
CIA Part 1Internal Audit Activity's Role

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

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- 1) The **Internal Auditing Standards Board (IASB)** is charged by the IIA to develop professional standards for internal auditors.
- 2) The **International Ethics Committee** maintains the Code of Ethics and also investigates complaints against members of the IIA or CIAs.
- 3) The **Board of Regents** establishes the requirements to become a CIA and also the CPE requirements.
- 4) The **Professional Issues Committee** reviews and releases the Practice Advisories. Practice Advisories are not mandatory, but they are viewed by the IIA as best practices.
- 5) The **Executive Committee** approves the administrative directives that are submitted by the appropriate committees.
- 6) **Administrative Directives** specify the processes and procedures that must be followed by the IIA and the IASB in regard to the administration of the Standards and the related pronouncements.

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In 2004, the IIA
expanded its definition
of internal auditing
to include what *activities*?

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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**.

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In 2004, the IIA
expanded its definition
of internal auditing
to include what *services*?

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

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What are the *organizations* that help establish the standards for professional internal auditors?

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What are the IIA *standards* and what are their *four purposes*?

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What are *attribute standards*?

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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."

Internal audit activities, which are performed:

- 1) in diverse legal and cultural environments;
- 2) within organizations that vary in purpose, size, complexity, and structure; and
- 3) by persons within or outside the organization.

Compliance with the International Standards for the Professional Practice of Internal Auditing is essential if the responsibilities of internal auditors are to be met.

Assurance services, which involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding a process, system or other subject matter. The internal auditor determines the nature and scope of the assurance engagement.

Consulting services, which are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. Consulting services generally involve two parties:

- 1) the person or group offering the advice - the internal auditor; and
- 2) the person or group seeking and receiving the advice – the engagement client.

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What are the
four main components
of attribute standards?

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What are
performance standards?
List the *first three*.

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List
performance standards
four through seven.

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Implementation Standards apply to the specific types of engagements: **assurance (A)** or **consulting (C)**.

Practice Advisories represent the best practices endorsed by the IIA as a means of implementing the Standards. They are usually optional (not mandatory) and do not represent all the considerations that may be necessary when applying them, but are simply the recommended set of items that should be addressed or followed.

"The **purpose, authority, and responsibility** of the internal audit activity (IAA) should 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**.

The **internal audit charter** provides the Internal Audit Activity (IAA) with a formal mandate to do its work. This charter should 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.

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What are *implementation standards* and *practice advisories*?

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

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

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The four main components of Attribute Standards are:

- 1) **Purpose, Authority, and Responsibility** – These IAA responsibilities should be defined in the charter and approved by the board.
- 2) **Independence and Objectivity** – The IAA should be independent, and the internal auditors should be objective in performing their work.
- 3) **Proficiency and Due Professional Care** - in the performance of engagements.
- 4) **Quality Assurance and Improvement Program** – The CAE should develop and maintain a program that covers all aspects of the IAA and continuously monitors its effectiveness, including periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity to add value, improve operations and provide assurance that the internal audit activity is in conformity with the **Standards** and the **Code of Ethics**.

Performance Standards describe the IAA and criteria against which the performance of these services can be evaluated. The first three are:

- 1) **Managing the Internal Audit Activity** – The CAE should effectively manage the IAA to ensure it adds value to the organization.
- 2) **Nature of Work** – The IAA should evaluate and contribute to the improvement of risk management, control, and governance processes using a systematic and disciplined approach.
- 3) **Engagement Planning** – Auditors should create a plan for each **engagement, including objectives, timing and resource allocations**.

Performance Standards four through seven are:

- 4) **Performing the Engagement** – Auditors should identify, analyze, evaluate, and record sufficient information to achieve the objectives.
- 5) **Communicating Results** – Internal auditors should communicate the engagement results.
- 6) **Monitoring Progress** – The CAE should monitor the disposition of results communicated to management.
- 7) **Resolution of Management's Acceptance of Risks** – If the CAE believes that senior management has accepted a level of residual risk that may be inappropriate, s/he must address the matter with them and further report it to the board if unresolved.

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Who are the *members* of
the audit committee?

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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.

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What are the
specific functions
of the audit committee?

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How do the
Standards define
consulting services?

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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.

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

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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.

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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.

What is
functional reporting?

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.

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What is *administrative reporting?*

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Describe a *scope limitation* as an impairment to independence or objectivity?

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What is *proficiency?*

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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.

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. In fact, after the CIA is obtained, to maintain the license, CPE is required.

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

According to the Standards: "The CAE should develop and maintain a quality assurance and improvement program 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 should include both internal and external assessments.

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What are the *requirements* of due professional care?

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

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Does the CAE play a part in *assuring quality*?

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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).

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 should 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.

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.

What are *internal assessments?*

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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 non-compliance impacts the overall scope of the operation, a **Disclosure of Noncompliance** statement should be made to senior management and the board.

What are *external assessments?*

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The IIA's statement on applicability and enforcement is:

"The IIA 'Code of Ethics' applies to both individuals and entities that provide internal auditing services. For Institute members and recipients of or candidates for IIA professional certifications, breaches of the Code of Ethics will be evaluated and administered according to The Institute's Bylaws and Administrative Guidelines. The fact that a particular conduct is not mentioned in the Rules of Conduct does not prevent it from being unacceptable or discreditable, and therefore, the member, certification holder, or candidate can be liable for disciplinary action."

What is the definition of *conducted in accordance with the Standards?*

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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.

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What is a *disclosure of noncompliance*?

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Internal assessments should 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 Standards, the Code of Ethics, and the efficiency and effectiveness of the IAA in meeting the needs of its various stakeholders.

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What is *applicability and enforcement* in regard to the Code of Ethics?

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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 should 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.

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What are the *key principles* that internal auditors must uphold?

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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*. Instances of noncompliance that impact the overall scope or operation of the IAA, including failure to obtain an **external** assessment by January 1, 2007, should be disclosed to senior management and the board (PA 1330-1).