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AUDIT IN THE FEDERAL PUBLIC SECTOR

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EXECUTIVE SUMMARY

The public sector strives to manage public funds responsibly and deliver programs effectively. Both internal and external audits play key roles in supporting these efforts. While complementary, they serve distinct purposes.

External audit focuses primarily on providing an independent opinion on whether financial statements are fairly presented and in accordance with the applicable financial reporting framework. Its findings are typically made public. Internal audit, by contrast, has a broader mandate. It evaluates governance, controls, operations and emerging risks, providing recommendations to improve organizational performance and resilience. Internal audit advice and findings are primarily intended for management and those charged with governance, although they may also be made public. Together, internal and external audit enhance accountability and public confidence.

In the federal public sector, internal audit is governed by Treasury Board policy and guided by recognized professional standards. Internal audit activities are prioritized through risk-based planning, and the internal audit function is accountable to deputy heads through departmental audit committees, helping ensure the audit's independence and objectivity. External audit is performed by the Office of the Auditor General of Canada, which conducts both financial and performance audits. The Auditor General's reports are intended for a broad public audience and provide Parliament and Canadians with independent assurance on the government's financial position and results and program performance.

Internal audit creates value by identifying risks early, strengthening organizational culture, improving operations and supporting informed decision-making. Its role extends beyond financial oversight to areas such as cybersecurity, information technology and human resources.

To be effective, internal audit must be independent, aligned with organizational priorities and adequately resourced. Although challenges such as threats to independence, limited capacity and resistance from auditees may arise, a strong internal audit function remains essential to sound governance, continuous improvement and the effective stewardship of public resources.

AUDIT IN THE FEDERAL PUBLIC SECTOR

1 INTRODUCTION

Canadians expect the federal government to manage public funds responsibly and to deliver programs and services efficiently and effectively. Audit plays an important role in meeting these expectations by providing objective assessments, recommendations and insights on these activities. This work in turn contributes to effective governance, accountability, transparency and the responsible stewardship of public funds.

This HillStudy outlines the roles of internal and external audit, how they differ and how they complement one another, with a focus on the federal public sector. In particular, it examines how internal audit can create value and some of the common challenges the internal audit function faces.

2 INTERNAL AND EXTERNAL AUDIT: CONCEPTS AND KEY DIFFERENCES

2.1 OVERVIEW

Effective governance of an organization requires structures and processes that enable management to achieve strategic objectives, manage risk and support accountability to stakeholders. While an organization might have appropriate processes and reliable reporting in place, audits can provide an objective view of what is working well and what can be improved.

Internal audit and external audit have complementary roles in ensuring accountability. Together, they enhance audit coverage and risk evaluation, and provide a more comprehensive view of operations; they also identify opportunities for improvement. Internal and external auditors conduct their work independently in accordance with professional standards. However, they differ in their mandates, approach and focus. Table 1 compares the key differences between external and internal audit.

Table 1 – Key Differences: Internal Audit and External Audit

Feature	Internal Audit	External Audit
Who Conducts Them	Internal auditors: employees or outsourced professionals (e.g., Certified Internal Auditor)	External auditors: independent third-party professionals (e.g., Chartered Professional Accountant)
Purpose	Improve operations by providing assurance and advice to management and the governing body	Verify financial statements and provide assurance to the governing body and external stakeholders
Scope	Broad and variable Covers operational, horizontal, and emerging areas aligned with the organization's risks and priorities	Defined and fixed Focuses on financial statements and financial information for the reporting period
Key Output	Findings and recommendations to improve risk management, control and governance arrangements	Audit opinion on the financial statements and recommendations to management where appropriate
Reporting	Flexible Reports may be for internal use or shared with external stakeholders	Public Reports are often shared with external stakeholders and the public
Frequency	Ongoing, year-round Provides continuous insight, monitoring and review	Annual or periodic Provides a point-in-time opinion

Source: Table prepared by the Library of Parliament.

Internal and external audit complement each other by providing distinct but equally important forms of assurance:

- Different perspectives – Internal audit brings detailed knowledge of the organization's operations, risks and culture, while external audit provides an independent and objective perspective.
- Audit coverage – Internal audit examines a broad range of operational, governance, risk management and control activities. External audit focuses primarily on financial reporting. Together, they provide more comprehensive assurance than either function could provide on its own.
- Trust and compliance – Internal audit helps strengthen governance, risk management and internal controls through continuous improvement. External audit supports compliance with legislative, regulatory and stakeholder requirements while enhancing confidence in financial reporting.

2.2 INTERNAL AUDIT

Internal audit is an independent, objective assurance and advisory activity. It aims to evaluate and improve the effectiveness of an organization's risk management, control and governance processes.[1] In this context, assurance is a statement intended to increase stakeholders' confidence in whatever issue, condition, subject matter or activity is under review when compared to established criteria. It is a professional assessment that helps build trust. Internal audit also includes advisory services by which internal auditors provide trusted insights on an organization's priority areas.

The internal audit function may be delivered internally, outsourced or provided through a combination of both approaches. It should also be structured through its reporting relationships to ensure integrity, accountability and independence.

