



Audit Report

Monetary Appraisal of Acquisitions

Internal Audit Function
Audit and Evaluation Directorate

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EXECUTIVE SUMMARY

Background

The *Audit of the Monetary Appraisal of Acquisitions* was part of the 2011-14 Risk-Based Audit Plan which was recommended for approval by the Departmental Audit Committee and was subsequently approved by the Deputy Head in June 2011.

In order to achieve its mandate, Library and Archives Canada (LAC) acquires archival items from three primary sources: Government of Canada, publishers, and private collections (through purchases and donations). For donations, LAC issues to donors a receipt for the fair market value of their donations which may be used for tax credit purposes.

For the period extending from fiscal 2005-06 to 2010-2011, LAC has completed a total of 500 appraisals for the issuance of tax receipts. The total value of these appraisals and the total value of tax receipts issued was \$20.8 million over this time period.

The objective of this audit was to determine if LAC had policies, systems, and controls in place that were communicated and followed in practice to enable transparent and effective monetary appraisals of acquisitions and subsequent issuance of tax receipts for donations, as per the requirements identified in the *Income Tax Act*.

Findings and Recommendations

Procedures Aligned with Legislation

LAC's documented procedures were aligned to be in compliance with legislative requirements and designed to document key controls.

Key Controls and Supporting Documentation

Acquisition procedures were well understood by LAC personnel; however improvements are required in the application of key appraisal controls. Some key controls were consistently applied and documented, while others required attention. Management should address the weaknesses regarding unsigned Acquisition Proposal forms and the lack of evidence supporting the Major Acquisitions Committee's (MAC) decision to ensure that these key controls are consistently applied and documented. These controls ensure that acquisitions are aligned with LAC's mandate.

The retention of key supporting documentation was not consistent, as evidenced in the acquisition files. The current acquisition file structure made it very difficult to find documentation supporting key controls. Documents were filed in no specific order or logic and different donations relating to a specific collection were mixed within the same file. To maintain a qualified donee status under the *Income Tax Act*, public bodies must keep adequate books and records. On the basis of these

observations, the Canada Revenue Agency (CRA) could determine that LAC does not comply with the *Income Tax Act* requirements in relation to its qualified donee status.

Reporting

A formal and regular reporting mechanism to monitor the status of donation receipts issued or in process was not in place. Management should ensure that monitoring reports are regularly prepared and reviewed. These reports should provide sufficient information to ensure donations are aligned with LAC's mandate.

Audit Conclusion

Overall, LAC's controls for the appraisal of collections for the issuance of tax receipts are properly designed to ensure that appraisals are performed in compliance with relevant legislation; however, areas for improvements were identified regarding:

- the rigour over the application of controls over the appraisal of donations and issuance of tax receipts;
- the expected documentation requirements that must be retained in each donation file; and
- the reporting and monitoring of donations.

Statement of Assurance

This audit engagement was planned and conducted to be in accordance with the internal auditing standards for the Government of Canada.

In my professional judgment as Chief Audit Executive, sufficient and appropriate procedures have been conducted and evidence gathered to support the accuracy of the conclusions reached and contained in this report. The conclusions were based on a comparison of the situations as they existed at the time of the audit and against the audit criteria.



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Acknowledgements

We wish to express our appreciation for the cooperation and assistance afforded to the internal audit team by management and staff during the course of this assurance engagement.

INTRODUCTION

Background

The LAC 2011-14 Risk-Based Audit Plan identified the need for an audit to be conducted to assess the adequacy of the control environment over the monetary appraisal of acquisitions and the issuance of tax receipts following a donation of collection items.

LAC is an organization within the Canadian Heritage portfolio whose mandate includes the acquisition of documentary heritage that best presents an accurate and representative portrait of Canadian society.

