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## **INDEPENDENCE**

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### **DEFINITION –**

Independence is the designed framework that ensures objectivity at the Audit Organization, Audit, and Auditor levels in order to provide stakeholders with reliable attestations, assurances, and conclusions.

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### **PURPOSE –**

- To assess condition or activity for threats to independence (threats);
- Weigh threats identified for significance;
- Identify and apply safeguards to eliminate or reduce significant threats to an acceptable level, thus avoiding impairments;
- Document the nature of threats and safeguards applied.

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### **APPROACH AND METHODOLOGY –**

#### **AUDIT ORGANIZATIONAL INDEPENDENCE:**

Organizational Independence is achieved by the City Controller (CC) as being an independently elected official, with responsibilities outside the operational reporting structure of the City of Houston's (City) local government. The authority to conduct audits of City governments and operations is granted by the City Charter (Chapter VIII, section 7.). As a result, the Audit Division (AD) within the Office of the City Controller is considered an External Audit Organization and free from impairment to independence as stated in 3.28, b. and 3.29, a. of the *Government Auditing Standards* in regards to functions performed outside the Office of the City Controller. Limitations or possible impairments to Organizational Independence, therefore are identified as the business functions that reside within the Office of the City Controller. These include: approval of payments over \$50,000 and miscellaneous payments (non-purchase order and one-time vendor), Execution of Investment Transactions (including Bond Payments approved and made by the CC) and the final approval authority of hiring, firing, promoting, changing compensation of its' employees.

A signed *STATEMENT OF ORGANIZATIONAL INDEPENDENCE* is executed upon changes to personnel in the CC, CA, or the AD Manager positions, or when there are changes to the organizational structure.

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#### **AUDIT/ENGAGEMENT INDEPENDENCE:**

The AD ensures Audit/Engagement Independence in the following two ways:

- In preparing the Annual Audit Plan (Plan), consideration is given to threats to Audit Independence and safeguards to eliminate or reduce threats identified to an acceptable level in order to ensure that only engagements without impairments are included in the Plan. Threats that are identified and safeguards employed are documented as support in the development of the Plan.
- The AD engages in projects that are not included in the Annual Audit Plan. As those engagements arise as the result of requests or other means, the AD considers Audit



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Independence for each of them individually, which includes specific consideration, documentation, and communication for Non-Audit Services as defined in GAGAS. As in the development of the Plan, threats that are identified and safeguards employed to eliminate or reduce threats are documented as support in electronic workpapers.

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**AUDITOR INDEPENDENCE:**

As part of compliance, the CA and each AD staff member assigned to an audit/engagement assure their independence and disclose when impairment occurs or exists for each audit/engagement to which they may be assigned. This is documented and included in the audit workpapers. Additionally, a signed *AUDITOR STATEMENT OF INDEPENDENCE* is executed annually for each individual auditor and is kept as a part of the AD records.

**Note:** The independence statements (Policy No. **110.10**, "Statement of Organizational Independence" and Policy No. **110.20**, "Auditor's Statement of Independence") act as support and validation of adherence to policy 110.00 *Independence* and this procedure. Concerns over external impairments to the AD will utilize the channels as outlined in the Audit Division Charter. They are attached herein.

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**THREATS TO INDEPENDENCE:**

The following are the seven categories of threats to independence as presented in Section 3.14 of the Government Auditing Standards 2011 Revision:

- a. Self-interest threat - the threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior;
- b. Self-review threat - the threat that an auditor or audit organization that has provided nonaudit services will not appropriately evaluate the results of previous judgments made or services performed as part of the nonaudit services when forming a judgment significant to an audit;
- c. Bias threat - the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective;
- d. Familiarity threat - the threat that aspects of a relationship with management or personnel of an audited entity, such as a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective;
- e. Undue influence threat - the threat that external influences or pressures will impact an auditor's ability to make independent and objective judgments;



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f. Management participation threat - the threat that results from an auditor's taking on the role of management or otherwise performing management functions on behalf of the entity undergoing an audit; and

g. Structural threat - the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will impact the audit organization's ability to perform work and report results objectively.

