

## **SIAAB Guidance #02**

### **Internal Audit Independence- Interaction with Agency Head, Senior Staff and Placement Within the Organizational Structure**

**Adopted July 9, 2013**

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

**Revised In Accordance with 2024 Standards – Effective January 7, 2025**

#### **SIAAB Interpretation**

*\*\*\* Note: The State Internal Audit Advisory Board (SIAAB) requires Illinois Internal Auditors to follow the Global Internal Audit Standards (GIAS) of the Institute of Internal Auditors (IIA). The structure of GIAS consists of 5 Domains, 15 Principles and 52 Standards. Any references made to GIAS will begin with the Domain, then Principle followed by a (.) and then the Standard. For example, Domain II, Principle 3, Standard 4 would be referenced as GIASII 3.4.*

*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.*

*The terms “Chief Internal Auditor,” “Chief Audit Executive,” “Director Internal Audit” or similar positions 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 GIAS and ensuring the quality of the performance of internal audit services. This document uses those terms interchangeably. 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. The Chief Internal Auditor or others reporting to the Chief Internal Auditor, will have the appropriate professional certifications and qualifications.*

#### **Reporting Relationship**

In order to ensure organizational independence and effectiveness within Illinois State Government, the Internal Audit function should be established within the organization as a separate function. Internal Audit must have neither any reporting responsibilities nor direct operational oversight of any program area nor may it report to any program area within the agency. The Chief Internal Auditor must report directly to the Chief Executive Officer or in the case of a Board, which has

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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. The Chief Internal Auditor should be equivalent in stature to those on the executive team who report directly to the Chief Executive Officer. Proper status and recognition of the internal audit function within the organization ensures independence and places the internal audit function at a level within the organization that enables internal audit to effectively fulfill its responsibilities and mission. This reporting relationship is required by the Fiscal Control and Internal Auditing Act (FCIAA) (30 ILCS/10), as well as GIAS.

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.” SIAAB believes that *Organizational Independence* is effectively achieved when the chief audit executive reports functionally to the Chief Executive Officer of the agency or Constitutional Officer, or for agencies which by Statute are required to have an actual board, dual reporting to both the Chief Executive Officer and the 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.”

GIASIII 7.1 states under the considerations for implementation, “Internal Auditing is most effective when the internal audit function is directly accountable to the board (also known as ‘functionally reporting’ to the board), rather than directly accountable to management for the activities over which it provides assurance and advice. A direct reporting relationship between the board and the chief audit executive enables the internal audit function to perform internal audit services and communicate engagement results without interference or undue limitations.” Within the context of this requirement, the GIAS Glossary defines the term “board” as, “The highest-level body charged with governance, such as a board of directors, an audit committee, a board of governors or trustees, a group of elected officials or politicians, head of a state agency, another body that has authority over the relevant governance functions. In an organization that has more than one governing body, ‘board’ refers to the body or bodies authorized to provide the internal audit function with the appropriate authority, role, and responsibilities. If none of the above exists, ‘board’ should be read as referring to the group or person that acts as the organization’s highest level governing body. Examples include the head of the organization and senior management.”

A Chief Internal Auditor must report functionally to the Chief Executive Officer but they may administratively report to the highest level within the Executive Office. An acceptable administrative reporting relationship within State of Illinois government operations would

generally be a Chief of Staff or equivalent position. This administrative reporting must be to a level above the Chief Internal Auditor. This means for most responsibilities of the operations of the Internal Audit function, the Chief Internal Auditor must report to and interact directly with the Chief Executive Officer of the agency. However, purely administrative functions, such as approval of time off, timesheets and travel vouchers, may be handled by a Chief of Staff.

GIASIII 7.1 states that the organization of the internal audit function must, “Require that the chief audit executive be positioned at a level in the organization that enables internal audit services and responsibilities to be performed without interference from management. This positioning provides the organizational authority and status to bring matters directly to senior management and escalate matters to the board (Chief Executive Officer) when necessary.” In Illinois State government, that individual is the Chief Executive Officer. Furthermore, evaluations and discussions of compensation must be between the Chief Internal Auditor and the Chief Executive Officer of the agency not a designee.

GIASIII 6 requires the responsibilities and authority of the Internal Audit function to be outlined in an Audit Charter approved annually by the Chief Executive Officer. Specifically, GIASIII 6 states, “The internal audit function receives its mandate from the board (or applicable law in certain public sector environments). The mandate specifies the authority, role, and responsibilities of the internal audit function and is documented in the internal audit charter.”

