

What is the IIA's definition
of *internal auditing*?

What is the *organization*
within the IIA that develops
the professional standards
for the internal auditing
profession?

What are the IIA
Standards
and what are their
four purposes?

What is the function of the
Attribute Standards?

How do we define
*"purpose, authority,
and responsibility"*
(Standard 1000)?

What is the
internal audit charter
and what does it define?

The Internal Auditing Standards Board (IASB) is charged by the IIA to develop professional standards for internal auditors.

Attribute Standards are concerned with the characteristics of the organization and the parties who will be performing the auditing activities.

The internal audit charter provides the Internal Audit Activity (IAA) with a formal mandate to do its work. This charter must be written by and come from the board of directors and senior management. It should also define the following items in respect to the IAA:

- 1) The scope of the services and work to be performed;
- 2) The objectives of the internal audit activity;
- 3) The authority that the internal audit activity has to access records, personnel and physical properties in the organization;
- 4) The accountability of the internal audit activity; and
- 5) The responsibility of the internal audit activity.

The IIA's definition of internal auditing is:

"An independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

The *Standards* are the criteria by which internal auditors should perform their duties. They represent the best practices of internal auditing, and the criteria applicable to all internal auditing departments. The professional *Standards* have the following four purposes:

- 1) Delineate (outline) basic principles that represent the practice of internal auditing, as it should be.
- 2) Provide a framework for performing and promoting a broad range of value-added internal audit activities.
- 3) Establish the basis for the evaluation of internal audit performance.
- 4) Foster (support) improved organizational processes and operations.

The professional standards consist of Attribute, Performance and Implementation Standards.

"The purpose, authority, and responsibility of the internal audit activity (IAA) must be formally defined in a charter, consistent with the *Standards*, and approved by the board."

A company's management and the board of directors is responsible for the organization's internal control. Internal auditors monitor the performance of the organization's internal control systems. Thus, internal auditing has developed in order to assist management in carrying out its monitoring responsibilities effectively and efficiently. The objective of internal audit is to promote effective control at a reasonable cost.

Describe the
audit committee
and its members.

What are the
specific functions
of the audit committee?

What are
Consulting Services?

Why are the terms
independence
and *objectivity*
important for
internal auditors?

What is
functional reporting?

What is
administrative reporting?

The specific functions of the Audit Committee are:

- 1) Aiding the board in selecting external auditors, detailing the scope of their work, reviewing engagement letters and negotiating fees.
- 2) Approving external auditor work plans.
- 3) Receiving copies of all external and internal audit reports and communications, and management's responses to them.
- 4) Reviewing all financial communications and statements to be publicly issued by the company.
- 5) Approving the strategy, activity and work plan of the internal audit activity, ensuring that it has sufficient staff and resources to function as planned.
- 6) Reviewing evaluations of risk management, control and corporate governance reported by auditors.
- 7) Communicating as necessary with the chief executive officer, either inside the meeting, or by other means.
- 8) Reviewing policies to eliminate illegal and unethical practices.

Independence is important for internal auditors. However, because the company they are auditing directly employs them, it is impossible to be independent in the same manner as external auditors. Therefore, internal auditors use a different term to refer to the way in which they act in the performance of their work. This word is "objective."

Internal auditors must be objective in their work, and the IAA needs to be independent within the organization. Internal auditors are considered independent when they can perform their work freely and objectively. This means that individuals or groups within the company cannot influence or affect their work and conclusions. Independence is achieved largely through the organizational status of the IAA. If the IAA is perceived to be important and reports to the board of directors, they will be more independent because of the support that they receive from the organization's highest levels. If they report to the chief accountant and it is perceived that they do not add value to the organization, or are not viewed as important by the board, the IAA will have less independence and their work will be less useful.

Administrative Reporting facilitates the day-to-day operations of the IAA, including:

- 1) Budgeting and management accounting;
- 2) Human resources administration including personnel evaluations and compensation;
- 3) Internal communications and information flows; and
- 4) Administration of the organization's internal policies and procedures.

Ideally, the CAE should report administratively to the chief executive officer (CEO).

The audit committee is normally a subcommittee of the board of directors. Its members should be outside directors. Outside directors are board members who do not have a role in the day-to-day running of the company. The committee receives reports and communications from both external auditors and internal auditors, and should promote their views to the board as a whole.

Consulting services are defined in the Glossary to the *Standards* as:

"Advisory and related client services, the nature and scope of which are agreed upon with the client and which are intended to add value and improve an organization's operations. Examples include counsel, advice, facilitation, process design and training."

It is the role of the CAE to determine the particular form and function of a consulting engagement. When an assurance engagement is better suited for the needs of the company, the IAA should perform an assurance engagement and not some sort of similar consulting engagement.

Functional Reporting is the ultimate source of independence and authority, which means that the governing authority would:

- 1) Approve the IAA charter, internal audit risk assessment and related audit plan;
- 2) Receive communications from the CAE on the results of the IAA or other private meetings with the CAE without management present;
- 3) Approve decisions regarding the appointment or removal of the CAE; and
- 4) Make appropriate inquiries of management and the CAE to determine whether there are scope or budgetary limitations that impede the ability of the IAA to execute its responsibilities.

Ideally, the CAE should report functionally to the audit committee, board of directors, or other appropriate governing authority.

What is a
scope limitation?

What is *proficiency*?

What is
due professional care?

What is the importance of
*continuing professional
development to
internal auditors*?

What is the CAE's role
regarding the IAA's
*Quality Assurance and
Improvement Program
(QAIP)*?

What are
internal assessments?

