

Factsheet: Internal Audit Independence and Objectivity

Why this Factsheet?

The Institute of Internal Auditors–Australia (IIA-Australia) is often asked by audit committees and internal auditors a range of questions around internal audit:

- › Independence.
- › Objectivity.
- › Conflict of interest.

This factsheet seeks to provide guidance for various situations which may be encountered in relation to internal auditing.

Definitions

- › **Independence:** The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

- › **Objectivity:** 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.
- › **Conflict of Interest:** Any relationship that is, or appears to be, not in the best interest of the organisation. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively.

Source: Glossary to the International Professional Practices Framework (IPPF) issued by the Institute of Internal Auditors (IIA).

✘	○	✓
Not recommended	Possible with safeguards	Recommended

Internal Audit Mandate and Positioning

A charter approved by the audit committee defines the internal audit mandate.	✓
Internal audit is independent and separated from the line management structure.	✓
Internal audit is part of the line management structure.	✘

Chief Audit Executive

Chief audit executive is an in-house senior management appointment.	✓
Audit committee is responsible for selection, performance assessment and termination of the chief audit executive with input from the chief executive officer.	✓
Chief audit executive reports functionally to the audit committee through the chair.	✓
Chief audit executive reports administratively to the chief executive officer.	✓
Chief audit executive attends all audit committee meetings as a non-voting adviser.	✓
Chief audit executive prepares, manages and executes the internal audit plan.	✓
Chief audit executive is responsible for 2nd line of assurance activities. *Note 1	○
Chief audit executive is responsible for 1st line operational activities.	✘
Chief audit executive reports functionally to line management.	✘

Chief audit executive reports administratively to line management.	x
Chief audit executive is an internal audit service provider.	x
Internal Audit Work	
An internal audit protocol approved by the audit committee defines internal audit and management obligations in relation to internal audit activities.	✓
Internal audit has unrestricted access to the organisation, its people and all activities both financial and operational.	✓
The scope of internal audit work is not limited in any way.	✓
The scope of internal audit work encompasses both assurance and advisory (consulting) services.	✓
Internal audit provides a range of services and not just traditional internal audit engagements – this may include services such as real-time project assurance activities.	✓
Internal audit has unallocated time available in the internal audit plan to provide ad hoc services to the audit committee and senior management in response to emerging risks and issues.	✓
The internal audit plan of work is approved by the audit committee.	✓
Internal audit provides an advisory (consulting) service then later audits it. *Note 2	○
The internal audit plan of work is approved by management.	x
An internal auditor audits something they do not have the capability or skills to audit.	x
Management vets internal audit reports before they go to the audit committee.	x
Internal Audit Service Providers	
Internal audit service providers should be engaged by way of a service agreement prepared and issued by the procuring organisation in its own format.	✓
Service providers should provide the chief audit executive with an attestation that all internal audit work performed has been undertaken by competent and objective professionals without undue influence in respect of the subject, scope or observations of the internal audit work – this would occur annually or for each internal audit service.	✓
Internal audit service provider performs consulting engagements. *Note 3	○
Internal audit service provider is the external auditor.	x
Conflicts of Interest	
The organisation has a process of managing internal audit service provider conflicts of interest, with the audit committee the final arbiter of whether a conflict of interest exists.	✓
Conflict of interest process is for internal audit service provider to self-declare whether consulting engagements represent a conflict of interest and the procuring organisation accepts this.	x

Note 1

Where the chief audit executive may be responsible for internal audit (3rd line assurance) and also non-audit activities such as risk management (2nd line assurance), safeguards need to be put in place to provide some measure of separation of the dual roles. The chief audit executive should never also be responsible for 1st line operational activities such as procurement.

Additional wording to be included in the internal audit charter to provide safeguards where there is chief audit executive responsibility for a non-audit activity could be:

Where the person occupying the role of chief audit executive may be responsible for a non-audit activity, there are independence safeguards in place:

- › *When responsible for a non-audit activity, the chief audit executive is not performing audit duties when managing or performing that activity; and*
- › *Review of non-audit activities must be managed and performed independently of the chief audit executive and reported direct to the audit committee.*

Note 2

There is a requirement that internal auditors must refrain from assessing specific operations for which they were previously responsible. The Internal Audit Standards offer guidance on this, stating that objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year – ‘auditing your own work’. However, every instance should be carefully assessed and a period of more than one year may be necessary to ensure internal auditor objectivity is not impaired.

Note 3

From time-to-time, another part of an organisation may seek to engage the internal audit service provider to perform consulting engagements. There may be a problem if there is potential for conflict of interest. The easiest way to avoid a potential conflict of interest is to confine the service provider to internal audit work and not permit consulting engagements. In saying this, there may be occasions when the internal audit service provider’s knowledge, or one of their previously completed audits, means they have useful information which may take another service provider some time to obtain which can result in a potentially lengthier engagement time and higher cost to the organisation. The following steps should be in place:

- › It should be communicated to all management they are not permitted to engage the internal audit service provider for consulting services without sign-off by the audit committee, in accordance with the formal conflict of interest policy.
- › The arbiter of whether a conflict of interest exists should be the audit committee – it should never be the service provider.
- › For transparency, all such consulting engagements should be incorporated into the internal audit plan at the time they occur and the report provided to the audit committee.