To: The Honourable Kathleen Wynne, Premier of Ontario

From: Timothy (Todd) Langlois, CPA-CFF, CIA, CFE, CRMA, CGMA

CC: Tim Hudak, MPP for Niagara West - Glanbrook of Ontario, Andrea Horwath, MPP – Hamilton Centre, Ontario Ministry of Municipal Affairs and Housing

Date: February 14, 2014

Re: Ontario Municipal Act - Transparency and Accountability

Ontario Municipal Conflict of Interest Act (limited analysis)

Background

I am the former Auditor General ("AG") for the City of Windsor, a municipality in Ontario, Canada with a population of approximately 211,000 people with a total revenue stream generally exceeding $750 million dollars. Based on my experience and awareness of the recent and not so recent issues with regard to other municipalities (e.g., Oshawa Auditor General function disbanded, Sudbury Auditor General function issues, etc.), I believe I am well-informed and in a position to provide realistic recommendations designed to improve the Ontario legislation; which, in turn would better protect and serve Ontario taxpayers.

Overview

This report is primarily based on and addresses "Ontario Municipal Law" as defined in the "Ontario Municipal Act" ("The Act") with regard to local municipalities in Ontario. This analysis is primarily limited to the "Accountability and Transparency" section of The Act; however, I will briefly touch on concerns many people have raised with regard to what may constitute a conflict per the "Municipal Conflict of Interest Act" ("MCOI-Act"). The main objective of the report is to provide recommendations/suggestions on how to improve/enhance current municipal law where I have concluded opportunities exist to make beneficial changes to properly protect municipal taxpayers.

The spirit and intent of the "Accountability and Transparency" section of The Act does indeed provide the necessary tools for a municipality to be successful in that regard if, and only if, the municipality allows for such transparency and accountability as there are only limited requirements. The Act may accomplish its objectives when municipalities are forthcoming; have nothing to fear and the elected politicians appreciate they were elected to serve the taxpayer and it is the taxpayers' right to expect transparency and accountability. However, municipalities willing to cooperate and open up their books and records are not the ones that generally would be deemed to require the legislative service of an Auditor General. Taxpayers are deserving of the same or similar protections as a stakeholder in a public/private company; but, currently the only real protection/influence the municipal taxpayer has occurs in their ability to vote for the Mayor and the Councillors during an election (once every four years). To make matters worse, candidates may lack the necessary experience and/or skills, therefore taxpayers are at the mercy of the group of elected officials to make decisions on their behalf for the next four years. A "recall" provision is also an often talked about subject and would certainly be a welcome addition to the legislation.

I will attempt to demonstrate some of the deficiencies and opportunities that exist to strengthen and improve the "Accountability and Transparency" section of The Act.

From personal experience, certain parts of the "Accountability and Transparency" section of The Act should be rewritten and mandatory oversight should be required for every municipality. There are currently no requirements to establish key critical oversight positions (i.e., Auditor General, Ombudsman, and Integrity Commissioner).

By comparison, the United States, in response to a significant number of public company scandals, Congress enacted the "Sarbanes–Oxley Act of 2002" ("SOX") legislation to protect investors and other stakeholders. Furthermore, "The Dodd-Frank Wall Street Reform and Consumer Protection Act" was signed into law on July 21, 2010 by President Barack Obama. The legislation set out to reshape the U.S. regulatory system in a number of areas including but not limited to consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency.

These acts, in addition to other required legislation, significantly increases protection for stakeholders, and rightly so – billons were lost to abuse, waste, fraud, corruption, scandal, and an overwhelming false sense of entitlement by key players in and outside the organizations. Extremely punitive "Whistleblower" laws have also been implemented in the United States. Government bodies and agencies are susceptible to the same poor judgement, frauds, scandals, etc., that have plagued both public and private companies, some of which have filed for bankruptcy and impacted individuals worldwide. A municipality should primarily operate as a business with a significant goal being to increase service levels while controlling /reducing costs, which ultimately impact taxpayer rates and other taxpayer charges, fees, levies, etc., regardless of the method of collection or what entity the charges originate from (e.g., Municipally Controlled Corporations – i.e., hydro/water, etc.).

