an approved purchase requisition and a purchase order, which is in contravention of the college's purchasing procedure.

Implications and risks if recommendation not implemented

If the college does not have controls to make sure staff comply with its purchasing procedure, the college may pay for inappropriate purchases.

[11] *Report of the Auditor General of Alberta—February 2013*, no. 12, page 67.

Implement a change management policy and controls—implemented

Our audit findings

The college implemented our 2013 recommendation[12] to develop and implement a comprehensive change management policy and effective control processes.

The college implemented its approved change management procedures and standards, which were operating effectively based on our sample testing. The college also obtained assurance that changes made to the Banner system, managed by the Southern Alberta Institute of Technology on the college's behalf, followed an appropriate change management process.

GRANDE PRAIRIE REGIONAL COLLEGE

SUMMARY

We recommend the college improve its systems to ensure compliance with legislation—see page 75.

KEYANO COLLEGE

SUMMARY

The college implemented our recommendation to improve general ledger processes—see below.

FINDINGS

Matters from prior audit

Improve general ledger processes—implemented

The college implemented our 2013 recommendation to improve accounting processes for the general ledger and minimize manual processes when creating its financial statements.[13]

The college minimized the use of manual processes to produce the annual financial statements for the year ending June 30, 2013. Balances for significant areas such as capital acquisitions, deferred contributions and endowments are now pulled directly from the general ledger without manual intervention.

LETHBRIDGE COLLEGE

SUMMARY

The college implemented our prior year's recommendation to improve software patch policies and procedures—see below.

FINDINGS

Matters from prior audit

Improve software patch policies and procedures—implemented

The college implemented our 2013 recommendation[14] to implement an appropriate patch policy and procedures to update and protect the servers that host its enterprise resource planning system.

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[12] *Report of the Auditor General of Alberta—February 2013,* no. 13, page 68.
[13] *Report of the Auditor General of Alberta—February 2013*, no. 16, page 78.
[14] *Report of the Auditor General of Alberta—February 2013,* no. 17, page 81.

The college has defined a schedule and process for testing server patches in a test environment and moving them into production. It is following these processes and schedule consistently.

MACEWAN UNIVERSITY

SUMMARY

The university implemented our prior years' recommendations to:

- improve and implement university policies—see below
- review endowments and related investment policies—see below
- strengthen controls over posting batched financial transactions—see page 84

FINDINGS

Matters from prior audits

Improve and implement university policies—implemented

The university implemented our 2010 recommendation[15] to improve its control environment by implementing and improving a number of policies.

The university:

- finalized board-approved policies for:
  - code of conduct
  - conflict of interest and commitment
  - safe disclosure
  - fraud and irregularities
  - sponsorships, donations and gifts made by MacEwan
- finalized guidelines on allowable expenses and expense reimbursement
- implemented processes to support the new policies
- initiated a strategy to communicate policy changes to employees

The university requires new employees to sign employee conduct, confidentiality and disclosure agreements. Management assessed requiring employees to acknowledge annually that they understand and agree to follow the code of conduct. Management concluded that educational sessions are more effective than annual signatures in promoting ethical behaviours among employees. The board approved management's approach.

Preserve endowment assets—implemented

The university implemented our 2010 recommendation[16] to improve its endowment and related investment policies and procedures.

The university:

- implemented a board-approved endowment policy to determine the amount it can spend from endowment funds
- developed a plan to alleviate encroachment
- established an endowment fund asset allocation guideline that includes specific benchmarks by asset classes for comparing performance to actual results
- improved its reporting to the board's audit and finance, and investments committees

[15] *Report of the Auditor General of Alberta—April 2010*, no. 18, page 174.
[16] *Report of the Auditor General of Alberta—April 2010,* page 170.

Limit use of a system/shared account—implemented

The university implemented our 2013 recommendation[17] to strengthen controls for posting financial transactions, so it can trace transactions to specific users. In 2013, we found that finance employees used a generic system account instead of their own user ID to post batched financial transactions. As a result, there was no traceability to the users who recorded the transactions.

The university improved internal controls by:

- removing the generic system account from the system
- ensuring that the system logs user ID automatically when the user records financial transactions.

