IPPF
International Professional Practices Framework

Implementation Guide

Standard 1110

Standard 1110 – Organizational Independence

The internal audit activity must be independent, and internal auditors must be objective in performing their work.

Interpretation:

Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels.

Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.

Getting Started

Independence is defined as, "The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner." Often, such conditions stem from the organizational placement and assigned responsibilities of internal audit. For example, when internal audit reports within other functions in an organization, it is not considered independent of that function, which is subject to audit. Similarly, if the chief audit executive (CAE) has functional responsibilities broader than internal audit, such as risk management or compliance, internal audit is not independent of these additional functions, which are also subject to audit.

However, the CAE cannot solely determine the organizational independence and placement for internal audit; the CAE needs help from the board and senior management to address independence effectively. Typically, the CAE, the board, and senior management reach a shared understanding of internal audit's responsibility, authority, and expectations, which lays the groundwork for a discussion on independence and organizational placement.

Depending on board and senior management experience and expectations, reaching a common vision may require numerous discussions to increase the awareness of senior management and the board on the importance of independence, the means of achieving it, and key considerations such as reporting lines, professional and regulatory requirements, benchmarking, and organization's cultural issues.

Generally, the internal audit charter will reflect the decisions reached regarding internal audit's responsibility, authority, and expectations, as well as organizational placement and reporting lines.

Objectivity refers to an unbiased mental attitude of internal auditors. To implement this standard, the CAE will want to understand policies or activities within the organization and within internal audit that could enhance or hinder such a mindset. For example, many organizations have standard performance evaluation and compensation policies, as well as employee conflict of interest policies. The CAE will want to understand the nature of relevant policies identified and consider their potential impact on internal audit objectivity. Internal audit will often customize these organizationwide policies to address internal audit roles specifically and may develop other relevant policies specifically for internal audit, such as policies pertaining to training requirements.

Considerations for Implementation

To recognize the mandatory elements of the IPPF in the internal audit charter, the CAE may make specific statements. One example is:

"The internal audit activity will govern itself by adherence to The Institute of Internal Auditors' Mandatory Guidance, which includes the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing, and the Definition of Internal Auditing. The IIA's Mandatory Guidance constitutes the fundamental requirements for the professional practice of internal auditing and the principles against which to evaluate the effectiveness of the internal audit activity's performance."

An alternative to using any specific wording is to use language and content throughout the internal audit charter that require conformance with the Mandatory Guidance.

The CAE's discussion of the internal audit charter with senior management and the board provides a good opportunity to explain the Mission of Internal Audit and the mandatory elements of the IPPF, as well as how the charter recognizes those elements. After the charter has been adopted, it is important for the CAE to monitor The IIA's Mandatory Guidance and to discuss any changes that may be warranted during the next charter review.

As noted above, the CAE works with the board and senior management to avoid conditions that would affect internal audit's ability to perform its responsibilities in an unbiased manner. Often, the CAE has a direct functional reporting line to the board and an administrative reporting line to a member of senior management. The reporting line to the board provides the CAE with direct board access for sensitive matters and enables sufficient organizational status. Administrative reporting to a member of senior management also provides the CAE with sufficient organizational status, as well as authority to perform duties without impediment and to address difficult issues with other senior leaders. For example, the CAE would not typically report to a controller or mid-level manager, who may be subject to audit routinely.

The IIA recommends that the CAE report administratively to the chief executive officer (CEO), both so that the CAE is clearly a senior position and so that internal audit is not positioned within an operation that is subject to audit. The CAE should also be aware of any requirements from regulators or other governing bodies that may specify a required reporting relationship. The Implementation Guide for Standard 1110 – Organizational Independence provides further guidance on CAE reporting relationships.

It is also recommended that the CAE not have operational responsibilities beyond internal audit, as these other responsibilities may, themselves, be subject to audit. In some organizations, the CAE is asked to assume operational responsibilities, such as for risk management or compliance. In such situations, the CAE typically discusses the independence concerns and the potential objectivity impairment with the board and senior management, who will implement safeguards to limit the impairment. Safeguards are oversight activities, generally undertaken by the board, to monitor and address independence conflicts. Examples include periodically evaluating CAE responsibilities, developing alternate processes to obtain assurance related to the additional areas of responsibility, and being aware of the potential objectivity impairment when considering internal audit risk assessments.

To manage internal audit objectivity effectively, many CAEs have an internal audit policy manual or handbook that describes expectations and requirements for an unbiased mindset. Such a policy manual may describe:

- The critical importance of objectivity to the internal audit profession.
- Typical situations that could undermine objectivity, due to self-interest, self-review, familiarity, bias, and undue influence. Examples include auditing in an area where an internal auditor recently worked; auditing a family member or a close friend; or assuming, without evidence that an area under audit is acceptable based solely on prior positive experiences.
- Actions the internal auditor should take if he or she becomes aware of a current or potential objectivity concern, such as discussing the concern with an internal audit manager or the CAE.
- Reporting requirements where each internal auditor periodically considers and discloses conflicts of interest.

To reinforce the importance of these policies and help ensure all internal auditors internalize their importance, some CAEs will hold routine workshops or training on these fundamental concepts. Such training sessions will often allow internal auditors to better understand objectivity by considering objectivity-impairing scenarios and how best to address them.

Further, when assigning internal auditors to specific engagements, the CAE will consider potential objectivity impairments and avoid assigning team members who may have a conflict.

It is widely understood that performance and compensation practices can significantly and negatively affect an individual's objectivity. For example, if an internal auditor's performance evaluation, salary, or bonus are significantly based on client satisfaction surveys, the internal auditor may hesitate to report negative results that may cause the client to report low satisfaction ratings. Therefore, the CAE needs to be thoughtful in designing the internal audit performance evaluation and compensation system and consider whether the measurements used could impair an internal auditor's objectivity. Ideally, the evaluation process will balance internal auditor performance, audit results, and client feedback measurements. The Implementation Guide for Standard 1120 – Individual Objectivity provides further guidance on objectivity.

Considerations for Demonstrating Conformance

Multiple items may indicate conformance with the standard, including the internal audit charter itself; an organization chart with reporting responsibilities; an internal audit policy manual that includes policies on independence, objectivity, addressing conflicts, and performance evaluation; training records; and conflict-of-interest disclosure forms. If applicable, documentation showing disclosure of impairments, consistent with Standard 1130 – Impairment to Independence or Objectivity, may also demonstrate conformance

About The IIA

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 200,000 members from more than 170 countries and territories. The association's global headquarters is in Lake Mary, Fla., USA. For more information, visit www.theiia.org.

About Implementation Guidance

Implementation Guidance, as part of The IIA's International Professional Practices Framework® (IPPF®), is designed to enhance the ability of internal auditors and internal audit activities to achieve conformance with The IIA's Mandatory Guidance. Implementation Guides describe considerations that may be applied and actions that may be taken to implement The IIA's Mandatory Guidance. For other authoritative guidance materials provided by The IIA, please visit our website at www.theiia.org/standards.

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