The Canadian Federal Government has mandated the AG position which is overwhelmingly viewed as the taxpayers' best friend; uncovering and disclosing billions in government waste, fraud, abuse, etc. We need look no further than the recent Senate scandals. The AG position is also mandated in the Ontario government, and has achieved significant successes in a similar fashion.

Certain provinces have also mandated the AG position for municipalities; and, although the models/framework may differ, the requirements are similar in nature and generally allow the same key goals and objectives to be achieved. A few examples facilitating transparency and accountability at the municipal level include BC which has appointed an AG for Local Government http://www.aglg.ca/, Nova Scotia has also appointed an AG http://www.gov.ns.ca/snsmr/municipal/finance/audits-and-auditors.asp and in Quebec, municipalities with a population of 100,000 or more must appoint an AG.

It is unclear why the Ontario government allows this function to be optional. More importantly is the fact the elected officials allowed to make the decision are in a conflicting capacity.

With all the recent and past reported scandals occurring at all levels of government, oversight should be an area addressed with a critical sense of urgency. Responsibility to ensure Municipal taxpayer protection resides with the Ontario Government as the creators of municipal law.

As I have stated above, The Act does allow for oversight, however, the law as written, even if voluntarily adopted, is not strong enough to protect the very people it is written to protect, nor does it protect the people accepting the appointed positions of Auditor General (AG), Ombudsman, or Integrity Commissioner. Windsor has eliminated the AG function, Oshawa recently terminated the AG and the AG function, and Sudbury has experienced significant controversy (refer to media articles) with regard to the position and function.

I will essentially focus on Ontario's current structure as written, not to say that an alternative Municipal Auditor General Model would not work. It is critical however, that certain concepts exist in any framework/model, the main one being the ability for these functions to act independently and without fear of repercussions.

MCOI-Act concerns will follow the next section.

Ontario Municipal Act – Deficiencies and Opportunities

For the purposes of this report, I will focus on the appointed position of "Auditor General". I will cite the excerpt from The Act and note the Deficiency/Concern (C) and Opportunity/Recommendation (R).

> *Section 223.19 (1) Auditor General – Without limiting sections 9, 10 and 11, those sections authorize the municipality to appoint an Auditor General who reports to council and is responsible for assisting the council in holding itself and its administrators accountable for the quality of stewardship over public funds and for achievement of value for money in municipal operations.*

(C) - Position is optional; hence, no oversight is required by law. Volunteer appointments are rare and even if an appointment is made, independence is compromised (e.g., the ability of Council to control/terminate position).

(R) – Mandate an onsite position for municipalities exceeding certain prescribed thresholds (i.e., population, revenues, expenses, tax levy, operational budget, etc.). Municipalities not meeting the threshold would most likely not be able to afford a full-time Auditor General. In this case, I recommend that these smaller municipalities be required to contribute a certain percentage of funds (based on certain criteria) to establish and maintain a Regional Auditor General Team (possibly two teams). A certain number of hours could be allocated to audit each location on a rotational basis over a three or five year period. A regional risk-based audit plan could be developed and all auditable entities would be deemed in scope.

(C) - Position reports to council. This reporting structure results in a lack of independence and constitutes a conflict of interest. Council is an extension of administration in that every key (and many times not key) decision requires authorization and approval by this very body. Council is not independent and does not operate at an arms-length like a Board of Directors of a public company where management is directed by the board but management is provided the day to day freedom to make decisions and run the company (understanding certain boards are more involved than others). Boards view their role as oversight, they direct, whereas council has a heavy hand in running the day to day operations of the corporation. Many councils micromanage the day to day to the point they could very well be deemed an extension of

administration or the highest level of administration. The fact that reports are made public in a municipality also has significant impact as negative exposure is clearly unfavorable to an elected politician.

