PART-2 UNIT 1

1. Internal auditing is an assurance and consulting activity. An example of an assurance service is a(n)

A. Advisory engagement.

B. Facilitation engagement.

C. Training engagement.

D. Compliance engagement.

Answer (D) is correct.

According to The IIA Glossary, an assurance service is "an objective examination of evidence for the purpose of providing an independent assessment of governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements."

A. An advisory engagement is a consulting service.

B. A facilitation engagement is a consulting service.

C. A training engagement is a consulting service.

2. Which of the following potentially are subject to the internal auditors' evaluations?

1. The human resources function.

2. The purchasing process.

3. The manufacturing and production database system.

A. 1 only.

B. 2 only.

C. 1, 2, and 3.

D. None of the answers are correct.

Answer (C) is correct.

Internal auditing is an organizationally independent and individually objective assurance and consulting activity that adds value and improves operations. It evaluates and contributes to the improvement of the organization's governance, risk management, and control processes. When performing the assurance function, internal auditing evaluates the adequacy and effectiveness of controls. For example, it evaluates the effectiveness and efficiency of operations and programs.

A. Items 2 and 3 are subject to internal auditor evaluation.

B. Items 1 and 3 are subject to internal auditor evaluation.

D. All of the listed items are subject to internal auditor evaluation.

3. What is the most accurate term for the procedures used by the board to oversee activities performed to achieve organizational objectives?

A. Governance.

B. Control.

C. Risk management.

D. Monitor

Answer (A) is correct.

Governance is the “combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives” (The IIA Glossary).

B. Control is “any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved” (The IIA Glossary).

C. Risk management is “a process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization’s objectives” (The IIA Glossary).

D. Monitoring consists of actions taken by management and others to assess the quality of internal control performance over time. It is not currently defined in the Standards or The IIA Glossary.

4. A basic principle of governance is

A. Assessment of the governance process by an independent internal audit activity.

B. Holding the board, senior management, and the internal audit activity accountable for its effectiveness.

C. Exclusive use of external auditors to provide assurance about the governance process.

D. Separation of the governance process from promoting an ethical culture in the organization.

Answer (A) is correct.

The internal audit activity must assess and make appropriate recommendations for improving the governance process (Perf. Std. 2110).

B. The internal audit activity is an assessor of the governance process. It is not accountable for that process.

C. External parties and internal auditors may provide assurance about the governance process.

D. The internal audit activity must assess and make appropriate recommendations for improving the governance process in its promotion of appropriate ethics and values within the organization.

5. After using the same public accounting firm for several years, the board of directors retained another public accounting firm to perform the annual financial audit in order to reduce the annual audit fee. The new firm has now proposed a one-time engagement relating to the cost-effectiveness of the various operations of the business. The chief audit executive has been asked to advise management in making a decision on the proposal. An argument can be made that the internal audit activity is better able to perform such an engagement because

A. External auditors may not possess the same depth of understanding of the organization as the internal auditors.

B. Internal auditors are required to be objective in performing engagements.

C. Engagement procedures used by internal auditors are different from those used by external auditors.

D. Internal auditors will not be vitally concerned with fraud and waste.

Answer (A) is correct.

Internal auditing evaluates and contributes to the improvement of the organization's governance, risk management, and control processes. Accordingly, its scope of work is far broader than that of the external auditors.

B. Internal and external auditors are required to be objective.

C. Internal and external auditors use the same procedures.

D. Internal auditors are vitally concerned with fraud and waste.

6. A manufacturer has been expanding rapidly and is considering adding a new production line. Employees are currently working double shifts and receiving large amounts of overtime pay. Demand for all of the organization's products is currently high, but management worries about demand fluctuations with changes in the economy and technological developments by competitors. Management is concerned with such issues as whether it is efficiently using its resources, whether it is expanding too rapidly or not rapidly enough, whether employee morale is decreasing, and whether future expansion should be financed internally or through debt. Of the following management requests, which is within the normal scope of work of the internal audit activity as stated in the Standards?