In order to achieve this mandate, LAC acquires archival items from three primary sources:

1. Publishers – which have a legal obligation to provide copies of all works published in Canada to LAC (Published Heritage Branch);
2. The Government of Canada's departments and agencies – required to transfer documents that have operational or archival value (Government Records Branch); and
3. Private Collections – donations and purchases (Canadian Archives and Special Collections Branch).

As stated in the *Income Tax Act*, donors of documentary heritage are eligible for tax credits for the fair market value (FMV) of the donation. Tax receipts allow the donors (for individuals) to claim a federal tax credit equal to 15% for donations of less than \$200 and 29% for donations of that amount and over. The receipts also allow donors to claim provincial tax credits which vary depending on the province of residence of the donor.

In addition to the above tax credits, the *Cultural Property Export and Import Act*, allows additional tax incentives for donations of movable cultural property. The Act, which is administered by the Canadian Cultural Property Export Review Board (CCPERB), was established to regulate the import and export of cultural property and provide special tax incentives to encourage Canadians to donate or sell such objects to Canadian public institutions. The tax incentive exempts the donor of any assessment of related capital gains based on the attestation of cultural property by the CCPERB.

LAC's policies require that donations estimated up to a FMV of \$1,000 be appraised internally. Donations with an estimated FMV above \$1,000 must be evaluated by a third party. The National Archival Appraisal Board (NAAB), an independent appraisal society, has been selected as LAC's primary appraiser based on a competitive selection process. In instances where the NAAB does not have the competencies or resources to appraise the donation, LAC may call upon an independent appraiser to perform the appraisal. In addition, all donations above \$5,000 are also presented to the CCPERB for attestation of cultural goods.

The table below provides a summary of the volume of monetary appraisals completed for donations during the fiscal years 2005-06 to 2010-11.

MONETARY APPRAISALS OF DONATIONS						
Fiscal Year	Total Number of Appraisals and Tax Receipts Issued	Source of Appraisal			Application for Cultural Certification (CCPERB)	Value in \$ Millions
		Internally by LAC (\$ 1,000 or less)	NAAB	Other Private Source		
2005-06	99	26	55	18	0	\$6.2
2006-07	114	20	65	12	55	\$4.8
2007-08	85	17	60	14	65	\$3.1
2008-09	107	20	58	8	60	\$3.6
2009-10	94	16	71	7	58	\$3.1
2010-11	1*		1			
Total	500	99	310	59	238	\$20.8

* Note – Appraisal activities ceased during fiscal 2010-11. No tax receipt was issued for this item.

Risk Assessment

A risk assessment was conducted during the planning phase of the audit to ensure the audit focused on the areas of most significance. The following main risks were identified:

- Risk that tax receipts are issued fraudulently and/or not in compliance with the *Income Tax Act*, causing penalties or revocation of LAC’s registered status under the *Income Tax Act*;
- Risk that appraisals of collection items are unreasonable, leading to large differences between initial and final valuations which may create reputational damage and/or result in disputes between the donor and LAC as to the valuation of the acquisition;
- Risk that monetary valuations are performed and tax receipts are issued for items acquired that are not within LAC’s mandate;
- Risk that tax receipts are not issued within the regulated timeframe due to delays in the appraisal process, which may result in potential lawsuit and reputational damage to LAC; and
- Risk that appraisals are incorrect due to lack of specialized knowledge and the nature of the archives.

Objective and Criteria

The objective of this audit was to determine if LAC had policies, systems, and controls in place that were communicated and followed in practice to enable transparent and effective monetary appraisals of acquisitions and subsequent issuance of tax receipts for donations, as per the requirements identified in the *Income Tax Act*.

The audit criteria for this audit were:

- Policies and procedures have been documented and are designed to be in compliance with relevant federal legislation.
- Controls over the appraisal of donations are effectively designed to ensure that appraisals are performed in accordance with relevant legislation.
- Controls over the safeguarding and issuance of tax receipts are effectively designed to ensure that receipts are issued in a timely manner and in accordance with relevant legislation.
- Policies and procedures are communicated to key stakeholders in a timely manner.
- Policies and procedures are understood by key stakeholders and key controls are operating effectively in practice.
- Monitoring is performed to ensure that appraisals are accurate and completed in a timely manner.