(R) - This position should report functionally to the Ontario Government and administratively to City Council. An alternative would be to empower and delegate full authority to a fully independent Audit Committee with a reporting provision allowing both the Audit Committee and the Auditor General access to a body of the Ontario Government with powers to hear and reverse decisions made with regard to termination, compensation, staffing, etc.

An additional clause should be added with regard to "Accountability". The Auditor General should be primarily accountable to taxpayers but also accountable to the Municipality and the Ontario Government. This would be achieved by providing reports to taxpayers through the Ontario Government or through a fully independent Audit Committee (as the alternative suggests) and the Municipality.

> *Section 223.19 (1.1) The Auditor General shall perform his or her responsibilities under this Part in an independent manner.*

(C) - This was a necessary addition to the act (added in 2009); unfortunately, as written, the intent can be challenged due to the vagueness.

(R) – Enhancements are necessary to allow the position to function appropriately – the intent of the law is what is important - e.g., why is an AG role in existence, why was the independence statement added?

The following changes are necessary:

a. Only the Ontario Government should be able to remove the appointed Municipal Auditor General – removal decisions should be decided by an independent review commission formed within the Ontario Government. Both Council and the Auditor General should be granted opportunities to present their respective cases.
b. All compensation issues with regard to the Auditor General should be addressed and controlled by the Ontario Government.
c. AGO budget should be mandated by the Ontario Government and based on a percentage of total revenues (refer to the Institute of Internal Auditors GAIN study for benchmarking purposes) and/or other relevant criteria.
d. For smaller municipalities not meeting the threshold for an onsite AG, a formula/calculation should be developed to ensure each municipality pays a fair and equitable amount to cover the cost of the Regional Auditor General Team(s).
e. All significant disputes should be resolved at the Provincial level.

> *Section 223.19 (3) Powers and duties – Subject to this Part, in carrying out his or her responsibilities, the Auditor General may exercise the powers and shall perform the duties as may be assigned to him or her by the municipality in respect of the municipality, its local boards and such municipally-controlled corporations and grant recipients as the municipality may specify.*

(C) - Power to decide scope resides with the very municipality subject to audit. It is unreasonable to allow individuals responsible for the decision making to have full autonomy over a function designed to provide

independent oversight for the taxpayers. Municipally Controlled Corporations (MCCs) are created by the municipality and even though they are taxpayer owned, taxpayers are prevented in most cases from having any knowledge of how they are run – they operate as if they are a privately owned company. A significant conflict arises when council establishes paid boards (compensation is material in many cases) and self-appoints themselves to these boards while also making decisions pertaining to these very entities while sitting in their council chairs. By any reasonable standard, and by most definitions, this would constitute a Conflict of Interest; however, interpretations and exemptions in the MCOI-Act have made people wary of filing a suit in court. Taxpayer's fear of losing a court case and having to pick up the astronomical legal fees the City is willing to spend (and funded by taxpayers) to protect their position has negated the desire to take action.

(R) - Powers and duties should be granted/approved by the Ontario Government and the audit universe should include anything and everything funded by the taxpayer including loans, grants, MCCs, grant recipients, etc. Everything should be deemed in scope unless there is a bona-fide reason for exclusion. In addition, rules should be written into law disallowing Councillors to sit on paid boards created by Council itself, thus eliminating at least one significant conflict. Other conflicts of interest would have to be dealt with in the normal course of business accordingly.

Other Changes to Municipal Law Necessary to Protect the Taxpayer and the AG function:

- Prescribed penalties and sanctions should exist and be severe with regard to interference with the AG function.
- Whistleblower protection should be robust and significant, and remediation measures should be firm, explicit, and timely.
- As stated above, paid MCC boards and related Conflicts of Interest require immediate changes including elimination of Councillor compensation with respect to paid boards.