GIASIII 6.1 states, “The chief audit executive must provide the board and senior management with the information necessary to establish the internal audit mandate. In those jurisdictions and industries where the internal audit function’s mandate is prescribed wholly or partially in laws or regulations, the internal audit charter must include the legal requirements of the mandate. (See also GIASIII 6.2 Internal Audit Charter.) “

GIASIII 6.2 states, “The chief audit executive must develop and maintain an internal audit charter that specifies, at a minimum, the internal audit function’s:

- Purpose of Internal Auditing.
- Commitment to adhering to the Global Internal Audit Standards.
- Mandate, including scope and types of services to be provided, and the board’s responsibilities and expectations regarding management’s support of the internal audit function. (See also GIASIII 6.1 Internal Audit Mandate.)
- Organizational position and reporting relationships. (See also GIASIII 7.1 Organizational Independence.) “

GIASIII 6.2 also states that it is essential that the Board, “Review the internal audit charter with the chief audit executive to consider changes affecting the organization, such as the employment of a new chief audit executive or changes in the type, severity, and interdependencies of risks to the organization.”

In State of Illinois operations, such approval must come from the Chief Executive Officer or Board if applicable. The Internal Audit Charter is critical because it provides written direction from the Chief Executive Officer of the clear authority and responsibilities of the Internal Audit function.

Internal Audit should have no “*Operational Duties*” outside those directly related to responsibilities of an Internal Audit function. This allows the Internal Audit function to retain proper independence in order to conduct independent evaluations of the various agency functions. Internal Audit must have this “*Organizational Independence*” in order to have the ability to independently and objectively evaluate all functions and activities of the agency. If Internal Audit is responsible for any operational activity, it would be unable to evaluate that activity because Internal Audit would not be independent, as no one can independently evaluate their own work. Therefore, Internal Audit must not be responsible for making any decision on behalf of management or be responsible for any operational or program area, development or authorization of operational policies and procedures, conduct grant or contract monitoring, quality assurance, construction overhead audits or other direct and indirect costs of external parties or be responsible for any direct audits or reviews of external parties, except in the capacity of conducting an Internal Audit of those functions and activities.

Proper organizational structure provides the “*Organizational Independence*” necessary for Internal Audit to function as intended allowing it to provide meaningful evaluations and information to management. Section 2002 (b) of FCIAA states in part, “All chief internal auditors and all full-time members of an internal audit staff, shall be free of all operational duties.” Therefore, it is not possible for the Internal Audit to functionally report directly to anyone who is responsible for managing any operational function, as that would create a lack of organizational independence issue for the Internal Audit function. The IIA defines “*independence*” as, “The freedom from conditions that may impair the ability of the Internal Audit function to carry out Internal Audit responsibilities in an unbiased manner.”

These controls are in place to ensure internal auditors maintain independence so that our audits of the agency’s functions may provide an independent assessment of management’s operations. If internal auditors fail to adhere to these requirements, the results of any audit performed may be questioned due to Internal Audit’s inability to independently evaluate a function. Independence in both fact and appearance is an integral part of a meaningful evaluation and is the heart of the Internal Audit profession and the services that are provided.

### ***Periodic Meetings Between the Chief Executive Officer and Chief Internal Auditor***

The Chief Internal Auditor should meet periodically with the Chief Executive Officer as well as the Board if applicable, to provide updates regarding the Internal Audit function. The frequency should be determined after the Chief Internal Auditor’s discussion with the Chief Executive Officer or Board, if applicable, regarding what is reasonable. However, it should be frequent enough to enable the Chief Internal Auditor to sufficiently keep the Chief Executive Officer and Board, if

applicable, apprised of critical activities of the Internal Audit function. The Chief Internal Auditor must have unrestricted access to the Chief Executive Officer and Board if applicable, in order to retain independence and freely bring to their attention any important matters or concerns. It is only through this kind of relationship that the Chief Internal Auditor can effectively communicate anything which they believe may have a negative impact on the agency.

The importance of communication with the board or agency head is recognized in IIA GIASIII 8.1 which states that it is essential that the board, “Communicate with the chief audit executive to understand how the internal audit function is fulfilling its mandate. Communicate the board’s perspective on the organization’s strategies, objectives, and risks to assist the chief audit executive with determining internal audit priorities. Set expectations with the chief audit executive for: The frequency with which the board wants to receive communications from the chief audit executive, the criteria for determining which issues should be escalated to the board, such as significant risks that exceed the board’s risk tolerance, the process for escalating matters of importance to the board, gain an understanding of the effectiveness of the organization’s governance, risk management, and control processes based on the results of internal audit engagements and discussions with senior management. Discuss with the chief audit executive disagreements with senior management or other stakeholders and provide support as necessary to enable the chief audit executive to perform the responsibilities outlined in the internal audit mandate.”

GIASI states, “Internal auditing is most effective when: The internal audit function is independently positioned with direct accountability to the board. Internal auditors are free from undue influence and committed to making objective assessments.”

