INTERNAL AUDIT IN THE CANADIAN FEDERAL GOVERNMENT

In many areas of endeavor Canadians tend to look south for inspiration, but with a time lag of ten or more years. Internal Audit in the Canadian federal government has tended to follow the same pattern.

The US Congress first recognized the potential contribution of internal audit in 1950 in requiring, by statute, that each executive agency include internal audit in the agency’s system of internal controls. In Canada, the Report of the Royal Commission on Government Organizations (the GLASSCO Report), in 1962, recommended that departmental management be responsible for the establishment of proper systems of internal audit, rather than relying exclusively on the Auditor General to identify inadequate financial control.

The Treasury Board’s Guide on Financial Management, issued in 1966, stated that “as the process of decentralizing control to departments proceeds, the need emerges for audits specifically designed to inform both the department and the executive branch of government whether resources are being used legally and effectively”. It went on to say that the audit function “has an important place in all departments to review and appraise the soundness, adequacy and application of all accounting, financial and operating controls”. (See Table at end for a chronological summary of events)

In 1973, the Treasury Board made it mandatory for all departments and agencies to have internal audits performed on their systems of financial administration. Directive 9.1 of the policy stated: Departments shall have financial audits performed, which include:

- Reviewing and appraising the effectiveness and efficiency of departmental systems of financial administration, including the safeguarding of assets, and
- Ascertaining the extent of compliance of departmental systems and procedures with financial policies, regulations and other instructions of Parliament, Treasury Board and the department or agency.

It should be noted at this point that although the scope and practice of internal auditing had thus far been primarily financially oriented, given its private sector roots, many internal auditors recognized that if you yank the financial resources chain hard enough you will inevitably be led to real processes, activities, projects and their respective outputs and outcomes. In North America, the term “effectiveness” began to be used, in addition to the usual economy, efficiency, probity and prudence, and in United Kingdom the term “value for money” was becoming popular.

In Canada, the practice of internal audit in federal government departments and agencies in the 60s and 70s was not by any means restricted to financial audit, Treasury Board pronouncements notwithstanding. During this period the scope of the practice varied from narrowly based, financial auditing to Operational Auditing and Management Auditing, with virtually unlimited scope. As would be expected, the rigour of internal audit practice varied considerably as well, remembering that when you moved any distance from the financial auditing domain, methodology and standards were sparse.
Although the scope of internal audit began to broaden to the edges of their host organizations and somewhat beyond (e.g. to surveying client satisfaction with government goods and services), the rigour of this practice varied considerably. It depended largely on financial audit standards, methods, tools and techniques, mostly borrowed from private sector financial audit literature. The Institute of Internal Auditors (IIA) did not issue its Standards for Internal Audit until 1979.

It should be no surprise that reports by the Treasury Board and the Auditor General came to the conclusion that, with some exceptions, Internal Audit in the federal government was largely ineffective. Partly in response to these reports and partly in recognition of the findings of the Royal Commission on Financial Management (Lambert Commission; 1976 to 1979) the federal government launched a watershed series of initiatives, affecting both internal audit and evaluation, as follows:

- In 1976 Treasury Board approved the creation of the Financial Administration Branch to strengthen financial administration and issued a Treasury Board Circular reasserting the role of internal audit;
- In 1977 Treasury Board launched the Evaluation Function through Circular 1977-47, which was to provide evaluations of the effectiveness of programs;
- In 1978, created the Office of the Comptroller General and issued the Standards for Internal Financial Audit, aimed at the standardization of the scope and performance of internal financial auditing, while recognizing the existence of other forms of internal auditing and review;
- In 1982, in recognition of the growing popularity of broad scoped auditing, the Treasury Board issued the Standards for Internal Audit in the Government of Canada as well as the Principles for the Evaluation of Programs, and its companion Guide for the Program Evaluation Function. These initiatives extended the scope of internal audit to encompass all aspects of program management within the boundaries of their respective organizations, while leaving the evaluation of program outcomes, beyond the boundaries of the organizations to the evaluation function. There remained an overlap, at least potentially, to the extent that program evaluation also included evaluation of the efficiency of the program delivery platform.

The impetus for the next change in the review regime in the federal government came, at least in part, from the 1993 Auditor General’s audits of the internal audit and evaluation functions in departments and agencies. The Auditor General’s Report concluded the internal audit and evaluation functions were, generally, not meeting expectations and that the information for decision-making and for reporting results, provided by the internal audit and evaluation functions, could be better integrated with that provided by management. Parenthetically, the downsizing years resulted in a reduction of, between two-thirds and three-quarters of the federal government audit and evaluation population, a development which, no doubt, contributed considerably to its deteriorating performance during this time period.
The Treasury Board’s response was the Review Policy, issued in 1994. This policy brought together various, Treasury Board performance and review requirements. It was intended to support the principles of managing for results through:

- Emphasizing the responsibility line managers have for demonstrating performance and acting on performance information, and
- Creating a productive alliance between managers and review professionals that will link review more visibly to management decision-making and innovation, as well as accountability practices.

The new policy promoted the use of review to help introduce and credibly assess innovative uses of management reforms and incentives, such as single-window service delivery; strategic use of new information technologies; Special Operating Agencies; quality management; de-layering, decentralization and empowerment; forming service delivery alliances with third parties; new approaches to manage risks better; and flexible operating budgets.

The most recent phase of the evolution of the internal audit practice in the federal government was launched as part of the “Results for Canadians” and “Comptrollership Modernization” initiatives. The main thrusts of the new approach to internal auditing (aside from, once again, separating the Internal Audit and Evaluation functions, includes:

- A new Policy on Internal audit, which repositions the function as a provider of “assurance” services to senior management, which focuses on:
  - Risk management strategy and practices;
  - Management control framework and practices; and
  - Information for decision-making and reporting.

(This policy aims to changes the mix of services to encourage greater use of assurance services, as compared to advise and assist engagements (e.g. consulting services); it also recognizes that internal auditors will be called upon to provide other, related services, such as investigations, control self-assessment facilitation, special reviews, as well. This policy not only shares the review universe with the evaluation function, but with management as well.)

- The establishment of a Centre of Excellence for Internal Audit, at Treasury Board, which will provide the following support to the internal audit community:
  - Policy advice, as well as advice on standards, methodology, practices tools and techniques;
  - Foster the development of audit guidance in key areas;
  - Seek funding for rebuilding departmental internal audit capability;
- Initiate an omnibus recruitment initiative, to help departments to acquire new staff in an expeditious manner;
- Develop internal audit training courses, and
- Provide a liaison service, which deals with internal audit ad-hoc issues in a timely manner and provides a convenient means for feeding important issues from departments to policy authorities and vice-versa.

The Internal Audit Policy component of the Review Policy made no substantive changes to the scope of internal audit but bolstered the professional underpinnings of the practice by integrating Treasury Board and IIA Standards and Ethics provisions. Also, in this policy, frequency requirements were dropped and the concept of risk-based audit planning was introduced.

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