An inordinate amount of supplementary best practice guidelines and information exists and there is overwhelming evidence that corporations and organizations adhere to, and hold themselves accountable to the standards outlined by these organizations.

Although the Municipal Act is law, an approved Charter/Mandate which can become an approved bylaw can be an effective tool to incorporate enhancements to the function to compensate for the current deficiencies of The Act/MCOI-Act. The problem however, remains that approval must come from Council, the very body that may not want to provide oxygen to the AG.

This returns us to the issue of City Council controlling what is supposed to be, in both spirit and intent, an independent Auditor General. A red flag is raised, "why are these individuals voting against the highest level of independent oversight allowing for the greatest powers currently available – through an AG?" Clearly it is not a cost issue because an AG budget is certainly immaterial in comparison to annual spending, and it has clearly been demonstrated that the Return on Investment has always been positive when a well-funded, well-managed function is allowed to exist. Yet, taxpayers hear every reason possible to not allow for the best form of transparency and accountability.

This is why Municipal Law must be enhanced to protect the taxpayers of Ontario. In addition, the Ontario government funds the municipalities through various grants, loans, etc., and should therefore be comfortable that the municipalities are spending appropriately including quality of stewardship over public funds and for achievement of value for money in municipal operations.

Included are excerpts from key documents from the Institute of Internal Auditors ("IIA") – perhaps certain concepts included in these documents will assist in strengthening both The Act and the MCOI-Act. The Association of Certified Fraud Examiners (ACFE) also provides a wealth of invaluable information to help address some of the shortfalls in municipal law.

The Institute of Internal Auditors ("IIA") is an international professional association and is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator. The IIA has implemented the "International Professional Practices Framework" ("IPPF") which provides the guiding framework from which the AGO Office should be run and would serve to fill the gaping holes in addition to supplementing the Municipal Act. The IPPF could also be utilized to assist in creating the Charter and the Mandate for which the AGO should be governed.

Aside from the IPPF, two documents can be extremely helpful in assisting with developing best practices for the department. The first document is titled "IIA - Supplemental Guidance: The Role of Auditing in Public Sector Governance (2nd edition - January 2012)". Refer to APPENDIX A. The second document is supplementary to the IPPF and is titled; "IPPF – Practice guide – Independence and Objectivity". Please refer to APPENDIX B.

Ontario Municipal Conflict of Interest Act

Rather than highlighting sections and excerpts of the MCOI-Act, I am merely going to present the issues in the areas where I perceive there to be significant deficiencies in how the legislation is written. If there is a catch-all section, or the intent is broader and does cover the various examples, clarification is necessary. As it stands, because of a lack of clarity or certainty of intent, concerned citizens are unwilling to bring forth a lawsuit even though they feel the MCOI-Act has been breached such that no one is willing to risk losing the suit and being forced by the courts to pay the exorbitant legal fees the municipalities are willing to incur (taxpayer money – unlimited funds) for personal benefit, fighting the issue in court.

Although the concepts are generally the same wherever defined, I've included two examples of "Conflict of Interest" definitions:

> Merriam-Webster: a conflict between the private interests and the official responsibilities of a person in a position of trust.
>
> BusinessDictionary.com: 1. A situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest. 2. A situation in which a party's responsibility to a second-party limits its ability to discharge its responsibility to a third-party.

To follow are a few situations which clearly present a conflict of interest by standard definition. It is unclear whether these examples would constitute a COI per the MCOI-Act. One attorney has conveyed to

me that these are exceptions per the MCOI-Act; however, if that's the case, clearly, I suggest the act needs to be re-written.

Scenario #1: Member of a voluntary "Committee" and also a highly paid Sr. Executive of a Municipally Controlled Corporation ("MCC").

A COI exists if, while in the voluntary "Committee" role, this person votes on material matters specific to the MCC of which they are a Sr. Executive, and which could positively or negatively impact this individual. The exemptions in the MCOI-Act make this unclear. I recommend an explicit law be added to forbid this individual from participating in any decisions related to their MCC role regardless of whether there could be direct or indirect impact.