MOUNT ROYAL UNIVERSITY

SUMMARY

The university implemented our recommendation to review the adequacy of its financial statements closing process and improve its ability to produce timely and accurate financial statements—see below.

FINDINGS

Matters from prior audit

Improve year-end financial reporting—implemented

The university implemented our 2013 recommendation[18] to review the adequacy of its financial statements closing process and improve its ability to produce timely and accurate financial statements.

The university produced timely and reliable financial statements through:

- a revised schedule and processes to narrow the timelines for the financial statement closure
- university-wide communication to inform staff on proper cut-off procedures
- system changes such as functional improvements to the accounting module it uses for capital and amortization calculation transactions
- stronger quality processes that led to more frequent and expansive management reviews of the draft financial statements, notes and supporting working papers

NORQUEST COLLEGE

SUMMARY

The college implemented our prior years' recommendations to:

- segregate incompatible job duties within the payroll module—see page 85
- provide guidance on employee spending—see page 85
- regularly maintain information systems—see page 85
- improve quality control for year-end financial information—see page 85
- segregate incompatible job duties in its bookstore—see page 85
- improve computer access controls for accountability—see page 86
- improve controls over donations—see page 86
- improve financial internal controls—see page 86

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[17] *Report of the Auditor General of Alberta—February 2013*, no.15, page 73.
[18] *Report of the Auditor General of Alberta—February 2013,* no. 18, page 82.

FINDINGS

Matters from prior audits

Segregate incompatible job duties within the payroll module—implemented

The college implemented our 2013 recommendation[19] to segregate access within the payroll module.

The college segregated access rights between the payroll and human resources departments to ensure that only staff with appropriate authority could set up an employee and their payroll information in the system. No exceptions were identified in our testing of the access controls.

Provide guidance on employee spending—implemented

The college implemented our 2013 recommendation[20] to:

- improve policies and guidelines on appropriate expenses for travel and hosting working sessions and guests
- follow its policies and processes for employee expense claims and corporate credit cards

The college developed and implemented a new travel and business expense policy that provides guidance to staff on appropriate expenditures. For a sample of expense claims and purchase card transactions tested, no exceptions were identified with the application of the policy.

Regularly maintain information systems—implemented

The college implemented our 2013 recommendation[21] to regularly maintain its information systems to reduce the risk of security weakness.

The college improved the security patch management practices for its information systems and reduced the threat of security vulnerabilities to its computing environment. Our testing found the college regularly maintains its servers and has consistently applied security patch updates to critical Windows production servers.

Improve quality control for year-end financial information—implemented

The college implemented our 2012 recommendation[22] to improve its quality control processes for preparing timely year-end financial information to improve efficiency and accuracy. We repeated this recommendation in our February 2013 report.

The college significantly improved the year-end financial statement preparation process by:

- developing guidelines and schedules to ensure year-end financial information is accurate and timely
- adopting a monthly close process
- providing timely and well-supported financial statements with notes and schedules

Segregation incompatible job duties in its bookstore—implemented

The college implemented our 2010 recommendation[23] to appropriately segregate incompatible duties in its bookstore. We repeated this recommendation in our February 2013 report.

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[19] *Report of the Auditor General of Alberta—February 2013,* no. 19, page 84.
[20] *Report of the Auditor General of Alberta—February 2013,* no. 20, page 85.
[21] *Report of the Auditor General of Alberta—February 2013,* no. 22, page 87.
[22] *Report of the Auditor General of Alberta—February 2013,* no. 24, page 89 (originally *March 2012*, no. 7, page 25).
[23] *Report of the Auditor General of Alberta—February 2013,* no. 25, page 90 (originally *April 2010*, page 186).

The college:
- defined clear roles and responsibilities for customer service representatives and the coordinator of business services
- implemented new cash handling and inventory count procedures which our sample testing found to be effective

Improve computer access controls for accountability—implemented

The college implemented our 2013 recommendation[24] to improve its computer access controls to ensure accountability over its information systems. The college established a generic account policy and control procedures to ensure there is appropriate oversight on the use of shared user accounts. Our testing found that management conducted a risk analysis on shared user accounts and disabled those that were not required.

Improve controls over donations—implemented

The college implemented our 2012 recommendation[25] to improve its process to manage donations. The college developed detailed policies and procedures to ensure all donations are tracked and recorded. For a sample of donation receipts tested, no exceptions were identified in the application of the new policy and procedures.