Internal audits are planned, performed and reported in accordance with an organization's policies and applicable professional internal audit standards, including the *Global Internal Audit Standards* of the Institute of Internal Auditors (IIA).

Consistent with these professional standards, internal audit work is identified and prioritized through a risk-based approach and plan. By focusing on areas of higher risk or significance, internal audit can provide advice and assurance to help improve the effectiveness and efficiency of an organization's operations. These audits may be performed either periodically or continuously throughout the year. In contrast, external audits are typically conducted periodically after an organization's financial year ends.

2.3 EXTERNAL AUDIT

External audit generally refers to a financial audit, in which an auditor who is independent of and external to the organization examines the organization's financial statements to provide assurance that they are reasonably accurate and free of significant errors, and prepared in accordance with the applicable financial reporting framework. External audit enhances credibility and confidence in financial information to satisfy stakeholder expectations or to meet statutory requirements. External auditors perform procedures and gather sufficient and appropriate audit evidence to support their conclusions and express an audit opinion on the financial statements with a high, but not absolute, level of confidence. The auditor's report provides the audit opinion on whether the financial statements are fairly presented – in other words, whether they accurately reflect the organization's financial results and position based on the underlying transactions and events.

Financial reporting and assurance standards are established by independent standard-setting bodies. Different types of entities have different applicable accounting standards, which seek to address the needs of these entities and the users of their

financial statements. For example, public sector entities, including the federal government, follow Public Sector Accounting Standards, while publicly accountable enterprises, such as companies with publicly traded debt or equity, banks, and many Crown corporations, follow International Financial Reporting Standards.

3 AUDIT IN THE FEDERAL PUBLIC SECTOR

3.1 INTERNAL AUDIT

The federal government's central and departmental internal audit functions examine government-wide and organization-specific matters, providing assurance, insight and objective advice. This work is guided by best practices and conducted in accordance with policy requirements and recognized internal audit standards.[2]

The Internal Audit Sector of the Office of the Comptroller General of Canada (OCG), within the Treasury Board of Canada Secretariat, is responsible for government-wide internal audit policy and professional practices, as well as guidance and engagement across the federal internal audit community and its operations.

The internal audit function of a federal organization reports internally to the deputy head through the departmental audit committee. Departments with annual funding of $300 million or more must have an independent internal audit function. For departments below this threshold, the President of the Treasury Board may direct a department to establish an internal audit function.[3] In addition, smaller departments may rely on the internal audit capacity provided by the OCG.[4]

The federal government's internal audit policy requires that "internal audit resources and capacity are appropriate to the needs of the department."[5] The work of the internal audit function is guided by a risk-based internal audit plan that is updated at least annually. This plan sets out the planned internal audit engagements and the level of assurance to be provided.

Other requirements include providing a formal response to internal audit recommendations and releasing completed internal audit reports in a prescribed manner. Unlike the private sector, where internal audit reports are generally intended for management and governance bodies, in the federal public sector there is greater transparency around the work of internal audit, and reports are often publicly available. This transparency contributes to greater public confidence and accountability.

3.1.1 Recognized Professional Standards

The IIA is an international professional body that sets internal audit standards and guidance and administers the certification of internal audit professionals. The IIA's

Global Internal Audit Standards cover the purpose of internal auditing, ethics and professionalism, governance of the internal audit function, management of the internal audit function and performance of internal audit services. The standards include requirements, implementation guidance and examples of how to document or demonstrate conformance with the standards.[6] As well, a section on applying internal audit standards in the public sector considers some of the unique conditions and circumstances of internal auditing in this context, such as identifying opportunities to improve government processes and programs.[7]

3.2 EXTERNAL AUDIT

The federal government's consolidated financial statements are subject to an independent external audit by the Office of the Auditor General of Canada, the government's legislative auditor.[8] The office is also responsible for performance audits that examine practices, controls and reporting systems to assess how well government manages its activities, responsibilities and resources. These audits consider economy, efficiency and environmental impact and assess whether appropriate measures are in place to determine whether activities are achieving intended results. The Auditor General's reports are intended for a broad public audience.

While discussed only briefly here to illustrate the distinction between internal and external audit, the Office of the Auditor General offers additional resources that explain the important role it plays in supporting accountability and transparency.[9]

4 INTERNAL AUDIT AS A VALUE-ADDED ACTIVITY

Internal audit has the potential to identify and address risks beyond the accuracy of financial information, such as weaknesses in procurement or contracting practices that could impact operations, or human resources policies that could result in toxic work environments or poor succession planning. Internal audit can offer insights to strengthen organizational culture and improve the likelihood that issues or emerging risks are identified early.

According to the United Kingdom's Government Internal Audit Agency,

> [a] robust internal audit approach should help to identify issues upstream. Earlier resolution ensures better outcomes for the public, saving taxpayers' money and leading to the more effective delivery of public services.[10]

Likewise, as noted in a paper on government internal audit functions in Canada, "[a]n important benefit of internal audit is the creation and protection of value, thus generating valuable return on investments."[11]

Internal auditors work across many areas of an organization, and their role extends beyond traditional financial oversight. For example, internal audit expertise in cybersecurity, information technology, human resources and data analytics is increasingly in demand. When providing assurance, internal audit assesses whether appropriate systems and processes are in place to help the organization achieve its objectives and manage risks.[12] Internal audit can also offer trusted support and advice to management. This work can help identify emerging issues and suggest practical improvements.