These threats are evaluated to determine if the Audit Organization Independence, the Audit/Engagement Independence or the Auditor Independence is sufficiently managed on all three levels.

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**SAFEGUARDS TO INDEPENDENCE THREATS:**

Section 3.17 of the Government Auditing Standards 2011 Revision provides the following examples of safeguards that could eliminate threats or reduce them to an acceptable level:

- a. Consulting an independent third party, such as a professional organization, a professional regulatory body, or another auditor;
- b. Involving another audit organization to perform or re-perform part of the audit;
- c. Having a professional staff member who was not a member of the audit team review the work performed; and
- d. Removing an individual from an audit team when that individual's financial or other interests or relationships pose a threat to independence.

Safeguards to independence threats are used as mitigating factors to offset the challenges of independence threats.

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**DOCUMENTATION REQUIREMENTS SUPPORTING COMPLIANCE WITH INDEPENDENCE:**

The following are documentation requirements under GAGAS to support an auditor's compliance with independence standards:

- a. document threats to independence that require the application of safeguards, along with safeguards applied, in accordance with the conceptual framework for independence as required by paragraph 3.24;
- b. document the safeguards required by paragraph 3.30 if an audit organization is structurally located within a government entity and are considered independent based on those safeguards;



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c. document consideration of audited entity management’s ability to effectively oversee a nonaudit service to be provided by the auditor as indicated in paragraph 3.34; and

d. document the auditor’s understanding with an audited entity for which the auditor will perform a non-audit service as indicated in paragraph 3.39.

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**NON-AUDIT SERVICES AND INDEPENDENCE:**

The AD in the City of Houston is organizationally independent from City Operations, as can be determined by reviewing the AD Policy of Independence ([Policy No. 110.00](#)). As such, most non-audit services are structurally protected from threats to independence. However, the AD makes Safeguards to Threat determinations as a part of the Audit/Engagement Independence reviews during assignments. This ensures that any potential future audit/engagement can be undertaken without threat to independence taking place.

To ensure that such threats are mitigated, steps are taken by the AD to ensure City Management understands its roles and responsibilities to effectively manage the area of responsibility the non-audit services address. This is done through documentation with the Audit Engagement Document – signed by City Management and the CA. It becomes a part of the electronic audit workpaper package. The AD ensures that City Management understands its roles and responsibilities relating to:

- Leading and Directing the Entity receiving the non-audit services;
- Decision-making for Operations;
- Deployment and Control of Human, Financial, Physical and Intangible Resources;
- Setting Policies and Directing Performance;
- Accepting responsibility for the design and operation of Internal Controls; and
- Other Significant Management Responsibilities

Additionally, should City Management not accept its responsibilities as listed above, the AD follows policy 215.00 for determining if the effect of such declination should result in the declining of the engagement or provision of non-audit services.

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**RELEVANT PROFESSIONAL STANDARDS AND GUIDANCE****GAGAS**

CHAPTER 3  
APPENDIX II

**IIA**

1100 – INDEPENDENCE AND OBJECTIVITY  
1110 – ORGANIZATIONAL INDEPENDENCE  
1111 – DIRECT INTERACTION WITH THE BOARD

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1120 – INDIVIDUAL OBJECTIVITY  
 1130 – IMPAIRMENT TO INDEPENDENCE OR OBJECTIVITY

**IIA PRACTICE ADVISORIES**

- 1110 – 1 ORGANIZATIONAL INDEPENDENCE
- 1120 – 1 INDIVIDUAL OBJECTIVITY
- 1130 – 1 IMPAIRMENT TO INDEPENDENCE OR OBJECTIVITY
- 1130.A1 – 1 ASSESSING OPERATIONS FOR WHICH INTERNAL AUDITORS WERE PREVIOUSLY RESPONSIBLE
- 1130.A2 – 1 INTERNAL AUDIT’S RESPONSIBILITY FOR OTHER (NON-AUDIT) FUNCTIONS

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**CHANGE HISTORY**

1	3/31/2016	All	Removed the independence statements for the audit staff and the organization and placed them into policy 110.0 rather than duplicating them in both the policy and procedure.
2	5/20/2016	Non-Audit Services and Independence:	Revised to address policy updates resulting from internal review.