Chapter 7
INDEPENDENCE AND OBJECTIVITY:
A FRAMEWORK FOR RESEARCH OPPORTUNITIES IN INTERNAL AUDITING

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I. Introduction

Amid a global drive to improve organizational governance, internal auditors face many challenges and opportunities, including increasingly complex and pervasive technology, a need for new skills, flattening organizational structures, demand for an expanding scope of services, and increasing competition and globalization. Internal auditors are developing new strategies to meet these challenges and are becoming more proactive, providing a broadened variety of services and otherwise changing the internal audit model. As the demand for the variety and amounts of non-audit services increases, the need for appropriate guidance and standards for assuring professionalism and especially objectivity in audit services also increases. In addition, the organizational positioning and independence of the internal audit function itself becomes increasingly important.

The purpose of this particular chapter is to discuss the concepts of independence and objectivity within the context of internal auditing and to suggest topics for future research. Internal auditing as a profession is described and within that context the importance of independence of the internal audit function and objectivity of internal auditors is discussed. Professional standards promulgated by The Institute of Internal Auditors and the General Accounting Office of the United States government are described and a framework is offered that may be used by internal auditors and the internal audit function in identifying and managing threats to internal auditor objectivity. Specific threats to objectivity are identified and discussed as well as mitigating factors and tools for managing those threats. Many research questions are raised to promote research that will increase our understanding of conflicts of interest faced by internal auditors and how best to promote and maintain internal auditor professionalism and objectivity and the independence of the internal audit function.

II. The Demand for Independence and Objectivity in Professions

As noted in Independence and Objectivity: A Framework for Internal Auditors (IIA, 2001), a profession is defined as:

“A calling requiring specialized knowledge and often long and intensive preparation including instruction in skills and methods as well as scholarly principles underlying the skills and methods, maintaining by force of organization or concerted opinion, high standards of achievement and conduct and committing its members to continued study and to a kind of work which has for its prime purpose the rendering of a public service.”

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Three components of professionalism, namely integrity, competence, and the use of due care are relevant to the internal audit profession. **Integrity** is an uncompromising adherence to a code of moral values, and the avoidance of deception, expediency, artificiality, or shallowness of any kind. The importance of **integrity** comes from the idea that a profession is a “calling” and requires professionals to focus on the idea that they are performing a public service. **Competence** means having the intelligence, education, and training to be able to add value through performance. **Competence** comes from “long and intensive preparation, including instruction in skills and methods as well as scholarly principles underlying the skills and methods,” and the commitment to “continued study.” Professional standards are generated “by force of organization or concerted opinion” and lead to the use of **due care**.

The use of **due care** has many components and requires that attention be paid not only to the nature of the professional services performed but also to the manner in which they are performed. It is important that the services offered are appropriate to the task and that such services are carried out in accordance with professional standards when available and in accordance with the highest standards of professional conduct when not available. Cooley on Torts, a legal treatise, describes the obligation for due care as follows:

> Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment (Haggard, 1932).

The definition of a profession is silent on the importance of objectivity when making assessments, judgments, and decisions. It is clear, however, that the necessary and sufficient conditions for value-adding professional services include objectivity along with the three components of professionalism, as described above. An individual can be very objective in the sense that they observe evidence in an unbiased manner. If that individual does not have integrity, a component of professionalism, he or she may choose to act inappropriately in the face of evidence obtained. Along the same lines, that individual may not be competent or may not use due care and thus may not use the evidence in the appropriate manner.
Objectivity ensures that unbiased assessments, judgments, and decisions will be made. Objectivity, integrity, competence, and due care collectively are necessary and sufficient conditions for value adding assurance and consulting services.

A user of professional services relies on the professional because he or she does not have the level of competence needed to conduct the services themselves. The user trusts and expects that the professional has integrity and competency and will use due care. The user also trusts that the professional will make objective assessments, judgments, and decisions while carrying out the professional services and will not be biased by any circumstances. Thus, the patient expects that the MD will order an MRI because he believes that it is necessary for assessing the patient’s conditions and not because the MD has part ownership in the MRI machine and receives a payback every time it is used. Likewise an investor expects that the analyst will only give a buy rating when the underlying fundamentals are good and the stock is expected to do well and not because the analyst owns stock in the company and wants to influence the stock price.

On a broad level, the above discussion of a profession and professionals applies to any profession, whatever the subject matter or specialized context. In every case, one expects that the competent professional has integrity and will use due care to make objective assessments, judgments, and decisions. If those conditions are present, then the professional services offered are value adding. On another level, however, the professions differ in the nature of the assessments, judgments, and decisions that are made and in the environmental forces that, on the one hand, operate to ensure that such services are value adding and, on the other, that lead to inappropriate assessments, judgments, and decisions. Clearly internal auditing is a profession and value-adding and effective assurance services offered by internal auditors require \textit{objectivity, integrity, competence}, and the use of \textit{due care}.

\textit{Academic Research}

Although research on the need for independence and objectivity for professionals in general appears scarce, Michael Davis, a professor of philosophy at the Illinois Institute of Technology, and Andrew Stark, a professor of management at the University of Toronto, recently edited a collection of essays on conflicts of interest in a variety of professions, including the law, anthropology, literary and art criticism, investment banking, and medicine (Davis and Stark, 2001). An analysis of this publication may provide useful insights into the nature of conflicts of interest relevant to internal auditors, how and why they may compromise objectivity, when they may not, and the best way to avoid and/or manage these conflicts.
Research Questions

- Are the concepts of independence and objectivity important to other professions?
- Which professions and why?
- How do other professions implement the demand for independence and objectivity?
- Are approaches used in other professions relevant to the internal auditing profession?

III. Independence and Objectivity Defined

Although the literature is not necessarily consistent in its precise definitions of independence and objectivity, it is generally agreed that objectivity relates to the quality of the assessments, judgments, and decisions that are activities of any assurance or consulting service, and independence relates to the state of the environment in which the assurance or consulting service takes place. Specifically, objectivity is defined as a state of mind in which biases do not inappropriately affect assessments, judgments, and decisions while independence is defined as freedom from material conflicts of interest that threaten objectivity. Objectivity is a desired characteristic of the individual or team who make choices among the full set of assurance service possibilities and of the individual or teams who are engaged in the performance of assurance services and who are making the necessary assessments, judgments, and decisions. Independence is a desired characteristic of the environment in which the assurance services are performed by the individual or team; i.e., it is desirable for the individual or team to be free from material conflicts of interest that threaten objectivity. Conflicts of interest can arise from the individual’s or teams’ personal environment or from the general environment in which the activity takes place.