Improve financial internal controls—implemented

The college implemented our 2012 recommendation[26] to improve its reconciliation of financial information, review of journal entries and documentation of these controls. We repeated this recommendation in our February 2013 report.

The college:
- approved invoices according to the college's financial policies and procedures
- prepared accurate and timely reconciliations for accounts payable, capital assets, payroll and cash
- reviewed all journal entries before they were posted in the general ledger

For a sample of invoices and journal entries tested and with the preparation of key account reconciliations, we identified no exceptions.

NORTHERN LAKES COLLEGE

SUMMARY

We have not completed our 2013 financial statement audit to the date of this report as the college did not prepare timely, accurate financial statements. We will again recommend the college improve its financial reporting processes at the conclusion of the audit.

During 2013 we completed our audit of the college's fiscal 2011 and 2012 financial statements and made the following recommendations.

We recommend the college improve its systems to ensure compliance with legislation—see page 75.

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[24] *Report of the Auditor General of Alberta—February 2013,* no. 21, page 86.
[25] *Report of the Auditor General of Alberta—March 2012,* no. 6, page 24.
[26] *Report of the Auditor General of Alberta—February 2013,* no. 23, p. 88 (originally *March 2012,* no. 4, page 22).

We recommend the college improve its financial reporting processes—see below.

FINDINGS AND RECOMMENDATION

Matter from the current audits

Financial reporting processes

Background

Management is responsible for preparing the financial statements and accompanying notes in accordance with relevant accounting standards. Institutions with weak processes to prepare year-end financial statements are likely to experience difficulty preparing timely and accurate periodic financial reports. There is a direct correlation between a strong year-end process to prepare financial statements and the ability to prepare quality financial information throughout the year.

RECOMMENDATION 9: IMPROVE PROCESSES FOR FINANCIAL REPORTING

We recommend that Northern Lakes College review the adequacy of its financial statements closing process and improve its ability to produce timely and accurate financial statements.

Criteria: the standards for our audit

The college should have effective processes to ensure complete and accurate financial statements are prepared and reviewed on time.

Our audit findings

KEY FINDING

- We found significant errors in the draft consolidated financial statements.

The 2011 and 2012 fiscal year-end consolidated financial statements were completed at the same time. The 2011 draft consolidated financial statements had significant accounting errors in capital assets and collections, accounts payable and accrued liabilities, deferred contributions, deferred capital contributions, Government of Alberta grants, federal and other government grants, sales of services and products, and salaries and benefits. In addition to inconsistencies with the recommended disclosures in the Department of Innovation and Advanced Education pro-forma financial statement template, there were presentation errors in the consolidated statement of cash flow and the note disclosures for deferred contributions, related party transactions and balances and the Canada-Alberta Knowledge Infrastructure Program.

We assessed that there was some improvement in the completeness and accuracy of the 2012 draft consolidated financial statements, but we still found significant accounting errors in cash, accounts receivable, accounts payable and accrued liabilities, Government of Alberta grants, federal and other government grants, and sales of services and products. In addition, we found presentation errors in the consolidated statement of cash flow and in the note disclosures for deferred contributions and related party transactions and balances.

Implications and risks if recommendation not implemented

Without processes to ensure its financial statements are complete and accurate, the college may fail to identify material errors or omissions. As a result, there is a higher risk that management and the board may make decisions based on inaccurate financial information.

OLDS COLLEGE

SUMMARY

We have not completed our 2013 financial statement audit to the date of this report as the college did not prepare timely, accurate financial statements. We will again recommend the college improve its financial reporting processes at the conclusion of the audit.

PORTAGE COLLEGE

SUMMARY

We again recommend that the college improve the accuracy of its perpetual inventory system at the bookstore—see below.

FINDINGS AND RECOMMENDATION

Matters from prior audit

Improve controls over bookstore inventory—recommendation repeated

Background

In 2010 we recommended[27] that the college improve the accuracy of its perpetual inventory system at the bookstore. At that time, we noted two college staff performed a physical count of the bookstore inventory at year-end. The inventory system produced an inventory reconciliation report that identified the discrepancies between the results of the physical count and the perpetual inventory listing. The college performed no follow-up work over the discrepancies.