Scope

The audit field work was carried out from January to March 2012. The audit focused on the assessment of LAC's policies, procedures, processes and controls over the monetary appraisal of acquisitions and subsequent issuance of tax receipts as per the Canadian *Income Tax Act* and the *Cultural Property Export and Import Act*. The audit covered acquisition transactions (donations and purchases) for fiscal years 2005-2006 through 2010-2011.

Methodology

The audit field work was conducted in accordance with the Government of Canada's *Policy on Internal Audit* and with the auditing standards established by the Institute of Internal Auditors. These standards require that the audit be planned and performed in such a way as to obtain reasonable assurance that the audit objective is achieved.

The audit included various audit procedures as considered necessary to provide such assurance. These included but were not limited to the following:

- Review of documentation including policies, procedures, and work plans related to the monetary appraisal process and issuance of tax receipts;
- Review and mapping of business processes and related internal controls;
- Interviews with key process owners and related personnel to obtain an in-depth view of the strengths and weaknesses of the appraisal process; and

- Review and examination of ninety (90) acquisition files, selected from the MIKAN¹ system for fiscal years 2005-2006 through 2010-2011. All transactions related to “Publisher” and “Government” collections were excluded from the population.

¹ LAC’s collection management system

FINDINGS AND RECOMMENDATIONS

Procedures aligned with legislation

LAC’s documented procedures were aligned with relevant legislations and designed to document key controls.

The Canada Revenue Agency (CRA) requires that the FMV of a gift in kind be determined as of the date of the donation before an amount can be recorded on an official donation receipt. The CRA further recommends that donations with a value greater than \$1,000 be appraised by a competent and qualified independent third party.

The Appraisals and Acquisition Branch had documented policies and procedures² for the appraisal of acquisitions as well as the issuance of tax receipts. These policies specified the requirements for the appraisals of the FMV of donations and required donations in kind to be appraised. The policy further specified that donations with a monetary value greater than \$1,000 be appraised by an external party. The review of these policies and procedures demonstrated that they were effectively designed to be in compliance with the Canadian *Income Tax Act* and the *Cultural Property Export and Import Act*.

In addition, key controls in the acquisition process were effectively designed to ensure that appraisals were performed in accordance with relevant legislation. These key controls are discussed later in this audit report.

We also noted that LAC was in the process of establishing a common framework, the Whole of Society Model (WoSM), for the assessment and acquisition of documentary heritage. Management should ensure that the key controls identified through this audit are considered in the design of the WoSM and associated policy and operational instruments.

Key controls and supporting documentation

Acquisition procedures were well understood by LAC personnel; however improvements are required in the application of key appraisal controls.

Based on the results of the interviews, walkthroughs, and testing of a sample of acquisition files, the audit confirmed that LAC representatives have a solid understanding of the acquisition procedures in regards to monetary appraisals and issuance of tax receipts. In addition, acquisition procedures were available and easily accessible on LAC’s intranet.

² Tax Appraisals and the Certification of Cultural Property – Policies and Procedures

LAC also implemented a number of controls to ensure that monetary appraisals were performed in accordance with relevant legislation. Key controls identified through the audit included the following:

- Standard Contract (Deed of gift): The procedures required that LAC have legal title to the property, and actual custody of it, prior to resources being invested in the appraisal of the collection. A standard deed of gift needed to be signed by the donor and LAC prior to any work being conducted. The deed specified the terms and conditions of the donation and a description of the collection.
- Acquisition Proposal: In order to ensure that acquisitions were in compliance with LAC's mandate, the procedures required that archivists complete an Acquisition Proposal form. The acquisition proposal substantiated the relevancy of the acquisition and required the approval (signature) by the manager.
- Major Acquisitions Committee (MAC): The MAC had the mandate to review major acquisition proposals presented by archivists. Major acquisitions were defined as:
 - purchases with a value greater than \$1,000; or
 - donations with a FMV greater than \$50,000; or
 - acquisitions with a total acquisition value greater than \$75,000.