Proficiency means that individuals must have the skills necessary to perform their jobs. Overall, proficiency is the responsibility of the CAE, but it is also critical that internal auditors have the skills that are necessary to the work they are undertaking, such as financial statement work or internal controls. Some skills are more general in their necessity, such as understanding management principles in order to recognize and evaluate materiality, which requires an appreciation of the basics of accounting, taxation, economics, business law, finance, information technology and statistics.

In addition to technical audit and accounting related skills, internal auditors need to be skilled communicators, including written and oral communications as well as interpersonal relationships. Knowledge that cannot be communicated is useless to the organization.

As part of being a Certified Internal Auditor it is required that individuals maintain the skills and knowledge necessary to successfully complete their tasks, which is done through continued professional development, referred to and known as Continuous Professional Education (CPE).

CPE may be done through professional organizations (such as the IIA), attending training, formal education classes, etc.

Internal auditors are encouraged to obtain the CIA designation as part of their continuing professional development.

Internal assessments must be carried out periodically to assure the CAE that subordinates are complying with the *Standards* and other applicable criteria. The internal audit assessment should include an ongoing review of performance of the internal audit activity, as well as a periodic review of the program from an independent person within the organization who is familiar with the internal auditing program.

Ongoing Reviews are the conclusions and follow-up actions that should be taken to assure appropriate improvements are implemented. Periodic Reviews should be designed to assess compliance with the activity's charter, the Definition of Internal Auditing, the *Standards*, the Code of Ethics, and the efficiency and effectiveness of the IAA in meeting the needs of its various stakeholders.

Scope limitations are situations in which auditors cannot accomplish the engagement's objectives and plans. They occur any time auditors are not able to perform all of the tests that they would like to perform. A scope limitation must be reported to the engagement managers who will determine the severity of the limitation and whether it will affect the auditors' ability to come to a conclusion. The more serious scope limitations, and those caused by higher-level individuals, may need to be reported to the board of directors, audit committee, or other appropriate governing authority.

Due professional care requires that internal auditors apply the skill and care expected of a reasonably prudent and competent internal auditor. This standard does not mean that the auditor will perform perfectly and never make a mistake, but it does mean that the auditor will do everything that could be expected to achieve that goal.

Internal auditors are not expected to perform a detailed review of every statement or document they receive, but they should examine the more material items in more detail than immaterial items. They should always consider the possibility of intentional errors on the part of others, inefficiencies, waste and conflicts of interest.

Assurance procedures are intended to help the auditor reduce risk in the audit, but the internal auditor must understand that assurance procedures will not guarantee that these risks will be identified or eliminated.

An important function of the CAE is to assure the quality of the work performed.

According to the *Standards*: "The CAE must develop and maintain a quality assurance and improvement program (QAIP) that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with the *Standards* and the Code of Ethics."

The CAE will be responsible for the implementation of a quality program, the monitoring of that quality program and the assessment of the quality of the program. The quality program must include both internal and external assessments.

What are
external assessments?

When can internal auditing
report that their activities
were *conducted in
accordance with
the Standards*?

When would a CAE
have to report a
disclosure of noncompliance?

What are the
key principles
of the IIA's
Code of Ethics?

What are the CAE's
overall responsibilities
in managing the IAA?

What is the
most important factor
when *prioritizing*
audit engagements?

The *Standards* state "Internal auditors are encouraged to report that their activities are conducted in accordance with the International Standards for the Professional Practice of Internal Auditing." But, internal auditors may use the statement only if the quality assessments demonstrate that the internal auditors are in compliance with the *Standards*.

The use of the compliance phrase will require periodic assessments of the quality improvement program and a conclusion that the IAA program complies with the *Standards*.

Internal auditors are expected to apply and uphold the following principles:

- 1) Integrity. The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.
- 2) Objectivity. Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.
- 3) Confidentiality. Internal auditors respect the value and ownership of information they receive and do not disclose it without appropriate authority unless there is a legal or professional obligation to do so.
- 4) Competency. Internal auditors apply the knowledge, skills, and experience needed in the performance their services.

The CAE should establish risk-based plans to determine the priorities of the internal audit activity and to make certain that they are consistent with the organization's goals.

External assessments provide an independent assurance of audit quality to the CAE, senior management, audit committee and external auditors. It is recommended that a qualified, independent person or team outside the organization conduct these external reviews at least once every five years. This more independent assessment is not as likely to be biased, but it is offset by the higher cost. This is a decision that the CAE will need to make. Also, an external assessment can probably not provide the necessary cost benefit analysis to determine if the IAA is, in total, "profitable" to the company because that financial information may not be as available to an external assessor as it would be to an internal assessor.

The external assessor must write a report that expresses an opinion as to whether or not the IAA activities are in compliance with the appropriate standards, and if not, should include recommendations for improvement.

There may be cases in which full compliance is not possible due to the lack of skilled and qualified people, or for any other reason. In the incidences when noncompliance impacts the overall scope of the operation, a Disclosure of Noncompliance statement must be made to senior management and the board.

The CAE must effectively manage the IAA to ensure that it adds value to the organization as a whole.

The CAE has the responsibility of managing the internal audit activity to ensure that:

- 1) The engagement work fulfills the general purposes and responsibilities described in the charter that was approved by senior management and accepted by the board of directors or audit committee.
- 2) The resources of the IAA are efficiently and effectively employed.
- 3) Engagement work that is performed conforms to the *Standards* for the Professional Practice of Internal Auditing.
- 4) The individual internal auditors demonstrate conformance with the Code of Ethics and *Standards*.