We repeat this recommendation because the college does not know the root cause of significant differences in the accuracy of its bookstore perpetual inventory system.

RECOMMENDATION 10: IMPROVE ACCURACY OF BOOKSTORE INVENTORY—REPEATED

We again recommend that Portage College improve the accuracy of its perpetual inventory system at the bookstore.

Criteria: the standards for our audit

The college's perpetual inventory systems should accurately reflect the amount of inventory on hand. Periodic physical inventory counts should verify the amounts recorded in the system.

Our audit findings

KEY FINDINGS

- Significant variances still exist between the inventory on hand and inventory in the system.
- The college does not sufficiently investigate the variances.

The college:

- implemented the use of a universal product code identifier in its inventory management system
- performed variance analysis when the inventory physical count was different from quantities reported in the system—Significant variances existed in these amounts. The college limited its examination of the variances to assigning a hypothetical rationale for each discrepancy rather than determining the actual root cause.

[27] *Report of the Auditor General of Alberta—March 2012*, no.15, page 34 (originally *April 2011*, page 82).

To fully implement this recommendation, the college should examine its bookstore practices and controls to identify and eliminate the root cause of the discrepancies between the amounts of inventory on hand and that in the perpetual inventory system.

Implications and risks if recommendation not implemented
Without effective systems in place to track inventory, the college has a higher risk of undetected fraud and misappropriation occurring as well as inaccurate financial information at the bookstore.

RED DEER COLLEGE

SUMMARY

The college implemented our recommendation to implement policies and guidance on appropriate expenses for internal working sessions and hosting—see below.

FINDINGS

Matters from prior audit

Systems over costs for internal working session and hosting guests—implemented

The college implemented our 2010 recommendation[28] to:

- implement policies and guidance on appropriate expenses for internal working sessions and hosting guests
- strengthen its processes to ensure staff follow its policies and process for employee expense claims and corporate credit cards

Management improved its policy for hosting, internal working sessions and employee expense claims. We conclude the policy provides sufficient guidance and control. For a sample of transactions tested, no discrepancies were identified with employees applying the policy.

[28] *Report of the Auditor General of Alberta—April 2010,* page 167.

OUTSTANDING RECOMMENDATIONS

The following is a list of outstanding recommendations to public post-secondary institutions. The list does not include the University of Alberta, University of Calgary, University of Lethbridge, Athabasca University or the Department of Innovation and Advanced Education, which were included in our October 2013 report. Institutions are listed alphabetically with recommendations organized from oldest to newest.

MULTI-INSTITUTIONAL RECOMMENDATION

Improve systems to ensure compliance with legislation—February 2013, no. 7, p. 60
We recommend that the post-secondary institutions[29] implement systems to:

- understand what legislation they must comply with
- develop appropriate policies, procedures and controls to ensure compliance with legislation
- monitor and report non-compliance to senior management and board audit committees

ALBERTA COLLEGE OF ART + DESIGN

Improve risk management systems—March 2012, no. 3, p. 19
We recommend that the Alberta College of Art + Design:

- finalize its enterprise risk management framework document
- periodically update and manage the framework as it identifies new potential risks and opportunities
- enforce compliance with its risk management policy by requiring the president and CEO to periodically report the risks and mitigating strategies to the board

Improve controls over contracts—February 2013, no. 9, p. 64
We recommend that Alberta College of Art + Design improve controls over contracts by:

- developing, documenting and enforcing contract procedures
- standardizing contracts with templates that ACAD's legal counsel approves
- developing systems to track and monitor all contracts prepared by all its departments

Implement a disaster recovery plan—February 2013, no. 10, p. 65
We recommend that Alberta College of Art + Design implement and test a disaster recovery plan.

Strengthen controls over procurement cards transactions—February 2013, no. 11, p. 66
We recommend that Alberta College of Art + Design strengthen its processes over the authorization, review and approval of procurement card transactions.

Improve controls over expense claims and purchase card transactions—February 2014, no. 4, p. 76
We recommend that Alberta College of Art + Design strengthen its controls over expense claims and purchase card transactions by:

- improving documentation to support the business reason for and cost effectiveness of expenses
- improving staff training on their responsibilities for complying with policies monitoring expenses and reporting results to the board

[29] As a result of our assessment, we made the following common recommendation to all of the colleges and universities as part of our February 2013, October 2013 and February 2014 reports.

