



Key Issues in Establishing a Forensic Audit Capacity

Alan Gilmore

Departments are increasingly grappling with the need to conduct forensic audits. Forensic audits are used to examine allegations or complaints about serious wrongdoing. However, they are complex undertakings that should not be entered into without careful consideration since they are difficult to conduct, are costly, and may not result in definitive conclusions.

This article outlines key issues to consider when establishing a forensic audit capacity that can efficiently and effectively conduct investigations of alleged wrongdoing involving the use of government funds, particularly grants and contributions. The aspects of forensic audits that are reviewed include:

- the key features and characteristics of forensic audits,
- the required competencies of forensic auditors,
- a definition of wrongdoing,
- a method for assigning responsibility for forensic audits,
- the first steps needed to decide whether or not to conduct a forensic audit,
- the nature of the information needed to assess the merits of an allegation,
- ensuring that a department has the authority to conduct a forensic audit, and,
- issues relating to the referral of cases to the RCMP.

What is a forensic audit?

In the federal government, forensic audits usually examine allegations and complaints about wrongdoing involving significant federal funds or assets. The procedures used are designed to gather facts (who, what, how, when and where) in a manner that ensures that any evi-

dence of wrongdoing may ultimately be presented in administrative, civil or criminal proceedings. Forensic audits are more intensive than regular audits and are usually conducted in a series of steps to determine if allegations can be substantiated and to identify the nature of any further work needed. Important first steps are to ensure that the allegation or complaint has merit, that adequate evidence is available, and that a department has the authority to investigate or audit. This is particularly important when a recipient of a grant, contribution, or other transfer payment receives resources from sources other than the department. In this regard, it is also important that the records of the recipient allow for the investigation or audits to trace how a department's funds were used.

Forensic audits require a clear and detailed audit plan that is designed to obtain information on the who, what, how, and where a wrongdoing occurred. Normally, a preliminary examination would be conducted to allow for the assessment of the allegation or complaint in terms of specified criteria such as materiality and impact. An audit plan should have clear objectives and timelines, and identify the skills needed, the estimated cost, and any limitations on the scope of the examinations. Contractors should have statement of work (engagement letter) detailing their role and responsibilities.

What competencies are needed?

Forensic audit reports are usually lengthy and extensively substantiated and contain a clearly documented chronology of events. Whether conducted by external experts under contract or by departmen-

tal staff, the auditors must have the necessary qualifications and knowledge to conduct them. Departmental officials who supervise such audits also need special training.

Experts who conduct forensic audits need special qualifications and knowledge. They will need to become familiar with a program's financial and management controls, and what would constitute a wrongdoing under applicable legislation and policies. In addition, forensic auditors need to:

- have the skills to determine what to examine, what constitutes relevant and valid evidence, where to look for it, and how to obtain or extract it,
- be adept at interviewing departmental and recipient officials; and,
- be able to present findings and explanations in a manner that can be used to support administrative, civil or criminal action.

It should be kept in mind that forensic auditors may be called as expert witnesses in administrative, civil or criminal proceedings. They must therefore be able to testify in an understandable and impartial manner. It should also be noted that departmental officials involved in the administration of the program as well as those responsible for initiating or acting on the results of the audit may be called as witnesses.

What is "Wrongdoing"?

The *Public Servants Disclosure Protection Act* contains definitions of "wrongdoing." It is suggested that the definition of wrongdoing used in the Act be used for the purposes of establishing a forensic audit capability. The Act defines wrongdoing as follows:

- a contravention of any Act of Parliament or of the legislature of a province, or of any regulations made under any such Act;
- a misuse of public funds or a public asset;
- a gross mismanagement in the public sector;
- an act or omission that creates a substantial and specific danger to the life, health or safety of persons, or to the environment, other than a danger that is inherent in the performance of the duties or functions of a public servant;
- a serious breach of a code of conduct established by Treasury Board and the Chief Executive of a public sector agency; and
- knowingly directing or counselling a person to commit any of the preceding wrongdoings.