Scenario #2: Mayor/Councillor also functioning in the capacity of a self-appointed paid (material to total compensation received from Mayor/Council positions) board member of several MCC's.

A Mayor and Council sitting on one of these self-appointed paid MCC boards receiving significant portions of their income (in some cases over half their total income) from these boards should not be allowed to vote while occupying their Mayor/Council seats on material matters specific to the MCC, that could potentially have direct personal impact, favorable or unfavorable. A problem exists in that many issues voted on have direct or indirect impact on these individuals personally even though the issue itself may not appear to present a COI on the surface (e.g., an independent audit function existence, budget & scope). Again, the exemptions in the MCOI-Act make this unclear.

Scenario #3: Mayor appointing himself/herself as CEO of a MCC of which he/she is also Chairman of the Board

This constitutes a clear COI regardless of which role he/she is playing. Again, the exemptions in the MCOI-Act make this unclear.

With regard to the second and third scenarios, a Mayor/Councillor should not be entitled to self-appoint and/or sit on any of these paid MCC Boards, nor be appointed to a CEO position of a MCC – examples of excessive board compensation (e.g., approximately 1/3 of their remuneration from MCCs) has been reported in the media and this most certainly exacerbates the COI in addition to the COI from purely a control standpoint. Dependent upon the situation, I believe these appointments represent both real and perceived conflicts and should be halted immediately; hence, the exceptions/exemptions should be rewritten or eliminated where these situations are allowed to occur. I recommend in particular that exception (h) be eliminated i.e., (h) by reason only of the member being a director or senior officer of a corporation incorporated for the purpose of carrying on business for and on behalf of the municipality or local board or by reason only of the member being a member of a board, commission, or other body as an appointee of a council or local board.

Scenario #4: Another separate and distinct example of a clear conflict of interest arises when a complaint/allegation is filed by an employee of the City and the investigator and/or firm hired by the City to perform the investigation has performed a significant amount of work for the City.

The conflict arises such that a report reflecting negatively upon the City could jeopardize any future work for that particular investigator and/or the firm itself. This situation reminds us of what the SOX Act has tried to accomplish in disallowing the external auditors from performing certain other significant consulting type work for fear of losing their independence with regard to the required financial statement audit. Although the situation is reversed (i.e., external auditors performing the required financial statement audit which requires independence hired to do "other work" verse a lawyer/firm performing "other work" hired to perform an investigation which should require independence), it is easy to draw a conclusion of similarity. Similarities can also be drawn with regard to Cities choosing to voluntarily pay an outside service provider firm to perform the Ombudsman role (e.g., Windsor) when the Ombudsman services, which are clearly independent, can be had for free. Many people have referred to these concepts as "opinion shopping" or "purchased opinions".

There is clearly a lack of independence and lawyers/firms selected to perform these investigations are in many instances, advocates for their clients. This differs from the role of an external accountant performing a financial statement audit or testifying as an expert witness in a forensic investigation – they are not an advocate for the client and must give an honest, unbiased and professional opinion. There have been two reports in the media regarding investigations; one in Windsor and one in Oshawa. Both investigations related to the Auditor General's office; specifically, the Auditor General in Oshawa and an individual acting in the capacity of the Auditor General in Windsor. In both cases, based on media reports, the investigators and/or their firm had performed significant work for the City and in both cases the investigator sided with the city. This clearly raises the question of whether the investigation was performed in an independent, unbiased, impartial manner. The investigation may have been fair and impartial; however, due to the prior relationships; a perception of doubt can arise and therefore, a COI exists.

I recommend only independent investigators/firms be hired to perform these investigations – both sides should be allowed to be involved in the investigator selection process similar to a mediation/arbitration to avoid any COI and provide an undisputable fair investigation – this could also eliminate costly appeals and unnecessary lawsuits.