Improve periodic financial reporting—February 2014, no. 5, p. 78
(Originally April 2008, p. 180; repeated April 2010, p. 160)
We again recommend that Alberta College of Art + Design improve its processes and controls to increase efficiency, completeness and accuracy of financial reporting.

Implement and enforce procedures for codes of conduct and conflict of interest —February 2014, no. 6, p. 79
(Originally April 2011, p. 72)
We again recommend that Alberta College of Art + Design develop, implement and enforce procedures for code of conduct and conflict of interest.

Improve internal controls at the bookstore—February 2014, no. 7, p, 80
(Originally February 2013, no. 8, p. 62)
We again recommend that Alberta College of Art + Design improve its internal control systems for its bookstore operations by:
- properly segregating incompatible job duties
- improving its inventory count procedures and investigating discrepancies between inventory counts and inventory records
- resolving software deficiencies in its inventory management computer application

Implement proper purchase controls—February 2014, no. 8, p. 81
(Originally February 2013, no. 12, p. 67)
We again recommend that Alberta College of Art + Design ensure purchases are appropriately supported by purchase requisitions and purchase orders, in accordance with its policies and procedures.

GRANDE PRAIRIE REGIONAL COLLEGE

Improve conflict of interest procedures—February 2013, no. 14, p. 72
We recommend that Grande Prairie Regional College update its policy and procedures, and implement a process for directors and employees to annually disclose potential conflicts of interest in writing, so the college can manage the conflicts proactively.

MACEWAN UNIVERSITY

Systems over costs for internal working sessions and hosting guests—April 2010, p. 165
We recommend that MacEwan University:
- implement policies and guidance on appropriate expenses for events related to internal working sessions and for hosting guests
- follow its policies and processes for employee expense claims and corporate credit cards

Ensure contracts are signed before work begins—April 2011, no. 3, p. 75
(Originally November 2006, no. 9, p. 35)
We again recommend that MacEwan University have signed contracts (interim or final) in place before projects start.

Improve financial business processes—March 2012, no. 1, p. 13
We recommend that MacEwan University improve its financial business processes by:
- establishing clearly documented processes and controls
- developing clear roles and responsibilities and communicating these to staff
- training staff on the policies, processes and controls relating to their roles and responsibilities
- implementing monitoring and review processes to ensure staff follow the policies, processes and controls

Improve security of PeopleSoft computer system—March 2012, no. 2, p. 15
We recommend that MacEwan University improve the security of its PeopleSoft system to ensure that the university:
- uses the system to assign access permissions based on job roles, and properly limit access
- defines, monitors and enforces rules for segregation of duties
- authorizes and reviews logs of critical data changes
- provides appropriate oversight to maintain the integrity of security controls

MEDICINE HAT COLLEGE

Improve enterprise risk management systems—March 2012, no. 12, p. 31
We recommend that Medicine Hat College improve its risk assessment process by:
- documenting its assessment of risks for their impact and likelihood of occurrence
- prioritizing the key risks and clearly linking those risks to a program, operational plan or procedures designed to manage and monitor those risks
- formally reporting the key risks and mitigating actions to the board

Oversight by the board of governors—July 2013, no. 8, p. 62
We recommend that Medicine Hat College provide the Board of Governors with suitable and sufficient information regarding significant events and risks related to the college's international activities; and that the Board of Governors strengthen its processes to:
- ensure it is aware of significant risks the college faces
- monitor compliance of the college's international activities with the board's policies

Strategic and operational planning—July 2013, no. 9, p. 67
We recommend that Medicine Hat College implement systems to:
- clearly define the strategic and operational objectives for its international education activities
- provide business cases that assess the risks, benefits, costs and legal requirements before providing training in foreign countries
- set clear and measurable targets for planned outcomes
- periodically measure and report on progress towards achieving targets, meeting objectives and outcomes

Program management and monitoring—July 2013, no. 10, p. 72
We recommend that Medicine Hat College improve its management of its international education activities by:
- assessing and clearly defining the roles and responsibilities of its International Education Division
- implementing effective program delivery and quality assurance processes at its offshore campuses
- implementing an appropriate system of internal controls, financial reporting and accountabilities for its international education activities
- implementing contract management practices to ensure risks have been appropriately managed
- aligning the structure and management of the division to reflect these changes and to ensure adequate oversight

Improve controls over travel expenses—July 2013, no. 11, p. 77
We recommend that Medicine Hat College improve controls over travel expenses by enforcing its travel policy.