Academic Research

A seminal publication by Mautz and Sharaf (1961) discusses independence and describes several meanings of the concept. They note that Carey (1961) discusses two meanings of independence for professional auditors. One he called “the self-reliance of any professional person” and the other is described as the special kind of independence, an “honest disinterestedness” in the results of his or her work that arises because of the public’s reliance on an auditor’s work. Mautz and Sharaf note that they agree that a practitioner should maintain an honest disinterestedness to promote unbiased judgments and consideration of the facts as determinants of a final opinion. They also believe, however, that in order for a practitioner to have this honest disinterestedness, he or she must have a thorough
understanding of the pressures and factors, “some of which may be so subtle as to be scarcely recognizable,” that may color or influence that disinterestedness. They suggest the recognition of programming independence (the auditor has sole control over the nature of the audit program), investigative independence (the auditor is free to collect and evaluate all the evidence deemed necessary without interference), and reporting independence (the auditor is free to report the results of the audit without interference) as concepts that will help a practitioner achieve honest disinterestedness.

Research Questions

- Are there different or better definitions of independence and objectivity?
- Do the conceptual ideas of independence and objectivity for external auditors apply to internal auditors?
- Do or should the definitions of independence and objectivity differ across professions?
- Are programming, investigative, and reporting independence important to the internal audit profession? Why or why not?

IV. Independence and Objectivity and the Internal Auditing Profession

Whether it is assurance services provided by internal auditors working for a given company, outsourced internal audit assurance activities with minimal internal auditor involvement, or outside experts providing the services, both independence and objectivity remain important for internal auditors and the internal audit function. The differences across the various ways in which internal audit services are offered lie in the types of conflicts of interest that are faced because of differing incentives and environmental forces that are faced.

The definition of internal auditing found in the overview to this report provides some clues as to the incentives and environmental forces faced by internal auditors. Management employs internal auditors, yet these same internal auditors are also often asked to review the performance of management and others. In addition, management often relies on internal auditors for consulting services and incorporates audit recommendations into the reengineering of business processes. Auditors, in their role as assurance providers, evaluate these processes. The combination of the internal auditor’s dependence on management, the increasing importance of internal audit activities, the growth in the demand for internal audit consulting activities with the resultant problem of internal auditors assessing their own work
product, and increasing internal audit outsourcing leads to escalating concern about internal auditor objectivity.

There are situations, for example, where an internal auditor may have special knowledge and skills to undertake an in-house project but such participation may raise concerns about a potential compromise of objectivity through a lack of independence. The company faces the trade-offs of allowing the project to go forward and managing the associated independence/objectivity risks, or using more costly outside experts or outsourcing providers to complete the project with the internal auditors only playing a monitoring/review role, or the adverse trade-off of simply dropping the project. Internal auditors, because of the nature of the services they perform, gain a deep knowledge and understanding of the company. As such they face conflicts of interest simply because they are the only ones who understand, can undertake, and/or are qualified to perform such consulting services. If they then perform related assurance services, conflicts of interest (i.e., threats to objectivity) arise.

Much of the literature on independence of auditors (specifically external auditors) has differentiated between independence in appearance and independence in fact (often called independence of mind). Standards and the firms themselves have generally focused on controlling various situations and relationships of the auditors that constitute a real or perceived conflict of interest, including the assurance of firewalls between auditing services and any other service that would give rise to a conflict of interest. Most recently, events such as the downfall of Enron, Adelphia, WorldCom, and Global Crossing, among others, have led to a focus on prohibiting the firm rather than just an individual auditor from providing services that appear to conflict with the provision of assessments, judgments, and decisions related to auditing services. It remains to be seen whether similar prohibitions for the internal audit function will arise because of these problems.

In the case of internal auditing the organizational positioning of the function and the nature of activities undertaken both will dictate the set of conflicts of interest (i.e., the threats to objectivity) faced by individual auditors. Some organizations find it cost-effective to have a fully autonomous internal audit unit with high-level reporting to the organization’s audit committee or other similar body. Other organizations may not have achieved the economies of scale necessary to justify a separate internal audit unit. Between these two extremes, there are many different types of internal audit units with various organizational structures, differing scopes of responsibility, and differing reporting levels. In addition, the specific type of internal audit activities varies from organization to organization based on factors such as organizational size, type of operations, capital structure, and the legal and regulatory environment. In some organizations, the work of internal auditors is confined to special assurance and consulting
projects for management. In these situations, management is the only user of the internal audit work, and the only party that derives direct benefit from that work.\textsuperscript{4} In other organizations, the internal audit function may provide both assurance and consulting services to a variety of other users both within and outside the organization, such as governing bodies (e.g., boards of directors), regulators, external auditors, customers, and suppliers.

The particular role and placement of the internal audit unit in an organization determines the degree of reliance that should be placed on the assurance and consulting services provided. An internal audit unit with a broad assurance and consulting role ideally should report directly to the governing board of the organization and more specifically to the audit committee of the board or other similar body. Those functions with a narrowly defined role may report to an appropriate lower level of management. The degree of reliance that can be placed on any assurance service is a function of the type of assurance services provided, the conflicts of interest inherent in the organization of the internal audit activity, and the professionalism and objectivity of the assurance service providers. However, even if the status is relatively autonomous, if it serves as a training ground for management, problems may arise since the trainee learns the internal audit function and then goes and works for a unit being audited…they will know how to hide the problems and/or fraud.\textsuperscript{5}

In evaluating the appropriate organizational status of the internal audit unit, it should also be recognized that the value of the audit work might be enjoyed indirectly from those constituents that are not direct beneficiaries of the audit reports. For example, external auditors may have greater confidence in internal controls because they know an effective internal audit unit reviews the system. Similarly, the governing body of an organization may obtain assurance about overall control from the fact that the internal audit unit performs risk assessment to determine the appropriate areas to audit. The knowledge that risk assessment and monitoring is being performed may provide implicit assurance in areas beyond those explicitly examined and reported on by internal auditors.

As noted earlier, internal auditors are also being asked to provide assurance to parties outside the organization. For example, regulatory agencies occasionally require reports by management that may include assurances by the internal auditors. In addition, customers and suppliers are beginning to request assurances about such matters as the organization’s controls over the confidentiality of shared information, particularly in electronic commerce cases. Providing credible assurance to these outside parties requires the highest degree of organizational status and autonomy on the part of the internal audit unit. Indeed as internal auditors become more involved in reporting to outside parties, should there be any evidence of conflicts of interest and possible biased reporting, litigation possibilities may become a reality.

