SIAAB Guidance #03

Internal Audit Committees in State of Illinois Government

Adopted March 11, 2014

Revised In Accordance with 2017 Standards – Effective January 1, 2017

SIAAB Interpretation

Note: The terms "Chief Executive Officer" or "Agency Head" as utilized in this document are interchangeable and shall refer to the individual who has been designated by the Governor as the head of an agency under the Governor or the Constitutional Officer, in the case of those entities which do not fall under the direct jurisdiction of the Governor. The term "Agency" as utilized in this document, refers to an agency under the Governor or the Constitutional Office, in the case of those entities which do not fall under the direct jurisdiction of the Governor. Illinois Administrative Procedures Act (5 ILCS 100 Section 1-25) states, "'Agency head' means an individual or group of individuals in whom the ultimate legal authority of an agency is vested by any provision of law."

"Chief Audit Executive (or Chief Internal Auditor) describes the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the International Professional Practices Framework. The Chief Audit Executive (or Chief Internal Auditor) or others reporting to the Chief Audit Executive (or Chief Internal Auditor) will have the appropriate professional certifications and qualifications. The specific job title and/or responsibilities of the Chief Audit Executive may vary across organizations." [In Illinois, the Fiscal Control and Internal Auditing Act refers to this position as Chief Internal Auditor.]

Audit Committees in the private sector are formed from a public company's Board of Directors. The Chief Executive Officer reports to the Board of Directors and is accountable to them. Because the Board of Directors is independent from the operations of the company, they can provide independent oversight of the company. Likewise, an audit committee formed as a subset of that same Board of Directors would also be independent from operations and therefore can provide independent oversight of the Internal Audit function. However, in State government, a similar independent relationship only exists when a government entity is legally required to have a Board.
A Board or Commission may only be established in Illinois pursuant to the provisions under the Illinois Administrative Procedures Act (5 ILCS 100 Section 1-20) which states, "*'Agency' means each officer, board, commission, and agency created by the Constitution, whether in the executive, legislative, or judicial branch of State government, but other than the circuit court; each officer, department, board, commission, agency, institution, authority, university, and body politic and corporate of the State; each administrative unit or corporate outgrowth of the State government that is created by or pursuant to statute, other than units of local government and their officers, school districts, and boards of election commissioners; and each administrative unit or corporate outgrowth of the above and as may be created by executive order of the Governor."*

Unless an audit committee has been established by law, executive order, or other enacting language or is authorized by a Board established pursuant to the provisions of Illinois law, they do not exist and are not required within State of Illinois government's operations. There have been discussions at agencies who wish to establish audit committees comprised of members of the senior staff of the agency. The establishment of an audit committee composed of senior staff would affect the Chief Internal Auditor's independence, since under these circumstances; the Chief Internal Auditor would have to audit areas for which the group of people they reported to were directly responsible. This would not be allowed by the Standards or the Fiscal Control and Internal Auditing Act. An independent reporting relationship is required by the Fiscal Control and Internal Auditing Act (FCIAA) (30 ILCS/10), as well as The International Standards for the Professional Practice of Internal Auditing (IIA Standards), published by the Institute of Internal Auditors (IIA).

FCIAA 30 ILCS/10 Section 2002 (b) of FCIAA states in part, *"The chief internal auditor shall report directly to the chief executive officer and shall have direct communications with the chief executive officer and the governing board, if applicable, in the exercise of auditing activities."*

Essential to understanding this position is the concept that Internal Audit must be an *independent* function within the organization. *Organizational Independence* can only be achieved within an organization if the Chief Internal Auditor reports directly to the Chief Executive Officer or in the case of a Board, which has been established by Statute to oversee a State agency, the Chief Internal Auditor should have a dual reporting relationship directly to the Chief Executive Officer as well as the Board (See SIAAB Guidance #02 for additional details).

However, if the emphasis of a committee is to ensure the timely implementation of corrective action plans, then that group may be comprised of senior management. Under those circumstances, the name of the group should not be entitled audit committee as that term carries with it a certain understanding within the audit and business community regarding typical responsibilities of such a group. Establishing a separate group of senior management to hear findings and ensure their appropriate implementation could be an effective tool as long as the group could not dictate the validity of a finding but merely enforced the timely implementation of corrective action plans, which is a direct management responsibility. The determination of the validity of a finding should rest solely with the Chief Internal Auditor. Furthermore, if senior management elects to accept the risk of not complying with a finding, the Chief Internal Auditor's obligation is to communicate that decision directly with the Chief Executive Officer of their agency for a final determination.

This is required by *IIA Standard 2600 Resolution of Senior Management's Acceptance of Risk, "When the chief audit executive concludes that management has accepted a level of risk that may be unacceptable to the organization, the chief audit executive must discuss the matter with senior management. If the chief audit executive determines that the matter has not been resolved, the chief audit executive must communicate the matter to the board."* The IIA defines a Board as, *"The highest level of governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable If a board does not exist, the word "board" in* *the* Standards *refers to a group or person charged with governance of the organization. Furthermore, "board" in the* Standards *may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee)."* As stated previously, if the agency does not have a legally established Board, then the term 'Board' means the Chief Executive Officer of the agency.

Chief Internal Auditors are required by the Standards to consider input from senior management during the Internal Audit planning process. However, under no circumstance should an audit committee or any other group comprised of senior management, have the authority to decide what will be included in the Internal Audit Plan. The plan should be created by the Chief Internal Auditor and be submitted directly to the Chief Executive Officer of the agency for discussion and approval. FCIAA 30 ILCS/10 Section 2003(a) states in part, *"The chief executive officer of each designated State agency shall ensure that the internal auditing program includes: (1) A two-year plan, identifying audits scheduled for the pending fiscal year, approved by the chief executive officer before the beginning of the fiscal year."* In addition, the Institute of Internal Auditors states in its definition of objectivity, "*internal auditors must not subordinate their judgment on audit matters to others."*

<u>Fiscal Control and Internal Auditing Act</u>

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<u>Illinois Administrative Procedures Act</u>

Illinois Administrative Procedures Act (5 ILCS 100 Section 1-20) states, "'Agency' means each officer, board, commission, and agency created by the Constitution, whether in the executive, legislative, or judicial branch of State government, but other than the circuit court; each officer, department, board, commission, agency, institution, authority, university, and body politic and corporate of the State; each administrative unit or corporate outgrowth of the State government that is created by or pursuant to statute, other than units of local government and their officers, school districts, and boards of election commissioners; and each administrative unit or corporate outgrowth of the above and as may be created by executive order of the Governor."

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IIA Standards

1110 – Organizational Independence
The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

IIA Interpretation Practice Advisory

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

1110.A1 – The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The chief audit executive must disclose such interference to the board and discuss the implications.

IIA Glossary of Definitions:

- **Board-** "The highest level of governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. If a board does not exist, the word "board" in the *Standards* refers to a group or person charged with governance of the organization. Furthermore, "board" in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee)."

- **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."