NORQUEST COLLEGE

Improve controls over contracts—March 2012, no. 5, p. 23
We recommend that NorQuest College improve its controls over contract management.

NORTHERN LAKES COLLEGE

Define goals for preserving economic value of endowments—February 2013, no. 26, p. 92
We recommend that Northern Lakes College define its goals for the use and preservation of the economic value of endowment assets.

Improve controls over tuition revenue—February 2013, no. 27, p. 93
We recommend that Northern Lakes College improve controls over tuition revenue by implementing the following processes:
- review the approved fee schedule entered into the accounting system, to ensure completeness and accuracy
- review user access to the accounting system for tuition fees to ensure that roles and level of access are appropriately granted to individuals

Establish accounts receivable write-off policy—February 2013, no. 28, p. 94
We recommend that Northern Lakes College establish an accounts receivable write-off policy to ensure that balances are valid and appropriately valued.

Improve processes for year-end financial report—February 2014, no. 9, p. 87
We recommend that Northern Lakes College review the adequacy of its financial statements closing process and improve its ability to produce timely and accurate financial statements.

OLDS COLLEGE

Improve systems on financial year-end reporting—February 2013, no. 29, p. 95
(Originally April 2011, p. 68; repeated March 2012, no. 8, p. 27)
We again recommend that Olds College further improve its processes and controls over year-end financial reporting.

Improve segregation of privileged user access roles—February 2013, no. 30 p. 96
(Originally March 2012, no. 9, p. 28)
We again recommend that Olds College segregate privileged systems access from data entry responsibilities and business functions.

PORTAGE COLLEGE

Follow access controls and remove access promptly—March 2012, no. 13, p. 32
We recommend that Portage College ensure that employees follow its system user-access control procedures and that management promptly removes access privileges when staff leave.

Develop and test a business resumption plan—March 2012, no. 14, p. 33
We recommend that Portage College fully develop and test a business resumption plan to ensure that it can resume IT services in a reasonable time after a disaster.

Improve information system change management—February 2013, no. 31, p. 98
We recommend that Portage College develop and implement formal change management policies and control procedures to ensure all changes to systems and applications within the computing environment are implemented in a consistent and controlled manner.

Improve accuracy of bookstore inventory—February 2014, no. 10, p. 88
(Originally April 2011, p. 82; repeated March 2012, no. 15, p. 34)
We again recommend that Portage College improve the accuracy of its perpetual inventory system at the bookstore.

RED DEER COLLEGE

Improve general computer control environment—February 2013, no. 32, p. 100

We recommend that Red Deer College improve its general computer control environment by:

- finalizing its risk assessment process and implementing a comprehensive IT control and governance framework for its key processes
- implementing appropriate security over information and information technology assets
- managing changes to computer programs
- testing its disaster recovery plan and then assessing its adequacy

SOUTHERN ALBERTA INSTITUTE OF TECHNOLOGY

IT strategic plan—February 2013, no. 33, p. 101

We recommend that SAIT reassess and update its IT action plan. We further recommend that SAIT develop:

- a project plan with effective controls to ensure its plan is implemented on time and achieves SAIT's strategic objectives
- an effective process to identify, rank and prioritize all IT projects and update plans as needed.

Glossary

REPORT OF THE AUDITOR GENERAL OF ALBERTA

February 2014

GLOSSARY

Accountability The responsibility of an organization (government, ministry, department or other entity) to:
- report results (what they spent, and what they achieved)
- compare results with plans, budgets or goals
- explain any difference between the actual and expected results

Government accountability allows Albertans to decide whether the government is doing a good job. They can compare the costs and benefits of government action: what it spends, what it tries to do (goals) and what it achieves (results).

Accrual basis of accounting A way of recording financial transactions that puts revenues and expenses in the period when they are earned and incurred.