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The key point in this discussion is that the organizational status of the internal audit unit correlates with the scope of engagements that can be undertaken, with the conflicts of interest that will be faced and with the level of reliance that may be placed on assurance and consulting services provided by the internal audit function. When there is high-level reporting, the scope of potential engagements is less limiting and the conflicts of interest are less significant; when there is lower-level reporting, the reporting universe (i.e., the population of users who could benefit from the audit reports) becomes more limited and the conflicts of interest are more significant. The larger the function, the more permanent the staff and the higher up in the organization the function is placed, the less conflicts of interest will be faced.

**Academic Research**

Much of the research on auditor independence and objectivity has been conducted in the external audit realm. For information on the particular issues in that sector and an analysis of research, see the still-active Web site for the now defunct Independence Standards Board, for research commissioned by that board, http://www.cpaindependence.org/, and the Web site of the AICPA for a white paper on independence issues that they commissioned, http://www.aicpa.org/members/div/secps/isb/white.htm. Some, but not necessarily all, of that research is relevant in the internal audit realm.

Recent research by Geiger, Lowe, and Pany (2002) examines how loan officers view and make decisions based on loan proposals within the context of various relationships between the applicant, the auditor that performs the external audit, and the auditor that performs the internal audit function, whether in-house or outsourced to the applicant’s external auditor. The results support the position that having outsourced internal audit services performed by the company’s external auditor does not, by itself, appear to negatively affect financial statement users’ perceptions of auditor independence and other related decisions. The results also support the position that if the external auditors are associated with internal audit activities, they should not perform any management functions as part of the outsourced internal audit work. The results also provide support for internal audit outsourcing if there is a requirement that the engagement team for the external audit and internal audit activities remain separate. More research is needed on issues related to independence and objectivity for internal auditors and the internal audit function.

**Research Questions**

- What are the differences, if any, in the conflicts of interest faced by internal and external auditors?
• What are appropriate controls (firewalls) for those internal audit units that provide both consulting and assurance services?

• Do outsourced internal audit activities result in greater internal auditor objectivity?

• Do governance, control, and/or audit failures occur more often in firms where the internal audit function provides both assurance and consulting services?

• What are litigation risks for internal auditors who fail to show objectivity in their judgments?

• Will legal exposure change for internal auditors in the post-Enron/WorldCom environment?

• What is an appropriate model to determine the degree of reliance that may be placed on internal audit assurance service activities?

• What is the relation between the organizational positioning of the internal audit function and the overall effectiveness and independence of the organizational governance system?

• What is the relation between the organizational positioning of the internal audit unit and company performance in the capital markets?

• What is the relation between the organizational positioning of the internal audit unit and the occurrence and detection of fraudulent company activities?

• What is the relation between the organizational positioning of the internal audit unit and financial reporting quality?

• How do external auditors make assessments of the work of internal auditors? Do they assess independence and objectivity? If so, how?

• Other than the direct employment relationship, what are the differences in the relationships between internal auditors and management and external auditors and management?

• Do these differences in relationships drive differences in objectivity threats?
• What are differences between perceptions of independence and objectivity and actual independence and objectivity in the internal audit realm?

• What can we learn about independence and objectivity related to internal auditing from the Enron, WorldCom, and the seemingly countless other failures? Where were the internal auditors?

• What is (was) the nature of the internal audit function in Enron, WorldCom, Adelphia, Global Crossing, and other such companies?

V. Standards for Internal Auditors Related to Independence and Objectivity

The Institute of Internal Auditors, in the attribute standards, recognizes the importance of differentiating between an independent internal audit activity and the objectivity of the internal auditors as follows:

1100 – Independence and Objectivity: The internal audit activity should be independent, and internal auditors should be objective in performing their work.

1110 – Organizational Independence: The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.

1110.A1: The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results.

1120 – Individual Objectivity: Internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest.

The attribute standards also attempt to provide guidance on activities that may lead to impairments of independence and objectivity and call for disclosures when there is impairment.

1130 – Impairments to Independence or Objectivity: If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties. The nature of the disclosure will depend on the impairment.
1130.A1: Internal auditors should refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an auditor provides assurance services for an activity for which the auditor had responsibility the previous year.

1130.A2: Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal audit activity.

1130.C1: Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.C2: If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure should be made to the engagement client prior to accepting the engagement.

The United States government’s General Accounting Office (GAO) recently issued an amendment to government auditing standards related to independence. The standards note that internal auditors play a vital role in government auditing and should be free from organizational impairments to independence. They also note, however, that since internal auditors report to management while external auditors are responsible to third parties outside the audited entity, a fundamental difference exists between internal and external auditors. As such, the amendment to the standards acknowledges the difference by focusing the discussion on organizational impairments when reporting internally to management. Specifically, Section 3.30.5 of the amendment states:

...A government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management if the head of the audit organization meets all of the following criteria:

a) Is accountable to the head or deputy head of the government entity,
b) Is required to report the results of the audit organization’s work to the head or deputy head of the government entity, and
c) Is located organizationally outside the staff or line management function of the unit under audit.

Only in such cases where there is organizational independence can top management rely on reports from the internal audit organization.
Because objectivity is itself difficult to measure, independence has been relied upon as a surrogate measure of an unbiased assessment, judgment, or decision related to assurance services. Consequently, professional standards have focused on assuring that assurance service providers are free from conflicts of interest rather than focusing on assuring that objective assessments, judgments, and decisions are made. It is difficult, if not impossible, and even counterproductive, for standards to list all possible threats to internal auditor objectivity. However, it is important to provide a framework for thinking about such threats. To make unbiased assessments, judgments, and decisions while performing assurance services, the internal audit function and internal auditors must be able to manage threats to objectivity even if there are no standards to guide actions. The ability to manage threats to objectivity is an important signal to governing boards, stakeholders, and other external parties that internal audit activities can be relied upon to provide assurance about control, compliance, and other relevant matters. The next section of this chapter provides a model for managing threats to objectivity.

**Academic Research**

There is no research on internal audit standards, how they are used by internal auditors, or the effects of such standards on the behavior and objectivity of auditors or on the organizational placement of the function.

**Research Questions**

- With regard to IIA Standard 1130.A1, is a year an appropriate period of time?
- With regard to IIA Standard 1130, how can one measure the impairment of objectivity?
- With regard to IIA Standard 1130.C1, if internal auditors provide consulting services relating to operations for which they had previous responsibility, can they still provide objective assurance services for that unit?
- Are there other standards that may help to assure independence of the internal audit function?
- Are there other standards that may help to assure objectivity for internal auditors?
- How do internal audit functions implement IIA Standards?
• What are the effects of the IIA Standards on the organizational positioning of the internal audit function?

