Implementation Guide 1130

Standard 1130 – Impairment to Independence or Objectivity

If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

Interpretation:

Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest; scope limitations; restrictions on access to records, personnel, and properties; and resource limitations, such as funding.

The determination of appropriate parties to which the details of an impairment to independence or objectivity must be disclosed is dependent upon the expectations of the internal audit activity's and the chief audit executive's responsibilities to senior management and the board as described in the internal audit charter, as well as the nature of the impairment.

Revised Standards, Effective 1 January 2017

Getting Started

The standard requires the chief audit executive (CAE) to disclose real or perceived impairments to independence or objectivity. Therefore, the CAE must have a clear understanding of independence and objectivity requirements, as described in the Code of Ethics and standards 1100, 1110, 1111, 1112, and 1120. Further, by communicating these requirements to the board and senior management, the CAE will help ensure that they understand the criticality of independence and objectivity for an effective internal audit activity. Generally, the board and senior management will want to discuss how and to whom impairments are disclosed, depending on the nature and potential impact of the impairment.

To fully understand and appreciate independence and objectivity, it is important that internal auditors consider the perspectives of their various stakeholders and the conditions that could be perceived as undermining (or appearing to undermine) independence or objectivity. Often, the CAE will develop an internal audit policy manual or handbook that includes a discussion of organizational independence and internal auditor objectivity, the nature of impairments, and how internal auditors should handle potential impairments.

Considerations for Implementation

As noted above, to effectively manage independence and objectivity, including impairments, many CAEs have an internal audit policy manual or handbook that describes the related expectations and requirements. In addition to defining *independence* and *objectivity*, such a manual may identify the specific related standards; describe the types of situations that could create, or appear to create, impairments; and specify the expected actions the internal auditor should undertake if faced with a potential impairment.

Impairment situations generally include self-interest, self-review, familiarity, bias, or undue influence. These situations can lead to personal conflicts of interest, scope limitations, resource limitations, or restrictions on access to records, personnel, or properties. Internal audit examples of organizational independence impairments include the following, which, if in effect, can also undermine internal auditor objectivity:

- The CAE has broader functional responsibility than internal audit and executes an audit of a functional area that is also under the CAE's oversight.
- The CAE's supervisor has broader responsibility than internal audit, and the CAE executes an audit within his or her supervisor's functional responsibility.
- The CAE does not have direct communication or interaction with the board.
- The budget for the internal audit activity is reduced to the point that internal audit cannot fulfill its responsibilities as outlined in the charter. (Standard 2020 – Communication and Approval, provides further guidance on communicating the impact of resource limitations.

Examples of objectivity impairments include:

- An internal auditor audits an area in which he or she recently worked, such as when an employee transfers into internal audit from a different functional area of the organization and then is assigned to an audit of that function. (Standard 1130.A1 specifically addresses this situation).
- An internal auditor audits an area where a relative or close friend is employed.
- An internal auditor assumes, without evidence, that an area being audited has effectively mitigated risks based solely on a prior positive audit or personal experiences (e.g., a lack of professional skepticism).
- An internal auditor modifies the planned approach or results based on the undue influence of another person, often someone senior to the internal auditor, without appropriate justification.

Often, the internal audit policy manual describes the appropriate actions for an internal auditor to take should he or she become aware of, or concerned about, such impairments. Typically, the first step is to discuss the concern with an internal audit manager or the CAE to determine whether the situation is truly an impairment and how best to proceed.

Both the nature of the impairment and board/senior management expectations will determine the appropriate parties to be notified of the impairment and the ideal communication approach. For example:

- When the CAE believes the impairment is not real, but recognizes there could be a *perception* of impairment, the CAE may choose to discuss the concern in engagement planning meetings with the operating management, document the discussion (such as in an audit planning memo), and explain why the concern is without merit. Such a disclosure may also be appropriate for a final engagement report.
- When the CAE believes the impairment is real and is affecting the ability of internal audit to perform its duties independently and objectively, the CAE is likely to discuss the impairment with the board and senior management and seek their support to resolve the situation.
- When an impairment comes to light after an audit has been executed, and it impacts the reliability (or perceived reliability) of the engagement results, the CAE will discuss it with operating and senior management, as well as the board. (Standard 2421 – Errors and Omissions states that if a final communication contains a significant error or omission, the CAE must communicate corrected information to all parties who received the original communication.)

The CAE is usually personally involved in determining the best disclosure approach.

Considerations for Demonstrating Conformance

Multiple documents may demonstrate conformance with the standard, including an internal audit policy manual that includes policies on independence, objectivity, addressing conflicts, and the nature of impairments, and how to communicate them. Other documentation may include board meeting minutes, if impairments to independence or objectivity were discussed; memos to file; or reports that contain such disclosures.

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