

## Policy 3110 – Independence and Ethics

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### BACKGROUND

In order to fulfill the Office's mission to promote government accountability, staff must perform and report on all engagements with unbiased impartiality in both fact and appearance. Generally Accepted Auditing Standards also recognize the primary significance of the auditor's role as an unquestionably impartial professional. The American Institute of Certified Public Accountants' Professional Standards (Volume 2, Section ET), *Government Auditing Standards* (Yellow Book), and Washington state law, including RCW 42.52.020 require audit organizations and individual auditors to maintain independence in fact and appearance in all matters related to the audit process.

Washington state law addresses conflicts of interest, including RCW 42.52.020 as do interpretations by the State Executive Ethics Board. The Board, in Advisory Opinion 98-11, states:

"No state officer or state employee may have an interest, financial or otherwise, direct or indirect, or engage in a business or transaction or professional activity, or incur an obligation of any nature, that is in conflict with the proper discharge of the state officer's or state employee's official duties.

Prospective employment is an interest that may conflict with the proper discharge of a state officer's or state employee's official duties when the state officer or state employee participates in matters that affect the interests of the prospective employer.

To avoid a conflict of interest, the state officer or state employee may disclose the fact that he or she is considering prospective employment to a supervisor, and ask that he or she be removed from participating in any matter that involves the prospective employer. In choosing to disclose and recuse from participation, the state officer or state employee may effectively remove concerns that their judgment has been affected, or that prospective employment has influenced the performance of official duties."

The ethical principles that guide the work of auditors who conduct audits in accordance with *Government Auditing Standards* are **a.** the public interest; **b.** integrity; **c.** objectivity; **d.** proper use of government information, resources, and position; and **e.** professional behavior. These ethical principles provide the foundation, discipline and structure that influence the application of *Government Auditing Standards*.

### REQUIREMENTS

- ✓ **1. In all matters relating to an engagement, staff must maintain independence of mind and independence in appearance.**

Independence of mind is the state of mind that permits the performance of an audit without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

Independence in appearance is the absence of circumstances that would cause a reasonable and informed third party, having knowledge of the relevant information, to reasonably conclude that the integrity, objectivity, and professional skepticism of an audit organization or member of the audit team had been compromised.

✓ 2. **Audit directors are ultimately responsible for ensuring that each engagement is conducted by staff who are independent and free from conflicts of interest.**

a. The directors have assigned the responsibility for managing audit staff independence on each engagement to the following:

- For state and local audits, the designee is the team's audit manager
- For performance and IT audits, the designee is the appropriate assistant director

The term "designee" refers to the responsible individual identified above throughout the remainder of the policy.

b. Each staff member is responsible for notifying the appropriate designee in writing when intending to or making an application for employment with any entity/agency SAO audits. If the staff member is currently working on any engagement that might be affected by the prospective employment, the notification shall include a request to be removed from participation in that engagement.

c. Each individual staff member is further responsible for notifying, in writing, the appropriate designee if he or she becomes aware of any actual or potential conflicts of interest or impairment of objectivity or independence related to any engagement(s), including receipt of any formal or informal unsolicited offer of employment from a current auditee, or circumstances that create a

- self-interest threat, such as having a direct financial interest in the audited entity
- self-review threat, such as involvement in designing or implementing the system(s) being audited
- bias threat, such as having convictions or preconceived ideas about the objectives of a program being audited to the extent the auditor cannot be objective
- familiarity threat, such as having an immediate or close family member, or a close relationship with someone, who is a principal or senior manager of the audited entity, or who is in a position to exert significant influence over the subject matter of the audit
- undue influence threat, such as external interference or influence that could improperly limit or modify the scope of an audit
- management participation threat, including a member of the audit team having recently been a principal or senior manager of the audited entity

Additional examples of threats to auditor independence can be found in the references noted at the end of this policy.

- d. Designees will immediately inform their assistant director or director, and the Director of Quality Assurance, in writing, when they receive any such notifications under 2b or 2c, or if they become aware of any other actual or potential conflicts of interest or impairment of objectivity or independence, including concerns voiced by external parties. As part of that written communication, the designee should provide their assessment of the potential threat to independence, if any, and should report on the actions being taken or proposed to address it. If the threat is significant, that can include immediately relieving the staff member of all responsibilities associated with an engagement. In addition, the designee's assistant director or director, as appropriate, should provide their concurrence with the actions being proposed.
- e. The Director of Quality Assurance will evaluate the significance of the threat in accordance with the *conceptual framework* (see Yellow Book paragraphs 3.26 - .51) in order to ensure identified threats to independence are at an acceptable level or have been eliminated or reduced to an acceptable level. The Director of Quality Assurance will respond in writing to any notifications received under this policy, providing the results of this evaluation and any recommendations for further action.
- f. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, designees will ensure the threats and the safeguards applied to eliminate the threats or reduce them to an acceptable level are documented in the work papers.
- g. Monthly, each staff member will certify their objectivity, freedom from conflicts of interest, and independence when submitting their timesheet for supervisory approval.
- h. Annually, employees must certify they have read the required audit and administrative policies, including Audit Policy 3110 - Independence and Ethics and Audit Policy 3120 – Independence Related to Nonaudit Services and Routine Advice to Audited Entities.
- i. Upon hire, annually, and any time a change in status occurs, all employees must complete the Outside Employment / Conflict of Interest Declaration form.
- j. The Office may take disciplinary action against employees who do not comply with the requirements of this policy.