GIASIII 7 states, “The board establishes and protects the internal audit function’s independence and qualifications. The board is responsible for enabling the independence of the internal audit function. Independence is defined as the freedom from conditions that impair the internal audit function’s ability to carry out its responsibilities in an unbiased manner. The internal audit function is only able to fulfill the Purpose of Internal Auditing when the chief audit executive reports directly to the board, is qualified, and is positioned at a level within the organization that enables the internal audit function to discharge its services and responsibilities without interference.”

GIASIII 7.1 states that it is essential that the Board, “Establish a direct reporting relationship with the chief audit executive and the internal audit function to enable the internal audit function to fulfill its mandate. Provide the chief audit executive with opportunities to discuss significant and sensitive matters with the board, including meetings without senior management present.”

GIASIII 7.1 further states the organization should, “Position the internal audit function at a level within the organization that enables it to perform its services and responsibilities without interference, as directed by the board. Recognize the chief audit executive’s direct reporting relationship with the board. Engage with the board and the chief audit executive to understand any potential impairments to the internal audit function’s independence caused by non-audit roles or

other circumstances and support the implementation of appropriate safeguards to manage such impairments.”

In addition to periodic reporting to the Chief Executive Officer to provide updates regarding the Internal Audit activities, FCIAA also requires the Chief Internal Auditor to create a Two Year Internal Audit Plan which must be approved by June 30 every year and an Annual Report regarding the status of all Internal Audit findings by September 30 of every year. Section 2003 (a) states, “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. By September 30 of each year the chief internal auditor shall submit to the chief executive officer a written report detailing how the audit plan for that year was carried out, the significant findings, and the extent to which the recommended changes were implemented.”

GIASIII 7.1 states, “The chief audit executive must confirm to the board the organizational independence of the internal audit function at least annually. This includes communicating incidents where independence may have been impaired, and the actions or safeguards employed to address the impairment.”

GIASIII 8.1 states, “The chief audit executive must report to the board and senior management: Results from the quality assurance and improvement program. (See also GIASIII 8.3 Quality and GIASIII 8.4 External Quality Assessment, GIASIV 12.1 Internal Quality Assessment, and GIASIV 12.2 Performance Measurement.)”

GIASIII 8.3 states, “At least annually, the chief audit executive must communicate the results of the internal quality assessment to the board and senior management. The results of external quality assessments must be reported when completed. In both cases, such communications include: The internal audit function’s conformance with the Standards and achievement of performance objectives. If applicable, compliance with laws and/or regulations relevant to internal auditing. If applicable, plans to address the internal audit function’s deficiencies and opportunities for improvement.”

GIASIV 12.1 states, “If nonconformance with the Standards affects the overall scope or operation of the internal audit function, the chief audit executive must disclose to the board and senior management the nonconformance and its impact.”

### ***Senior Staff or Leadership Interaction***

The Chief Internal Auditor serves in the capacity of advising management regarding the appropriateness and effectiveness of the agency’s internal controls. In order to execute their responsibilities effectively, it is critical that the Chief Internal Auditor have access to and receive cooperation from the most senior level management of the agency. Senior management is defined as the upper most level of management reporting to the Chief Executive Officer that is responsible for delivering the various programs and responsibilities of the agency. In furtherance of this status within the organization, and in order to be best informed about present and future operations, the



Chief Internal Auditor should regularly attend periodic meetings held between agency senior management. This allows the Chief Internal Auditor to be better informed of the activities of the agency as well as any new developments. It also provides an opportunity for the Chief Internal Auditor to keep senior management informed of Internal Audit's activities.

In Illinois State government, the most senior level of management is the cabinet for the Chief Executive Officer or those delegated the responsibilities for carrying out the mission of the agency. In Illinois State government there are different terms utilized to identify that top level of management over the programs and responsibilities of the agency, but we are referring to those charged with direct responsibility for ensuring appropriate internal controls are in place and functioning effectively and that programs are delivered. SIAAB believes when applying this requirement in the State environment, it is best accomplished if the Chief Internal Auditor attends the agency Senior Staff or Leadership meetings, since there is no "Board of Directors" or Board Meetings for most State entities, as that term is understood in the private sector. It is at these meetings where management discusses activities and plans for the agency, strategic operational and business developments, changes to laws, rules and requirements, programmatic issues and the agency internal controls and environment. SIAAB believes this is consistent with the meaning conveyed in IIA Practice Advisory 1111-1. It addresses the need for the chief audit executive (Chief Internal Auditor) to regularly attend and participate in board meetings that relate to the board's oversight responsibilities for auditing, financial reporting, organizational governance, and control. The CAE's attendance and participation at these meetings provide an opportunity to be apprised of strategic business and operational development, and to raise high-level risk, systems, procedures or control issues at an early stage. Meeting attendance also provides an opportunity to exchange information concerning the internal audit activity's plans and activities and to keep each other informed on any other matters of mutual interest.