Who does what?

Establishing a forensic audit capacity may involve reconciling the responsibilities of various investigatory functions in a department.

The major functions that may need to be reconciled are the duties of the departmental Chief Audit Executive and the senior officer designated to receive and deal with the disclosure of wrongdoings. The Treasury Board policies on *Internal Audit* (April 2006) and *Internal Audit Responsibility with Respect to Fraud and Abuse in Government* (September 1986) do not explicitly assign responsibility for conducting forensic audits to departmental internal audit functions. However, they allow for internal audit to be designated as the function responsible for such audits.

However, the *Public Servants Disclosure Protection Act* does require that the deputy minister designate a senior officer to be responsible for receiving and dealing with disclosures of wrongdoing. The procedures established to deal with such disclosures must protect the identity of persons involved in the disclosure process and the confidentiality of information collected in relation to the disclosure. The departmental senior disclosure officer may thus conduct investigations of wrongdoing that are essentially forensic audits. A department may therefore wind up with two groups conducting forensic type audits in an

unco-ordinated manner and with different standards and methodologies.

In theory, the responsibilities of these functions can be easily reconciled through the establishment of a small co-ordinating committee responsible for establishing investigatory standards and reviewing allegations received by internal audit or the senior officer responsible for disclosure of wrongdoing to determine on a preliminary basis whether an allegation should be investigated and which function is best suited to investigate the allegation. However, personalities and procedural concerns may create difficulties that can only be resolved at the deputy minister level.

Generally, a forensic audit capacity would not deal with allegations of harassment, workplace misconduct relating to the terms and conditions of employment, or security violations. There are a variety of Treasury Board policies that cover these situations and set out the ways and means they are to be investigated. However, departments should be aware that allegations may overlap. For example, an allegation of harassment may be associated with reporting a wrongdoing. There may be a need to use the co-ordinating committee to ensure that the separate groups that could simultaneously be investigating related allegations do not compromise each other's investigations.

What are the first steps in assessing an allegation?

The first step in deciding whether or not to investigate an allegation is to conduct a preliminary examination of the validity of the allegation and to consider whether an investigation could be successfully pursued, and who should do it. It is suggested that the following criteria, taken as a whole, could be used to make such a determination:

- whether the allegation or complaint involves a wrongdoing;
- whether adequate information is available to proceed;
- whether the parties alleged to have committed the wrongdoing are identifiable;
- whether the Department will be able to demonstrate it has the authority to conduct an examination;

- whether adequate records and other evidence will likely be available;
- whether the amount of resources at risk is material;
- whether wrongdoing is significant in terms of ministerial accountability to Parliament, and Deputy Minister accountability under the *Federal Accountability Act* and *Financial Administration Act*; and
- whether the allegation or complaint should be immediately forwarded to the appropriate police force.

If the preliminary examination indicates that the available evidence is insufficient or that the department's authority is questionable, then conducting a successful forensic audit becomes very problematic.

What information is needed for an assessment?

Certain basic information is required to enable the assessment of an allegation or complaint. Generally, the following information will be needed to assess the merits of an alleged wrongdoing and whether to pursue it:

- whether the complainant has direct personal knowledge of the alleged wrongdoing;
- how the complainant became aware of the alleged wrongdoing;
- the names of the persons and organizations involved in the alleged wrongdoing;
- the place where the wrongdoing occurred;
- the dates when the wrongdoing occurred;
- how the wrongdoing was perpetrated; and,
- if additional evidence is available and where it may be located.

Does the department have the authority to conduct the forensic audit?

As indicated, one of the key issues that a department's may face in deciding whether to pursue a forensic audit is determining that it has the authority to conduct such an audit. To establish whether or not the department has the required authority involves examining whose resources are at risk and who the potential "wrongdoers" may be.