Final Comments

Issues and concerns have been raised by a significant number of taxpayer citizens who are concerned with the way the legislation has been used (inappropriately – against intent) to insulate and protect people elected to, or hired to perform work, on behalf of the taxpayer. Groups and social media sites have been formed and developed (e.g. TAMA – Taxpayers for Accountability in Municipal Affairs, Operation Enwin, etc.), protests initiated, delegates have spoken, letters have been written, FOI requests have been made, etc., etc. To date, it is clear the advocates for transparency in government, although successful in spreading awareness, have been equally unsuccessful in having government take long overdue action.

Changes to the acts could go a long way in providing better transparency and accountability and eliminating clear conflicts of interest. Changes could improve preventative controls (an ounce of prevention equals a pound of cure), deterrents and detective controls, and provide the required oversight and monitoring functions necessary to help protect the taxpayer – everyone's ultimate goal!!

I understand the Ontario Government is under tremendous pressure to address many critical issues and I therefore truly appreciate you taking the time to read this document. I firmly believe these are important issues as well and I am looking forward to hearing the Ontario Governments response and position with regard to my observations, conclusions and recommendations. As a taxpayer, I am hopeful there is a desire to fully support the necessary changes on a timely basis.

Please feel free to contact me with any questions or concerns.

Sincerely,

Todd Langlois, CPA-CFF, CIA, CFE, CRMA, CGMA

TLG Financial Consulting

APPENDIX A

The following are excerpts from the "IIA - Supplemental Guidance: The Role of Auditing in Public Sector Governance (2nd edition - January 2012)":

Organizational independence - Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct and be perceived to conduct its work without interference. Coupled with objectivity, organizational independence contributes to the accuracy of the auditors' work and the ability to rely on reported results. Independence is greatly impacted by how a Chief Audit Executive (CAE) is appointed and can be terminated. The International Professional Practices Framework (IPPF) Practice Advisory 1110-1 states that "the CAE, reporting functionally to the board and administratively to the organization's chief executive officer, facilitates organizational independence." Important parts of this independence are the CAE's ability to be protected from management or political interference or retaliation resulting from carrying out legitimate duties in accordance with the Standards. The CAE also should be free to staff the audit activity without interference from management or undue political influence from public officials.

Sufficient funding - The audit activity must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization being audited because the budget impacts the audit activity's capacity to perform its responsibilities.

Stakeholder support - The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed public sector officials, as well as by the media and involved citizens.

Transparency - The principle of transparency relates to the openness of a public sector entity to its constituents. Good governance includes appropriate disclosure of key information to stakeholders so that they have the relevant facts about the public sector entity's performance and operations necessary to clearly understand motives and reach correct conclusions about the impacts of its actions. Accordingly, the public sector's decisions, actions, and transactions must be conducted in the open. Many public sector entities are required by law to make public documents available upon request. Additionally, many public sector entities are required by law to publish meetings notices including specific agenda items. Although the public's interest is sometimes served by protecting information from disclosure — such as instances where national security, criminal investigations, or the proprietary information of a private company would be compromised — the transparency of public sector actions and information plays a significant role in public oversight. Auditors can provide a direct link between transparency and the credibility of the public sector entity. Lawmakers and the public look to audits for assurance that public sector actions are ethical and legal, and that financial and performance-reporting accurately reflect the true measure of operations.

Integrity - The principle of integrity calls for public officials to act consistently with the ethical principles and the values, expectations, policies, and outcomes of the public sector entity. The erosion of public trust if public information and actions are not credible and reliable undermines the public sector's legitimacy and ability to govern. The political, social, economic, and environmental costs to society can be extensive. The principle of integrity also applies when information is disseminated to lending authorities or other principals who have an interest other than an ownership share. The consequences of violating the expectation of the highest integrity can be swift and shattering when the people's trust in the public sector, its institutions, and leadership is undermined.