• What are the effects of the Standards on the objectivity of internal auditors?

• Does the focus of governmental auditing standards on organizational impairments to internal auditor independence apply to nongovernmental internal auditors?

• Does the idea from governmental auditing standards that internal auditors are responsible solely to management apply to nongovernmental internal auditors?

VI. A Framework for Managing Threats to Objectivity

Independence and Objectivity: A Framework for Internal Auditors (IIA, 2001) provides a comprehensive framework for managing threats to objectivity. This framework focuses directly on the goal of objectivity at the engagement and personal levels by requiring internal auditors to identify threats to their objectivity. Further, internal auditors are required to assess and mitigate those threats, and assess whether they can be objective given the steps they have taken to mitigate the threats identified. The framework recognizes the fact that objectivity is a state of mind. The assessment of threats to objectivity and their mitigation or management is largely a process of self-assessment by internal auditors (albeit subject to ex ante training/education and ex post internal/external reviews). The framework relies heavily on the professionalism of individual auditors and their supervisors. Internal auditors must be aware of potential cognitive biases that can cloud self-assessment judgments and ethical behavior in such situations. They also must accept the responsibility to manage and disclose threats to their own objectivity and accept departmental, organizational, and professional-level monitoring and reviews of the objectivity management process.

The goal of the framework shown in Exhibit 7-1 is to articulate a more rigorous process for self-regulation in the internal audit environment. The proposed framework, which assumes an appropriate audit scope based on the organizational status of the internal audit unit, is shown in the diagram below. The specific elements of the framework are discussed in detail following the diagram.
Exhibit 7-1
Managed Objectivity Framework for Individuals

**Identify Threat.** The first responsibility of auditors within the managed objectivity framework is to identify possible threats to objectivity. Any situation or circumstance that may cause internal auditors to question their ability to act without bias must be identified as a threat. Even seemingly insignificant threats to objectivity should be identified in this first stage. Threats identified by auditors should be conveyed to the unit or engagement manager so that he or she can proactively participate in the process of managing threats to objectivity.

**Assess Significance of Threat.** The second stage of the framework requires auditors to assess the significance of threats to objectivity identified in the previous stage. Assessing significance requires those performing internal audit services to consider whether threats might compromise their objectivity and whether seemingly insignificant threats could intensify during the conduct of the audit. The assessment of the significance of threats must be considered both in the context of immediate circumstances and expected or reasonably possible changes in circumstances through the course of the audit.
**Identify Mitigating Factors.** After identifying and assessing the significance of threats to objectivity, internal auditors should then identify specific mitigating factors present in the environment that may alleviate the threats. Mitigating factors could include, but are not limited to, job security issues, reputation capital, and legal/professional exposure. Internal auditors should take care to identify relevant mitigating factors in determining whether the threat can be mitigated, and if so, how to best mitigate the risk of compromised objectivity.

**Assess Residual Threat.** After identifying mitigating factors for related threats to objectivity, an internal auditor must then determine whether these factors have sufficiently mitigated the threats to allow them to perform their assigned audit work such that the risk of ineffective assurance services is minimal. The internal auditor must be cautious to avoid assuming that the factors have adequately mitigated all of their objectivity risks and should make this assessment (and others) from the perspective of persons relying on their judgments. In cases where significant residual threats exist, or if the internal auditor is not entirely sure of his or her own objectivity, the assessment should be made or reviewed by the chief audit executive or, when necessary, senior management and/or the audit committee.

**Proactively Manage Residual Threat.** Threats to objectivity that are not sufficiently offset by mitigating factors should be appropriately managed by the assurance service providers to the extent possible to ensure assurance procedures are performed without bias. Suggested tools to manage residual threats to objectivity include, but are not limited to, third-party review, separation of audit duties, or contracting of work to another party.

**Assess Presence of Unresolved Threats to Objectivity.** As assurance procedures are performed, the internal auditor should assess whether objectivity will be achieved to determine whether or not to perform the assigned assurance work. In this stage, the internal auditor must review any remaining threats that (1) were not previously identified or (2) could not be adequately resolved through the identification of mitigating factors or management efforts. Should the internal auditor determine that significant unmitigated and unmanaged threats to objectivity remain, he or she, in conjunction with appropriate parties, should then assess whether it is necessary or practical to perform the work. In most cases, it will be advisable to inform likely users of the services about the unresolved threats prior to commencing assurance work. If, after advisement and consultation, the decision is that the work should be performed despite unresolved threats to objectivity, reporting implications should be carefully considered.
Consider the Reporting and Documentation Implications. Identified mitigating factors and steps taken to manage threats to objectivity must be adequately documented to provide an accurate record of auditors’ efforts to achieve objectivity. This record will provide valuable information to the governing body of the organization and to professional quality assurance review teams and may be useful should a concern arise as to internal auditors’ objectivity. Further, if the decision is made to undertake work in the presence of material, unresolved threats to objectivity, internal auditors should report the details of the situation to the appropriate level, such as senior management, the audit committee, or the board of directors (or its equivalent) on a continuing or periodic basis, as appropriate. Unresolved threats should also be disclosed in the assurance services report of the engagement. Such communication prevents users from unknowingly deriving unwarranted assurance from work that was performed in the presence of a significant unresolved threat to objectivity.

Ex Post Review and Monitoring. The ex post review and monitoring process begins with the individual internal auditor, who can do a self-review at the end of the audit to determine if judgments were made in the most objective manner possible. This individual review is enhanced by a comprehensive review of the assurance team as a whole. The chief audit executive would conduct an overall review of the assurance program and related engagement staffing for the period to determine that objectivity was effectively managed on every assurance engagement. This would be determined by noting appropriate staffing and the acceptance of engagements compatible with the role of the internal audit unit in the organization. In addition, the director would review and monitor the process for managing threats to objectivity for individual assurance services. As part of the organizational governance function, audit committees or other like bodies can also be part of the ex post monitoring and review process. Finally, the internal audit profession requires quality assurance reviews of internal audits. These reviews can be extended to a peer review of the levels of internal audit involvement in the objectivity management process. Ex-post review and monitoring will help to counterbalance the possible cognitive bias inherent in a self-review process.

Exhibit 7-2 presents a “Framework for Managing Threats to Objectivity” at all levels of auditor involvement.
Level I depicts individual internal auditor level issues and is the point at which threats to objectivity are identified and proactively managed. It is also at the individual level that internal auditor professionalism (i.e., competence, integrity, and the use of due care) is fostered.

Level II depicts engagement-level issues. The engagement level is where a review of individual auditor objectivity and related threats would take place, as well as the standard review of audit practices, procedures, and judgments.