The MAC's membership consisted of directors general of all branches and was presided by the Director General of the Appraisal and Acquisitions Branch. In addition to approving major acquisitions, the MAC also had a monitoring role in regards to all acquisitions.

- Appraisal: A monetary appraisal is required to substantiate the FMV of the donation. For donations with an estimated monetary value of less than \$1,000, appraisals were performed internally. For donations with an estimated value greater than \$1,000, the appraisal was completed by a third party. All donations with a FMV greater than \$5,000 required certification by the CCPERB.
- Safeguarding of Donation Receipts: Donation receipts were maintained centrally and were only accessible to the Archival Appraisal and Acquisition Coordinator. All receipts required approval (signature) by the Deputy Head.

Based on the results of the review of the acquisition files, the audit team noted the following observations:

- All donation files reviewed contained a deed of gift.
- A strong description of the items acquired was available in the Acquisition Proposal form for all the files reviewed, however the Acquisition Proposal form was not consistently approved by the manager.

- For files where MAC approval was required, none of the files contained documented evidence of approval by the MAC.
- For the donation files appraised internally (donations under \$1,000), all examined files, except for one, contained the required Preliminary Monetary Appraisal form (form ARC-501).
- For donation files appraised externally (donations over \$1,000), all examined files contained an appropriate external evaluation report.
- For donations with a FMV over \$5,000, all examined files, except for two, contained the required certification by CCPERB however for these two files, the CCPERB certification request had been sent but not received by LAC at the time of the audit, while the donation receipt had already been issued based on the NAAB evaluation.
- The retention of key supporting documentation was not consistent, as evidenced in the acquisition files. The current acquisition file structure made it very difficult to find documentation supporting key controls. Documents were filed in no specific order or logic and different donations relating to a specific collection were mixed within the same file.

Management should address the weaknesses noted above regarding the unsigned Acquisition Proposal forms and lack of evidence supporting MAC’s decision to ensure that these key controls are consistently applied and documented. These controls ensure that acquisitions are aligned with LAC’s mandate.

Furthermore, to maintain a qualified donee status under the *Income Tax Act*, public bodies must keep adequate books and records. On the basis of these observations, the CRA could determine that LAC does not comply with the *Income Tax Act* requirements in relation to its qualified donee status.

Recommendation 1:

Management should reinforce the rigour associated with the governance related to the acquisition process to support management decisions.

Recommendation 2:

Management should reinforce the rigour associated with the application of the controls and define the expected documentation requirements that must be retained in each donation file to support key controls. In addition, management should establish a quality control process to ensure that all required documentation has been properly completed.

Reporting

LAC does not have a formal and regular reporting mechanism to monitor the status of donation receipts issued or in process.

LAC implemented a monitoring process for donations currently in the process of being appraised (active donations). Specifically, management implemented a report, known as the pipeline, which provided a summary of the status of the active donation files. However, in the course of the audit, we noted that the pipeline had not been updated on a consistent or timely basis, and that information on the overall status of donation receipts issued was not readily available. Furthermore, the information from the MIKAN system could not be reconciled to the pipeline, and therefore, we were not able to confirm the completeness of the donations.

Although LAC maintained a summary table of donation receipts issued, LAC was not able to provide the audit team with a detailed report to substantiate the donation receipts issued during the period under review. Representatives of the Appraisal and Acquisition Branch confirmed that these reports were not readily available and would require substantial manual intervention to prepare.

By not having the capacity to produce a detailed list of donations, LAC cannot efficiently monitor the issuance of donation receipts and ensure compliance with the *Income Tax Act*.

Recommendation 3:

Management should ensure that monitoring reports are regularly prepared and reviewed. These reports should provide sufficient information to ensure donations are aligned with LAC's mandate.