✓ 3. **To avoid familiarity threats to independence, local and state team audit managers will rotate auditors-in-charge and supervisors between their entity audits, with the exception of assessment audits. For state teams, rotation may be based on the types of audits performed, not the entity.**

To avoid familiarity threats for local audit teams, audit staff should not be assigned as an auditor-in-charge (AIC) and/or supervisor for audits of the same entity for more than five consecutive audit periods, followed by a reassignment from all that entity's engagements for at least two consecutive audit periods.

For audits performed by state teams, AIC's and/or supervisors should not be assigned to the same accountability audit, financial audit, or single audit (or major component thereof)

for more than five consecutive audit periods, followed by a reassignment to another type of audit for at least two consecutive audit periods.

Managers are encouraged to rotate all audit staff more frequently than five audit periods, considering other engagement and staffing factors, for staff development purposes.

Managers will request approval from their director or designee for any exceptions to this policy. The written request must include justification explaining why the auditor's independence would not be impaired. The director or designee will consult with the Director of Quality Assurance for concurrence on the audit staffing plan and safeguards to impairment.

These rotation requirements do not apply to assessment audits, as these audits are so brief and remote that the familiarity threat to independence is sufficiently reduced. These rotation requirements also do not apply to performance audits or cybersecurity audits, as these audits do not involve regular audit cycles with the same audit clients.

- ✓ 4. **When a former employee of the State Auditor's Office is serving in a management- or policy-level position for an entity or agency we plan to audit, the director or designee will develop a staffing plan that adequately safeguards the Office's independence.**

Management- and policy-level positions can include controller, finance director, chief finance or accounting officer, or a program's director or assistant director. The designee will submit a staffing recommendation for the coming engagement to the appropriate assistant director or director for review and approval. Assistant directors will consult with the applicable director during the approval process.

The director or designee will forward the proposed staffing recommendation and plan to the Director of Quality Assurance, who will evaluate whether the proposed staffing plan has eliminated or reduced to an acceptable level any potential threat to the Office's independence. The Director of Quality Assurance will respond in writing to any notification received under this policy, providing the results of this evaluation and any recommendations for further action.

- ✓ 5. **When the State Auditor's Office hires an employee from a state or local government, the employee will not be assigned to perform audit-related work on that state or local government for a period of at least 12 months from the employee's hiring date.**

Any exceptions to this policy must be approved in writing by the team's director or designated assistant director, and the Director of Quality Assurance.

- ✓ 6. **Staff of the State Auditor's Office will not request a business reference from staff of a state agency or local government, nor should they provide one for those individuals.**

Any exceptions to this policy must be approved in writing by the team's director or designated assistant director, and the Director of Quality Assurance.

Requesting a reference from auditee staff creates a self-interest threat to independence and is also a violation of RCW 42.52. Additionally, providing a reference for staff of a state agency or local government could create the appearance of an independence impairment; therefore, SAO staff should obtain approval before doing so, as described above.

- ✓ 7. **If an impairment to independence is identified after the report is issued, the Director of Quality Assurance will immediately be notified and will assess whether the Office complied with Government Auditing Standards and determine the effect on the report.**

If the Director of Quality Assurance concludes the Office did not comply with *Government Auditing Standards*, we will notify in writing entity management, those charged with governance, and others on the standard distribution list who received a copy of the report about the independence impairment and associated effect. A public notification will also be posted on the Office's website indicating the report was removed.

The applicable director or designee, in consultation with the Director of Quality Assurance, will determine whether to conduct additional audit work necessary to either support the reposting of the original report or to reissue the report with revised findings or conclusions.

## ***RELATED POLICIES***

Outside Employment and Conflict of Interest Administrative Policy  
3120 – Independence Related to Non-Audit Services  
3230 - Using the Work of Specialists

## ***REFERENCES***

Government Auditing Standards (Yellow Book) ¶3.18-.108  
AU-C §200.15-16 – Overall Objectives of the Independent Auditor  
AT-C §105.27.a – Concepts Common to All Attestation Engagements