Adverse auditor's opinion An auditor's opinion that things audited do not meet the criteria that apply to them.

Assurance An auditor's written conclusion about something audited. Absolute assurance is impossible because of several factors, including the nature of judgement and testing, the inherent limitations of control and the fact that much of the evidence available to an auditor is only persuasive, not conclusive.

Attest work, attest audit Work an auditor does to express an opinion on the reliability of financial statements.

Audit An auditor's examination and verification of evidence to determine the reliability of financial information, to evaluate compliance with laws or to report on the adequacy of management systems, controls and practices.

Auditor A person who examines systems and financial information.

Auditor's opinion An auditor's written opinion on whether things audited meet the criteria that apply to them.

Auditor's report An auditor's written communication on the results of an audit.

Business case An assessment of a project's financial, social and economic impacts. A business case is a proposal that analyzes the costs, benefits and risks associated with the proposed investment, including reasonable alternatives. The province has issued business case usage guidelines and a business case template that departments can refer to in establishing business case policy.

Capital asset A long-term asset.

COBIT Abbreviation for Control Objectives for Information and Related Technology. COBIT provides good practices for managing IT processes to meet the needs of enterprise management. It bridges the gaps between business risks, technical issues, control needs and performance measurement requirements.

COSO Abbreviation for Committee of Sponsoring Organizations of the Treadway Commission. COSO is a joint initiative of five major accounting associations and is dedicated to development of frameworks and guidance on risk management, internal control and fraud deterrence.

Criteria Reasonable and attainable standards of performance that auditors use to assess systems or information.

Cross-ministry The section of this report covering systems and problems that affect several ministries or the whole government.

Crown Government of Alberta

Deferred maintenance Any maintenance work not performed when it should be. Maintenance work should be performed when necessary to ensure capital assets provide acceptable service over their expected lives.

Enterprise risk management (ERM) The systems and processes within an organization used to identify and manage risks so it can achieve its goals and objectives. An ERM creates linkages between significant business risks and possible outcomes so that management can make informed decisions. An ERM framework helps organizations identify risks and opportunities, assess them for likelihood and magnitude of impact, and determine and monitor the organization's responses and actions to mitigate risk. A risk-based approach to managing an enterprise includes internal controls and strategic planning.

Enterprise resource planning (ERP) Abbreviation for enterprise resource planning. ERPs integrate and automate all data and processes of an organization into one comprehensive system. ERPs may incorporate just a few processes, such as accounting and payroll, or may contain additional functions such as accounts payable, accounts receivable, purchasing, asset management, and/or other administrative processes. ERPs achieve integration by running modules on standardized computer hardware with centralized databases used by all modules.

Exception Something that does not meet the criteria it should meet—see "Auditor's opinion."

Expense The cost of a thing over a specific time.

IFRS International Financial Reporting Standards (IFRS) are global accounting standards, adopted by the Accounting Standards Board of the Canadian Institute of Chartered Accountants. They are required for government business enterprises for fiscal years beginning on or after January 1, 2011.

GAAP Abbreviation for "generally accepted accounting principles," which are established by the Canadian Institute of Chartered Accountants. GAAP are criteria for financial reporting.

Governance A process and structure that brings together capable people and relevant information to achieve goals (the cost-effective use of public resources).

Government business enterprise A commercial-type enterprise controlled by government. A government business enterprise primarily sells goods or services to individuals or organizations outside government, and is able to sustain its operations and meet its obligations from revenues received from sources outside government.

Internal audit A group of auditors within a ministry (or an organization) that assesses and reports on the adequacy of the ministry's internal controls. The group typically reports its findings directly to the deputy minister or governing board. Internal auditors need an unrestricted scope to examine business strategies, internal control systems, compliance with policies, procedures, and legislation, economical and efficient use of resources and effectiveness of operations.

Internal control A system designed to provide reasonable assurance that an organization will achieve its goals. Management is responsible for an effective internal control system in an organization, and the organization's governing body should ensure that the control system operates as intended. A control system is effective when the governing body and management have reasonable assurance that:
- they understand the effectiveness and efficiency of operations
- internal and external reporting is reliable
- the organization is complying with laws, regulations and internal policies

Management letter Our letter to the management of an entity that we have audited. In the letter, we explain:
1. our work
2. our findings
3. our recommendation of what the entity should improve
4. the risks if the entity does not implement the recommendation

We also ask the entity to explain specifically how and when it will implement the recommendation.