Appendix A – MANAGEMENT ACTION PLAN

Internal Audit Recommendations	Management Response to the Recommendation	Action(s) to be taken	Estimated Completion Date	Responsibility
<p>1. Management should reinforce the rigour associated with the governance related to the acquisition process to support management decisions.</p>	<p>Management agrees with this recommendation.</p> <p>LAC has implemented a new COO model. Within this restructuring, there will be new roles and accountabilities for various groups. Therefore, a revised governance structure with appropriate controls that support management decisions is needed to support this new organizational structure and workflows.</p>	<p>Management will establish a governance (including decision-making) structure with appropriate controls that support management decisions. A revised procedure will be developed and will include quality control mechanism and approach.</p> <p>Pending completion of the above procedure and control mechanisms, an interim process was put in place in February 2012 which includes additional reviews and approval steps (DG, COO, CFO).</p>	<p>Governance structure and revised procedure drafted by December 2012, communicated to staff and implemented by April 2013.</p>	<p>DG, Documentary Heritage Relevance Assessment</p>

Internal Audit Recommendations	Management Response to the Recommendation	Action(s) to be taken	Estimated Completion Date	Responsibility
<p>2. Management should reinforce the rigor associated with the application of the controls and define the expected documentation requirements that must be retained in each donation file to support key controls. In addition, management should establish a quality control process to ensure that all required documentation has been properly completed.</p>	<p>Management agrees with this recommendation.</p>	<p>A revised procedure will be developed and will include the revised required documentation. In addition, this procedure will include a quality control mechanism and approach.</p> <p>The approval process will be done electronically using the SharePoint system which will include all required documentation.</p>	<p>A revised procedure for delegations will be drafted by December 2012, communicated to staff and implemented by April 2013.</p>	<p>DG, Documentary Heritage Relevance Assessment</p>

Internal Audit Recommendations	Management Response to the Recommendation	Action(s) to be taken	Estimated Completion Date	Responsibility
<p>3. Management should ensure that monitoring reports are regularly prepared and reviewed. These reports should provide sufficient information to ensure donations are aligned with LAC's mandate.</p>	<p>Management agrees with this recommendation.</p> <p><u>Alignment to LAC's mandate:</u> LAC continues to develop an integrated approach to its acquisitions based on its mandate and the whole-of-society approach. All acquisitions will be aligned to this approach and will need to be validated throughout the various components of the model. This has already started but will be formalized in 2012-2013.</p> <p><u>Reporting on monetary evaluations:</u> Given the protected nature of information relating to tax matters, quarterly reports containing detailed case information will be restricted to those responsible for operations (CFO, DG and Director, Appraisal and Acquisition.)</p> <p>A more generic annual report, reporting on overall trends relating to donations for tax appraisal, and indicating any policy or process issues that require attention will be prepared for more general use within LAC.</p>	<p>Quarterly reporting to senior management of the monetary evaluations.</p> <p>Annual report on acquisitions and monetary assessment conducted during the year (content TBD).</p>	<p>Sept. 2012</p> <p>March 2013</p>	<p>DG, Documentary Heritage Relevance Assessment</p>

Appendix B – RISK RANKING OF RECOMMENDATIONS

The following table presents the recommendations and assigns risk rankings of high, moderate or low. Risk rankings were determined based on the relative priorities of the recommendations and the extent to which the recommendations indicate non-compliance with relevant federal legislation and LAC procedures.

Recommendations	Priority Level
1- Management should reinforce the rigour associated with the governance related to the acquisition process to support management decisions.	High
2- Management should reinforce the rigour associated with the application of the controls and define the expected documentation requirements that must be retained in each donation file to support key controls. In addition, management should establish a quality control process to ensure that all required documentation has been properly completed.	High
3- Management should ensure that monitoring reports are regularly prepared and reviewed. These reports should provide sufficient information to ensure donations are aligned with LAC's mandate.	Moderate