Level III depicts issues at the level of the internal audit department. This is the point at which the chief audit executive takes steps to enhance objectivity such as rotation of auditors on engagements. The chief audit executive would also be responsible for reporting any unmitigated residual threats to objectivity to the audit committee or other appropriate parties and for assuring that objectivity is appropriately managed on all engagements. The chief
audit executive may want to consider outsourcing an engagement if objectivity could not be managed to an appropriate degree.

Level IV depicts organization-level issues. The internal audit department must be given the freedom to appropriately manage threats to objectivity. It also should be encouraged by management to do so actively. Management policies should be established to ensure that auditors are not punished for pointing out problems in the organization. Ultimately, the chief audit executive should be actively involved with the audit committee or similar bodies to ensure the highest level of objectivity and integrity of audit activities.

Level V depicts the profession level and encompasses activities by professional bodies such as The Institute of Internal Auditors. These professional bodies can ensure that standards and guidance are promulgated that will enhance the internal auditor’s ability to manage objectivity and can continue to offer certification opportunities to enhance professionalism. They also can help to assure process quality through quality assurance peer reviews and certification opportunities. In financial and some regulated industries, higher thresholds for accountability may necessitate government review of objectivity documents. In other environments, regulatory encouragement and endorsement could oftentimes provide additional reinforcement on compliance with professional requirements. Further, educational programs can be devised to focus on enhancing objectivity and on an understanding of the literature that helps auditors identify and understand threats to objective judgments, rather than the memorizing lists of “independence” rules.

Academic Research

There are no previous academic efforts at devising a framework for managing threats to internal auditor objectivity. However, in the March 2002 edition of the Society for Judgment and Decision Making’s JDM Newsletter, Society President George Loewenstein wrote a letter that analyzed what behavioral decision research has learned about conflicts of interest. This is important work and very relevant to a discussion of managing threats to internal auditor objectivity.

Loewenstein argues that behavioral decision research can contribute a psychologically grounded perspective on a problem that has been traditionally viewed through an economic lens. He notes that in media coverage of conflicts of interest, the underlying and widely held theoretical perspective is that succumbing to a conflict of interest is a matter of conscious and deliberate choice. However, behavioral decision research provides a different perspective. That research shows that people are generally unaware that they process information in a biased fashion and that, when they are informed about the bias, they generally accept that it exists but believe that it does not apply to them.
Each perspective has its own implications for policy-making. Loewenstein notes that if succumbing to a conflict of interest were a deliberate matter, the problem could easily be cured with appropriate incentives or through inculcation of professionalism. He notes as examples the medical profession that has initiated training programs to help medical students to think independently and the auditing profession where there were then discussions at the SEC of increasing penalties for proven cases of auditor bias. One common remedy Loewenstein notes is, as we offer above, disclosure. Disclosure is supposed to lead to more objectivity on the part of the decision maker or will allow the user of the information to appropriately discount what they are reading. On the other hand, disclosure may lead professionals to feel as if they have discharged their professional responsibilities and may then cease trying to be objective. A final solution discussed by Loewenstein is that of limiting the magnitude of incentives, e.g., limiting the dollar amount of consulting internal auditors may do. Behavioral research, however, finds that bias is severe even with minimal incentives.

So if succumbing to conflicts of interest is deliberate, it can be managed by appropriate training, incentive schemes, and disclosures. On the other hand, if it is unconscious and unintentional, then, Loewenstein argues, the only effective route is to eliminate the conflict of interest. Some of the examples he lists as candidates for prohibition include: Politicians should not be in a position to be bought out by private interests, public accounting firms should not be offering consulting work, security analysts should not be analyzing securities in which they or their company have a private interest, board members should not be permitted to do business with the companies on whose boards they serve, doctors should not be allowed to accept gifts from pharmaceutical companies, and academics whose salaries are paid by universities should not be funded by firms that have an interest in a particular research finding.

**Research Questions**

- Are there other frameworks that would help internal auditors to manage threats to their objectivity?

- How do internal auditors in practice and internal audit functions manage threats to objectivity?

- Are internal auditor reactions to conflicts of interest more deliberate or unconscious and unintentional?

- Can internal auditor reactions to conflicts of interest be changed through training?
• Can internal auditor reactions to conflicts of interest be changed through disclosure of the conflicts?

• Can internal auditor reactions to conflicts of interest be changed through minimization of the conflict?

VII. Identifying and Managing Threats to Objectivity

While it is important to have a framework for guidance on how to manage threats to objectivity, it is perhaps even more important to have guidance in identifying the actual threats that may arise and any safeguards that may mitigate the effects of the threats. While there have been a few attempts to put a framework around the identification of threats and safeguards, offered here is that provided in Independence and Objectivity: A Framework for Internal Auditors (IIA, 2001). The publication identifies several categories of threats, including self-review, social pressure, economic interest, personal relationship, familiarity, cultural, racial, and gender bias, and cognitive bias. Each of these categories is briefly described below.

**Individual Threats**

1. **Self-review**

   Self-review threats may arise when an auditor reviews his or her own work. For example, an auditor may audit a department repeatedly, reviewing operations in one year that were previously reviewed in a prior year. Or, the auditor may provide consulting services in connection with a system implementation that he or she must subsequently audit. Or, the auditor may provide recommendations for operational improvements and subsequently review the operations that were revised in accordance with those recommendations. All of these examples represent situations where the auditor could, conceivably, become less critical or observant to errors or deficiencies due to the difficulty of maintaining objectivity when reviewing one’s own work.

2. **Social Pressure**

   Social pressure threats may arise when an auditor is exposed to, or perceives that he or she is exposed to, pressures from relevant groups. This situation may occur when the auditor, for example, has inadvertently “cried wolf” in the past when there were no problems. Pressure from the audit customer or group could drive the auditor to overlook suspicious items. Another form of social pressure could occur when an audit team member is reluctant to oppose a generally held view on the part of the audit team itself (a phenomenon labeled as “groupthink” in behavioral literature).
3. Economic Interest
An auditor may have stock options or other financial interests that might be threatened by negative audit findings. This threat also arises when the auditor audits the work or department of an individual who may subsequently make decisions that directly affect the auditor’s future employment opportunities or salary.

4. Personal Relationship
This threat may arise when an auditor is a close relative or friend of the manager or an employee of the audit customer unit. The auditor may be tempted to overlook, soften, or delay reporting negative audit findings to avoid embarrassing the friend or relative. Such a threat is magnified if there are any romantic relationships between the auditor and an employee of the auditee in work environments.