Material, materiality Something important to decision makers.

Misstatement A misrepresentation of financial information due to mistake, fraud or other irregularities.

Outcomes The results an organization tries to achieve based on its goals.

Outputs The goods and services an organization actually delivers to achieve outcomes. They show "how much" or "how many."

Oversight The job of:
- providing watchful care,
- checking that a process/system is working well, and
- signaling preferred behaviour.

Performance measure Indicator of progress in achieving a goal.

Performance reporting Reporting on financial and non-financial performance compared with plans.

Performance target The expected result for a performance measure.

PSAB Abbreviation for Public Sector Accounting Board, the body that sets public sector accounting standards.

PSAS Abbreviation for public sector accounting standards, which are applicable to federal, provincial, territorial and local governments.

Qualified auditor's opinion An auditor's opinion that things audited meet the criteria that apply to them, except for one or more specific areas—which cause the qualification.

GLOSSARY

Recommendation A solution we—the Office of the Auditor General of Alberta—propose to improve the use of public resources or to improve performance reporting to Albertans.

Review Reviews are different from audits in that the scope of a review is less than that of an audit and therefore the level of assurance is lower. A review consists primarily of inquiry, analytical procedures and discussion related to information supplied to the reviewer with the objective of assessing whether the information being reported on is plausible in relation to the criteria.

Risk Anything that impairs an organization's ability to achieve its goals.

Sample A sample is a portion of a population. We use sampling to select items from a population. We perform audit tests on the sample items to obtain evidence and form a conclusion about the population as a whole. We use either statistical or judgemental selection of sample items, and we base our sample size, sample selection and evaluation of sample results on our judgement of risk, nature of the items in the population and the specific audit objectives for which sampling is being used.

Standards for systems audits Systems audits are conducted in accordance with the assurance and value-for-money auditing standards established by the Canadian Institute of Chartered Accountants.

Systems (management) A set of interrelated management control processes designed to achieve goals economically and efficiently.

Systems (accounting) A set of interrelated accounting control processes for revenue, spending, preservation or use of assets and determination of liabilities.

Systems audit To help improve the use of public resources, we audit and recommend improvements to systems designed to ensure value for money. Paragraphs (d) and (e) of subsection 19(2) of the *Auditor General Act* require us to report every case in which we observe that:

- an accounting system or management control system, including those designed to ensure economy and efficiency, was not in existence, or was inadequate or not complied with, or
- appropriate and reasonable procedures to measure and report on the effectiveness of programs were not established or complied with.

To meet this requirement, we do systems audits. Systems audits are conducted in accordance with the auditing standards established by the Canadian Institute of Chartered Accountants. First, we develop criteria (the standards) that a system or procedure should meet. We always discuss our proposed criteria with management and try to gain their agreement to them. Then we do our work to gather audit evidence. Next, we match our evidence to the criteria. If the audit evidence matches all the criteria, we conclude the system or procedure is operating properly. But if the evidence doesn't match all the criteria, we have an audit finding that leads us to recommend what the ministry must do to ensure that the system or procedure will meet all the criteria. For example, if we have five criteria and a system meets three of them, the two unmet criteria lead to the recommendation. A systems audit should not be confused with assessing systems with a view to relying on them in an audit of financial statements.

GLOSSARY

Unqualified auditor's opinion An auditor's opinion that things audited meet the criteria that apply to them.

Unqualified review engagement report Although sufficient audit evidence has not been obtained to enable us to express an auditor's opinion, nothing has come to our attention that causes us to believe that the information being reported on is not, in all material respects, in accordance with appropriate criteria.

Value for money The concept underlying a systems audit is value for money. It is the "bottom line" for the public sector, analogous to profit in the private sector. The greater the value added by a government program, the more effective it is. The fewer resources used to create that value, the more economical or efficient the program is. "Value" in this context means the impact that the program is intended to achieve or promote on conditions such as public health, highway safety, crime or farm incomes. To help improve the use of public resources, we audit and recommend improvements to systems designed to ensure value for money.

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