Internal audit mandates should align with the organization's needs and provide assurance to other key stakeholders, including the public. In this way, the work will be recognized by stakeholders as adding value in the achievement of organizational objectives. To ensure that the internal audit function is objective and free of undue influence, it must operate independently from management.

When internal audit is an integral part of the organization, it contributes to stakeholder confidence, continuous improvement, and organizational readiness and resilience. Its positive impact can be seen in the following ways:

- It increases the effectiveness of governance bodies: Providing an independent assessment of risks and activities that will benefit from oversight and insight on operational effectiveness and efficiency.
- It drives meaningful improvement: Providing insights and assurance aligned with institutional priorities across the areas of greatest risk.
- It strengthens a culture of accountability: Providing objective and independent findings, through engagements that follow a systematic approach and recognized professional standards, which drive specific and timely action plans.

5 CHALLENGES FACED BY INTERNAL AUDIT

Internal audit can have the most impact as an enabling function when its capabilities and work are in alignment with the risks, objectives and priorities of the organization.[13] Nonetheless, the internal audit function faces several challenges. As outlined in a paper from the Organisation for Economic Co-operation and Development, "[p]ublic sector auditors often face various issues such as threats to independence, insufficient audit resources, and non-co-operation from auditees."[14]

Funding and resource constraints mean that audit plans need to be realistic.[15] As well, the overall approach to internal audit and the balance between assurance and advisory work may need to be considered. For example, to overcome resistance, the internal audit function can focus on identifying opportunities for improvement and follow a more collaborative approach with voluntary reporting.[16]

Finally, internal audit functions can be strengthened and held accountable through performance measurement practices and key performance indicators. For example, tracking the percentage of audits initiated each year, the percentage of the audit plan completed (i.e., number of projects completed versus planned), the percentage of recommendations accepted and implemented by auditees, conformance with internal audit standards, client satisfaction ratings, and feedback on whether internal audit work is perceived by stakeholders as adding value.

6 CONCLUSION

Ultimately, internal audit can help improve operations, add value and build trust. Together with external audit, internal audit forms part of the broader accountability framework within the federal public sector. Although challenges such as limited capacity and resistance from auditees may arise, internal audit remains a critical component of good governance, continuous improvement and safeguarding the responsible stewardship of public resources.

NOTES

1. The Institute of Internal Auditors (IIA), *What is internal auditing?*
2. Government of Canada, *Policy on Internal Audit*; and Government of Canada *Directive on Internal Audit*.
3. Government of Canada, *Policy on Internal Audit*.
4. Treasury Board of Canada Secretariat, *Internal audit*. The Treasury Board's responsibility for internal audit is set out in section 7 of the *Financial Administration Act*. See *Financial Administration Act*, R.S.C. 1985, c. F-11, s. 7.
5. Government of Canada, "4. Requirements," *Policy on Internal Audit*.
6. IIA, *Global Internal Audit Standards*, 9 January 2024.
7. IIA, "Applying the Global Internal Audit Standards in the Public Sector," *Global Internal Audit Standards*, 9 January 2024.
8. Office of the Auditor General of Canada (OAG), "What we do," *About us*. The Auditor General of Canada is an independent agent of Parliament and the external auditor of the federal government. In their role as legislative auditor, the Auditor General of Canada carries out financial audits, performance audits and special examinations of Crown corporations. It audits the federal government, Crown corporations and the governments of Nunavut, Yukon, the Northwest Territories and some territorial corporations and agencies.

9 OAG, *Background to the Commentaries on Financial Audits*; and OAG, "What we do," *About us*.

10. United Kingdom, Government Internal Audit Agency, *The role of internal audit identifying early warning signs across the public sector*, News release, 27 March 2025.
11. Canadian Audit & Accountability Foundation and Government Internal Auditors Council of Canada, *Profile of Government Internal Audit Functions in Canada in 2023–2024*, May 2025, p. 7.
12. IIA, *The IIA's Three Lines Model: An Update of the Three Lines of Defense*, September 2024, p. 2.
13. Robert P. Shepherd and Eric Champagne, "Delivering Results for Canadians: Improving the Contributions of Enabling Functions," *Canadian Public Administration*, Vol. 67, No. 4, December 2024.
14. Organisation for Economic Co-operation and Development (OECD), *Enhancing Co-operation Between Internal and External Auditors: Towards a Well-Co-Ordinated and Strengthened Public Sector Audit to Ensure Public Accountability*, OECD Public Governance Policy Papers, 17 December 2024, p. 6.

15. IIA, *2026 North American Pulse of Internal Audit*, 2026, p. 3.

16. Jennifer Ruff, "Internal Audit – Finding a better way," *Canadian Parliamentary Review*, Vol. 45, No. 1, June 2022.