Equity - The principle of equity relates to how fairly public sector officials exercise the power entrusted to them. The public grants its agents — public sector officials — both money and power to carry out their responsibilities. However, it is concerned with the misuse of public sector power, waste of resources, and any other issues involving corruption or poor management that could negatively impact the entity's obligations and service delivery to citizens. The need for a third party to attest to the believability (credibility) of the financial reporting, performance results, compliance, and other measures arises from several factors inherent in the relationship between the principal and its agent:

1. Conflicts of interest – Agents may use their resources and authority to benefit their own interests rather than the principal's interests.
2. Remoteness – Operations may be physically removed from the principal's direct oversight.
3. Complexity – The principal may not possess the technical expertise needed to oversee the activity.
4. Consequence of error – Errors may be costly when agents are stewards of large amounts of resources and are responsible for programs affecting citizens' lives and health.

Public sector entities must establish protections to ensure that internal audit activities are empowered to report significant issues to appropriate oversight authorities. Safeguarding auditor independence is particularly needed when the internal audit activity reports to officials who also may be held accountable for any significant problems. Examples of such protections include statutory requirements that:

- Prevent the audited organization from interfering with the conduct of audit work, staffing of the audit activity, and publication of the audit report.
- Ensure the CAE reports to the highest executive level in the public sector entity and that report distribution requirements ensure the transparency of audit results.
- Require notification to an external oversight entity in the event of plans to dismiss the CAE.
- Require that completed audit reports be made available to the public.

The reporting line of the auditor is tied to the function's independence, which is the most fundamental element of an effective and credible public sector audit activity. Because the public sector auditor's role is to provide unbiased and accurate information on the use and results of public resources, auditors must be able to conduct and report on their work without interference or the appearance of interference. Independence is achieved when the audit activity reports outside the hierarchy of the organization and activities under audit and when auditors are free to conduct their work without interference, restrictions, or pressures from the organization being audited. Such interference can occur if the audited entity limits access to records or employees, controls budget or staffing for engagements, or has authority to overrule or modify audit reports. Individual auditors also need to have independence, which means that the auditors are free from conflicts of interest or biases that could affect their impartiality, the appearance of impartiality, or how the auditor conducts the work or reports results.

"The professionals who audit federal, state, and local governments or other public entities must cope daily with career-threatening political risks from which private-sector internal auditors are largely immune."
Richard Chambers - IIA President and CEO - 2011

The Audit Committee's Role:
The audit committee can greatly strengthen the independence, integrity, and effectiveness of public sector audit activities by providing independent oversight of the internal and external audit work plans and results, assessing audit resource needs, and mediating the auditors' relationship with the

organization. Audit committees also ensure that audit results are aired and any recommended improvements or corrective actions are addressed or resolved.

Where an audit committee is established, depending on the characteristics of the jurisdiction, it should strive to:

1. Operate under a formal mandate, preferably legislation, with sufficient authority to complete its mandate.
2. Include independent members who collectively possess sufficient knowledge of audit, finance, risk, and control.
3. Be chaired by a member who is not the individual to whom a CAE reports administratively.
4. Assess the effectiveness of the organization's governance, risk management, and control frameworks and legislative and regulatory compliance.
5. Provide oversight to the organization's internal and external audit activities, including ensuring adequate coverage and resources, approving the internal audit charter and audit plans, reviewing the audit activity's performance, and approving the appointment or termination of internal and external auditors.
6. Oversee the organization's financial reporting and accounting standards.
7. Provide a direct link and regular reporting to the organization's governing board, council, or other authority.

APPENDIX B

The following are excerpts from the "IPPF – Practice guide – Independence and Objectivity":

1100 – Independence and Objectivity (Standard)
The internal audit activity must be independent, and internal auditors must be objective in performing their work.
Interpretation:
"Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. . . . Objectivity is 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."

1110 – Organizational Independence (Standard)
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.
Interpretation:
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.*

1130 – Impairment to Independence or Objectivity (Standard)
If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment. The various standards and practice advisories related to independence and objectivity are reproduced in detail in the appendix of this practice guide.