5. Familiarity
This threat may arise due to an auditor’s long-term relationship with the audit customer or when the auditor has formerly worked in the customer unit. Familiarity may lead an auditor to lose perspective on an audit by making the auditor overly sympathetic to the customer. Alternatively, familiarity may lead an auditor to prejudge an audit customer on the basis of previous problems (or non-problems) and assume a posture consistent with the prejudgment rather than taking a fresh, objective look.

6. Cultural, Racial, and Gender Biases
This threat may arise from cultural, racial, or gender biases. For example, in a multidivisional entity, a domestically based auditor may be biased or prejudiced against audit customer units located in certain foreign locations. Or, an auditor with limited understanding of a host culture may be unduly critical of different practices and customs. Or, an auditor may be unduly critical of audit customer units managed or staffed by employees of a particular race or gender.

7. Cognitive Biases
This threat may arise from an unconscious and unintentional psychological bias in interpreting information depending on one’s role in a situation. For example, if one takes a critical audit perspective, one may overlook positive information and, conversely, if one takes a positive facilitative perspective, one may discount negative information. In addition, an auditor may come in with certain preconceived notions and may then tend to see evidence confirming such notions.
**Combinations of Threats**

Although seven individual categories are used for expository purposes to enhance the clarity of the examples provided, there could be circumstances when two or more categories of threats are present at the same time. For example, many internal auditors provide control self-assessment services that involve working with audit customer representatives and facilitating their review of risks and controls. A number of threats can arise in these circumstances. For example, self-review threats may arise if an auditor acts as a facilitator and subsequently is assigned to review the controls that were the subject of the control self-assessment exercise. Also, social pressure threats may arise if the facilitating auditor feels pressure to not “breach the trust” placed in the self-assessment process by the participants who candidly reveal system weaknesses. In this context, an auditor may be concerned that future self-assessment exercises would be undermined by negative audit findings. Furthermore, when an auditor takes on a facilitating role, he or she may become too familiar with some audit customers, developing personal relationships that could make it difficult to be critical of those audit customers. Or, the auditor may develop unconscious cognitive biases due to the positive facilitative role adopted in the self-assessment process by interpreting information about the auditees more positively than objectively called for and seeking confirmatory information.

While the auditor may only be dealing with individual threats in some cases, in many situations there will be multiple threats, multiple mitigating factors, and multiple management tools used to address residual threats. Therefore, a comprehensive and integrated approach in identifying, assessing, and managing potential threats to objectivity is recommended.

**Threats at the Unit Level**

To this point, the examples that have been provided have all been at the individual level. However, the proposed framework for managing objectivity can be applied at the internal audit unit level as well. Some have suggested that certain activities, such as consulting services and control self-assessment services, performed by the internal audit unit may threaten the unit’s objectivity and result in role conflict. For example, if a unit provides extensive management consulting services, threats to objectivity may arise in the form of self-review threats and familiarity threats at the unit level. Self-review threats may arise when the same unit is involved in implementing an entity-wide management information system and subsequently is engaged in reviewing the same system.
Providing consulting services does not in and of itself necessarily compromise objectivity, particularly if the auditor is involved primarily in an advisory capacity rather than a decision-making capacity and there is no reason to presume that the auditor’s objectivity is automatically compromised. A professional internal auditor and internal audit unit, within the context of the framework described herein, should be able to recognize potential threats to objectivity in subsequent audit assignments related to the earlier consulting service, consider mitigating factors, and take appropriate action to reduce or eliminate residual threats to objectivity.

**Mitigating Factors**

The identification of potential threats is the starting point for the process of managing such threats to objectivity. As mentioned previously, there may be mitigating factors that limit the significance of identified potential threats. Mitigating factors would be considered in the context of specific circumstances; however, identified here are a number of mitigating factors that may counteract potential threats to objectivity. The following list is not intended to be exhaustive. Rather, it is intended to illustrate the range of mitigating factors that may reduce or eliminate threats to objectivity.

**Organizational Position and Policies:** The auditor/audit unit’s organizational position and policy statements at various levels addressing customer relations may bolster the auditor’s position in the organization and create disincentives for audit customers to influence or intimidate auditors. Such policies can provide insulation from being punished for raising management’s awareness of a problem.

**Environment — Strong Organizational Governance System:** A supportive environment, in both the internal audit department and the company as a whole, that encourages learning and continuous improvement may reduce the perceptions of failure associated with flaws in recommendations, system implementation processes, and other advice. Thus, auditors and audit customers would be less fearful of potentially negative outcomes and of reporting on possible prior mistakes. A significant component of a supportive environment is the audit committee. A strong audit committee is of crucial importance in assuring auditor objectivity and professionalism.

**Incentives (Rewards, Discipline):** A system of rewards and disciplinary processes in both the internal audit unit and in the company as a whole can reduce threats to objectivity. For example, an environment that rewards critical and objective thinking or penalizes bias or prejudice can encourage objectivity in the face of these types of threats.
Use of Teams: A key aspect of objectivity involves corroboration of assessments, judgments, and decisions by others. The use of teams rather than individuals to conduct assurance services can help diffuse cognitive biases, familiarity, personal relationship threats, and self-review threats. One caution that must be raised here is the risk that social pressures may cause a team member to be fearful of expressing a view opposing the generally held team view (i.e., due to “groupthink”) or the view of a socially powerful team member.\(^\text{14}\)

Supervision/Peer Review: Studies of accountability in auditing indicate that review processes and their attendant impact on audit judgments through performance incentives, justification requirements, and feedback can mitigate individual biases. The anticipation of peer and supervisory review may also increase an auditor’s self-awareness and help to avoid potential biases or other threats to objectivity.

Elapsed Time/Changed Circumstances: The passage of time can reduce the potential self-review threats arising when an auditor reviews his or her own recommendations made during previous audits. Elapsed time may also lead to changes in circumstances and changes in personnel in the audit customer area, leading to a reduction or elimination of potential threats such as familiarity, social pressure, and self-review.

Internal Consultations: This mitigating factor is related to the use of teams and supervision/peer review. Internal consultation is distinct in that in a situation of doubt, the auditor manages threats to objectivity by (voluntarily and on his or her own initiative) asking a respected, professional colleague or superior for input or feedback. The internal audit unit itself could develop a formal process, setting out criteria to establish when an internal auditor is encouraged or required to seek consultation.