An alleged wrongdoing may involve departmental resources, resources of other federal departments, agencies and Crown corporations, and non-federal resources. The potential “wrongdoers” may include departmental employees, officials and employees of initial recipients of grants and contributions, and officials and employees of ultimate recipients. The Treasury Board *Guide on Grants, Contributions and Other Transfer Payments* defines initial recipients and ultimate recipients as follows:

- **Initial Recipient:** The initial recipient of a transfer payment agreement who in turn disburses funds to an ultimate recipient.
- **Ultimate Recipient:** An individual or an organization that has entered into an agreement with an initial recipient to carry out the objectives of the original transfer payment agreement.

Generally, a department has the authority to conduct investigations or forensic audits of alleged wrongdoing involving its resources by its employees; alleged wrongdoing involving departmental resources by officials and employees of initial and ultimate recipients of transfer payments, if authorized in transfer payment agreements; and, alleged wrongdoing by recipients involving federal resources transferred by other federal departments, agencies and Crown corporations, subject to the authorization in transfer agreements and by joint agreement with these other entities.

If a transfer agreement does not provide for an audit by the department or only stipulates a requirement for a traditional financial audit, then the department may not have the authority to conduct a forensic audit. Generally, departments will not have the authority to investigate or conduct forensic audits of alleged wrongdoing by recipients involving its resources transferred by unconditional grants unless requested by recipients. Similarly, if a transfer agreement between the initial recipients and the ultimate recipients does not provide for a forensic audit, then the department

will probably not have the authority to conduct an audit of ultimate recipients unless requested by all parties.

The situation can become even more complicated when a recipient’s revenue includes federal and non-federal funds. In such situations, the department needs to ensure that the allegation relates to the use of its funds and that it will be able to show that its funds have been misused rather than funds from another level of government or from private sources.

Making these determinations is important before pursuing a full scale forensic audit. Generally, an auditing firm hired to conduct a forensic audit will assume that their client knows that it has the authority to audit with the result that a significant amount of resources may be expended fruitlessly if such authority is problematic. More proactively, provisions for forensic audits and the need to keep records of how the department’s funds were used could be built into transfer payment agreements.

What about referring cases to the RCMP?

Departments may wish to refer allegations of wrongdoing to the RCMP. In order to make such referrals it would be best if a department established an MOU with the RCMP. Generally, however, departments will find that the RCMP is not prepared to accept or act on a referred allegation without sufficient supporting and organized information. The RCMP like other government entities is working with limited resources and will expect a department to have done its homework before referring a case. The most effective way to obtain the information needed by the RCMP for a referral may be through a system-

atic preliminary assessment and a forensic audit.

Generally, an MOU will require that the department screen allegations to determine whether the wrongdoing constitutes a criminal offence. It will identify the information that the department should send the RCMP. This information will most likely be similar to the information identified above as required and used by the department to conduct a preliminary assessment of the alleged wrongdoing and to determine the validity of the allegation through a forensic audit. As a general policy, it may be best for departments to turnover information to the RCMP based on a search warrant so that technical legal difficulties over the inadmissibility of information can be reduced.

Conclusion

Establishing a forensic audit capacity and conducting forensic audit is a much more complex and risky endeavour than a traditional financial audit or even a performance audit. This article outlines some of the key issues that a department needs to consider when conducting a forensic audit, particularly when making a decision whether or not to conduct a forensic audit of a transfer payment such as a grant or contribution. To ensure that these and other significant issues have been addressed, a department should develop and approve a forensic audit policy that will co-ordinate the various forms of investigation that the department may conduct and establish the standards and procedures based on best practices. Otherwise, a lot of time, energy and money may be spent conducting forensic audits that are not useful.

About the Author

Alan Gilmore, Ph.D., is a former senior principal in the Office of the Auditor General of Canada. He has extensive experience with accountability and governance frameworks, regulatory programs, and management control systems. He is professor of Public Affairs Ethics at Saint Paul University, Ottawa, and he is an Associate with the strategic policy and management consulting firm Sussex Circle. Comments on this article may be sent to argilmore@rogers.com.