Objectivity Management Tools

As mentioned previously, after considering threats and mitigating factors, the auditor may conclude that there remain significant unmitigated threats to objectivity. In such cases, specific actions would be identified to eliminate those threats. While the actions taken must be tailored to the specific circumstances, identified below are a number of management tools that could be used to reduce or eliminate threats to objectivity. Some of these tools overlap with the mitigating factors previously identified; e.g., use of teams and supervision/peer review. This is because objectivity management may require implementing processes in one context to mitigate threats that exist, while in another context the mitigating factors may already be an inherent part of the process. For example, some audits are of a size that teams are always used, whereas in another context a team may be used specifically to mitigate a threat to objectivity. The following list is not intended to be exhaustive. Rather, it is intended to illustrate the range of management tools available to manage threats to objectivity.

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Hiring Practices: Although hiring practices relate primarily to managing professionalism, they can also relate to managing objectivity. For example, screening to assure that potential employees do not have conflicts of interest that threaten objectivity is the starting point for building an objective audit function.

Training: Training (in scientific methods and approaches) improves objectivity itself. Further, training can also help auditors recognize potential threats to objectivity so that they can avoid them or effectively manage them in a timely fashion.

Supervision/Review: Close supervision of auditors and careful review of their work beyond what is normal can encourage them to approach audit issues objectively since they are accountable for their judgments. As mentioned previously, research indicates that accountability is an important factor in improving judgments and reducing biases in an audit context.

Quality Assurance Reviews: Internal and external reviews of the internal audit department and its activities, processes, and procedures can help both to assure that threats to objectivity are effectively managed and that professionalism is maintained.

Use of Teams: Assigning an additional team member to an audit can diffuse or eliminate potential threats to objectivity by bringing an additional perspective to bear on the audit. This additional perspective can counterbalance potential threats due to familiarity, personal relationships, self-review, or other potential threats to objectivity on the part of one or more audit team member. In addition, appropriate assignments within teams can be made to maximize the mitigating effects of the team approach.

Rotation/Reassignment: Rotating audit assignments can reduce the degree of familiarity and self-review. There are different types of rotation, including rotating all the staff from one audit to another so that new staff always do the audit, rotating some of the staff but not all, and keeping the audit staff on a repeated audit but rotating the work done by the staff.

Outsourcing: When internal tools cannot be effectively used to manage threats to objectivity, outsourcing to an external service provider can help ensure that objective judgment is rendered in a specific circumstance. Such decisions, however, will require additional financial resources and may lead to unease among internal audit staff.

Unresolved Threats

There may be circumstances when threats to objectivity remain unresolved because no internal management tools are available to address unmitigated threats and the engagement cannot
be outsourced. The model indicates that these unresolved threats should be disclosed by means such as reports to audit committees or other similar independent bodies so that the auditor’s recommendations are interpreted in the appropriate context. This disclosure may also take place in the audit report as appropriate. Of course, in some situations, audit committee members or top management may in fact be the problem. In such cases, the best alternative may be to refuse to conduct the audit. If the problem is systemic, the internal auditor should evaluate the effect that remaining with the organization will have on his or her professionalism and the underlying commitment to integrity.

Exhibit 7-3 depicts the process of managing threats to objectivity, which along with professionalism yields effective internal audit activities. These examples of threats, mitigating factors, and management tools are only illustrations and are not meant to be an exhaustive, mutually exclusive, and comprehensive list. Future research, standard-setting efforts, and other professional activities will lead to the identification of additional and/or different categories of threats, mitigating factors, and management tools.
Academic Research

There is no academic research directly related to identifying and managing threats to internal auditor objectivity. There have been, however, attempts by professional and policy-making bodies to identify categories of threats to auditor objectivity and related safeguards or mitigating factors.

The Federation Des Experts Comptables Europeens (FEE) from the European Union describes threats to auditor objectivity and discusses possible safeguards (FEE, 1998). Although targeted at statutory auditors, it is also relevant for internal auditors.

The threats identified are as follows:

- Personal, business, or financial links between auditors and clients
- Holding a managerial or supervisory role in an audit client
- Providing non-audit services
- Audit fee arrangements\(^{15}\)
- Acting for a client for a long period of time
- Actual or threatened litigation between an auditor and client
- When the client seeks opinions from other statutory auditors
- Audit firm arrangements\(^ {16}\)

In its conceptual framework project, the Independence Standards Board described threats as pressures and other factors that impair an auditor’s objectivity and identified five types of threats to auditor independence — self-interest, self-review, advocacy, familiarity (or trust), and intimidation — that may be posed by various activities, relationships, or other circumstances.\(^ {17}\) They also described safeguards to auditor independence as controls that mitigate the effects of threats.

As noted earlier, the GAO issued an amendment to the standards on independence (GAO, 2002). In that document, auditors are guided to consider three general classes of impairments to independence — personal, external, and organizational. All of the various conceptualizations of threats and safeguards for auditors can serve as input to deriving specific guidance for internal auditors.
Research Questions

- Is there a better way to organize threats to internal auditor objectivity and the related mitigating factors and management tools?

- What are threats to objectivity that arise from personal characteristics and circumstances?

- What are threats to objectivity that arise from organizational characteristics and circumstances?

- Develop a model that will identify the threats to objectivity of an internal audit unit or internal auditors and then generate an “objectivity/independence” score.

- What is the point at which, in measuring objectivity of the auditor and independence of the function, those interested can no longer rely on the internal auditor’s work?

- What are the effects on objectivity and perceived independence of using the internal audit unit as a training ground?

- Is there an optimal mix of career internal auditors and those who pass through for training for an effective internal audit function?

- Can training improve the internal auditor’s objectivity?

- As internal audit becomes a more important component of the organizational governance systems, will disclosures of independence and threats to objectivity to parties outside of management and the audit committee become an issue?

- Should management report on the organizational structure and assignments of the internal audit unit to the audit committee of the board of directors? Should they report to external stakeholders in financial statements?

- Are team assessments, judgments, and decisions apt to be more objective than individual assessments?

- How often and for what reasons do audit committee members interact with internal auditors?
• Is there evidence that the greater the interaction between internal auditors and audit committee members, the higher the quality of operations and financial reporting?

• What are internal auditors and internal audit functions currently doing to identify threats to objectivity?

• What are the current tools that internal auditors and internal audit functions use to manage threats to objectivity?

**VIII. Conclusions**

Independence and objectivity continue to be important concepts in the internal auditing profession. Much of the previous research has been focused in the external audit arena. With the increasing visibility of and reliance on the internal audit function, it is important to begin focusing such research efforts on the internal audit world. Many research questions and issues are raised in this chapter to facilitate that effort.
IX. Appendix I: Chapter Research Questions

The Demand for Independence and Objectivity in Professions

- Are the concepts of independence and objectivity important to other professions?
- Which professions and why?
- How do other professions implement the demand for independence and objectivity?
- Are approaches used in other professions relevant to the internal auditing profession?

Independence and Objectivity Defined

- Are there different or more appropriate definitions of independence and objectivity?
- Do the conceptual ideas of independence and objectivity for external auditors apply to internal auditors?
- Do or should the definitions of independence and objectivity differ across professions?
- Are programming, investigative, and reporting independence important to the internal auditing profession? Why or why not?

Independence and Objectivity and the Internal Auditing Profession

- What are the differences, if any, in the conflicts of interest faced by internal and external auditors?
- What are appropriate controls (firewalls) for those internal audit units that provide both consulting and assurance services?
- Do outsourced internal audit activities result in greater internal auditor objectivity?
- Do governance, control, and/or audit failures occur more often in firms where the internal audit function provides both assurance and consulting services?
- What are litigation risks for internal auditors who fail to show objectivity in their judgments?

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• Will legal exposure change for internal auditors in the post-Enron/WorldCom environment?

• What is an appropriate model to determine the degree of reliance that may be placed on internal audit assurance service activities?

• What is the relation between the organizational positioning of the internal audit function and the overall effectiveness and independence of the organizational governance system?

• What is the relation between the organizational positioning of the internal audit unit and company performance in the capital markets?

• What is the relation between the organizational positioning of the internal audit unit and the occurrence and detection of fraudulent company activities?

• What is the relation between the organizational positioning of the internal audit unit and financial reporting quality?

• How do external auditors make assessments of the work of internal auditors? Do they assess independence and objectivity? If so, how?

• Other than the direct employment relationship, what are the differences in the relationships between internal auditors and management and external auditors and management?

• Do these differences in relationships drive differences in objectivity threats?

• What are differences between perceptions of independence and objectivity and actual independence and objectivity in the internal audit realm?

• What can we learn about independence and objectivity related to internal auditing from the Enron, WorldCom, and the seemingly countless other failures? Where were the internal auditors?

• What is (was) the nature of the internal audit function in Enron, WorldCom, Adelphia, Global Crossing, and other such companies?
IIA Standards Related to Independence and Objectivity

- With regard to IIA Standard 1130.A1, is a year an appropriate period of time?
- With regard to IIA Standard 1130, how can one measure the impairment of objectivity?
- With regard to IIA Standard 1130.C1, if internal auditors provide consulting services relating to operations for which they had previous responsibility, can they still provide objective assurance services for that unit?
- Are there other standards that may help to assure independence of the internal audit function?
- Are there other standards that may assure objectivity for internal auditors?
- How do internal audit functions implement IIA Standards?
- What are the effects of the IIA Standards on the organizational positioning of the internal audit function?
- What are the effects of the standards on the objectivity of internal auditors?
- Does the focus of governmental auditing standards on organizational impairments to internal auditor independence apply to nongovernmental internal auditors?
- Does the idea from governmental auditing standards that internal auditors are responsible solely to management apply to nongovernmental internal auditors?

A Framework for Managing Threats to Objectivity

- Are there other frameworks that would help internal auditors to manage threats to their objectivity?
- How do internal auditors in practice and internal audit functions manage threats to objectivity?
- Are internal auditor reactions to conflicts of interest more deliberate or unconscious and unintentional?
• Can internal auditor reactions to conflicts of interest be changed through training?
• Can internal auditor reactions to conflicts of interest be changed through disclosure of the conflicts?
• Can internal auditor reactions to conflicts of interest be changed through minimization of the conflict?

Identifying and Managing Threats to Objectivity

• Is there a better way to organize threats to internal auditor objectivity and the related mitigating factors and management tools?
• What are threats to objectivity that arise from personal characteristics and circumstances?
• What are threats to objectivity that arise from organizational characteristics and circumstances?
• Develop a model that will identify the threats to objectivity of an internal audit unit or internal auditors and then generate an “objectivity/independence” score.
• What is the point at which, in measuring objectivity of the auditor and independence of the function, those interested can no longer rely on the internal auditor’s work?
• What are the effects on objectivity and perceived independence of using the internal auditor unit as a training ground?
• Is there an optimal mix of career internal auditors and those who pass through for training for an effective internal audit function?
• Can training improve the internal auditor’s objectivity?
• As internal audit becomes a more important component of the organizational governance systems, will disclosures of independence and threats to objectivity to parties outside of management and the audit committee become an issue?
• Should management report on the organizational structure and assignments of the internal audit unit to the audit committee of the board of directors or to external stakeholders in financial statements?

• Are team assessments, judgments, and decisions apt to be more objective than individuals?

• How often and for what reasons do audit committee members interact with internal auditors?

• Is there evidence that the greater the interaction between internal auditors and audit committee members, the higher the quality of operations and financial reporting?

• What are internal auditors and internal audit functions currently doing to identify threats to objectivity?

• What are the current tools that internal auditors and internal audit functions use to manage threats to objectivity?
Footnotes


2 Loewenstein defines a conflict of interest as “a situation in which a person, such as a public official, an employee, or a professional has a private or personal interest sufficient to appear to influence the objective exercise of his or her professional duties.” (Society for Judgment and Decision Making *JDM Newsletter*, “A Letter from the President,” Volume XXI, Number 1, March 2002).

3 If one believes that the public is the real client of the internal auditor, then they would apply. The answer may differ if one believes that the board of directors and/or management is the client.

4 Note that management still has a need for professionalism and objectivity even if they are the only users.

5 This situation is similar to that of an external auditor accepting a position with a client.

6 For the reasoning behind the SEC’s decision to no longer rely on the Independence Standards Board for external auditor independence standards and for links to the SEC’s rules on external auditor independence, see http://www.sec.gov/rules/policy/33-7993.htm.

7 For the full text of The IIA’s *Standards for the Professional Practice of Internal Auditing*, see http://www.theiia.org/ecm/guidance.cfm?doc_id=124.

8 For information on the amendment and the full text of GAO standards, referred to as “Yellow Book” standards, see http://www.gao.gov/.

9 This, of course, assumes that audit committee members are competent and capable of making such assessments. For recent legislation that has significant impact on both the accounting profession and on audit committee responsibilities, see the Sarbanes-Oxley Act at http://www.fei.org/advocacy/download/Sarbanes-OxleyAct.pdf.

10 It then follows that internal auditors should not do consulting work.


15 This includes cases where fees are contingent on some outcome, situations where fees are outstanding beyond a normal credit period, etc.

16 An example is given where the statutory auditor must ensure that individuals employed by the audit firm who are not statutory auditors are unable to exert influence over the conduct of the audit.

References


The Institute of Internal Auditors Research Foundation