A. Perform an independent evaluation of management's planning process as a basis for making recommendations.

B. Talk with banks to identify financing alternatives and negotiate contract alternatives that will be presented to management for evaluation.

C. Analyze financing alternatives and present the alternatives to the audit committee.

D. Undertake a make-or-buy decision analysis to determine whether the organization should subcontract for part of its manufacturing versus adding capacity. Report the recommendation to management for approval.

Answer (A) is correct.

Internal auditing is an organizationally independent and individually objective assurance and consulting activity that adds value and improves operations. It evaluates and contributes to the improvement of the organization's governance, risk management, and control processes. Thus, evaluating the planning process is within the broad scope of work of internal auditing.

B. Discussing financing alternatives with banks is a responsibility of management. Such an activity also has the potential to impair the independence of the internal audit activity.

C. Analyzing financing options is a responsibility of the finance function. Moreover, information about the analysis should be directed to management or a finance committee of the board. The audit committee is concerned with oversight of internal and external auditing functions.

D. Make-or-buy decisions are a responsibility of management.

7. Control by management is the result of

A. Planning, organizing, and directing of organizational activities.

B. Ascertaining needs, identifying alternative courses of action, setting standards for measuring performance, and comparing outcomes with predetermined standards.

C. Authorizing and monitoring performance and comparing actual performance with planned performance.

D. Determining efficiency and economy of operations, including whether objectives have been met.

8. Controls should be designed to provide reasonable assurance that

A. Organizational objectives will be achieved economically and efficiently.

B. Management's plans have not been circumvented by worker collusion.

C. The internal audit activity's guidance and oversight of management's performance is accomplished economically and efficiently.

D. Management's planning, organizing, and directing processes are properly evaluated.

Answer (A) is correct.

A control is any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives will be achieved

(The IIA Glossary). Thus, control by management is the result of proper planning, organizing, and directing.

B. Collusion is an inherent limitation of internal control.

C. Representatives of the organization’s stakeholders (e.g., the board) provide oversight of risk and control processes administered by management.

D. Internal auditors evaluate management processes to determine whether reasonable assurance exists that objectives will be achieved.

9. The internal audit activity is responsible for implementing

1. Risk management

2. Governance

3. Control

A. 1 only.

B. 2 only.

C. 3 only.

D. None of the answers are correct.

Answer (D) is correct.

The internal audit activity is responsible for evaluating and contributing to the improvement of governance, risk management, and control processes. But management is responsible for implementing those processes.

A. The internal audit activity is not responsible for implementing risk management.

B. The internal audit activity is not responsible for implementing governance.

C. The internal audit activity is not responsible for implementing controls.

10. When assessing the risk associated with an activity, an internal auditor should

A. Determine how the risk should best be managed.

B. Provide assurance on the management of the risk.

C. Update the risk management process based on risk exposures.

D. Design controls to mitigate the identified risks.

Answer (B) is correct.

The internal audit activity must evaluate and contribute to the improvement of processes using a systematic, disciplined, and risk-based approach. Assurance service is an objective of evidence examination to provide an independent assessment.

A. Risk management is a key responsibility of senior management and the board, not the internal auditor.

C. Designing and updating the risk management process is a role of management.

D. The design and implementation of controls is the responsibility of management, not internal audit.

11. Which of the following items is least likely to be considered when determining the strategy for assessing governance, risk management, and control?

A. The maturity of the processes.

B. The seniority of the persons responsible.

C. The organizational culture.

D. The members of the audit committee.

Answer (D) is correct.

The members of the audit committee, an operating committee of the board of directors, is least likely to be considered when determining the strategy for assessing governance, risk management, and control. These three processes are closely related. Ordinarily, the board is responsible for guiding governance processes, and senior management is responsible for leading risk management and control processes. The CAE typically considers (1) the maturity of these processes, (2) the seniority of the persons responsible, and (3) the organizational culture when determining the strategy for assessing governance, risk management, and control.

A. The maturity of the processes is one of the items that should be considered when determining the strategy for assessing governance, risk management, and control.

B. The seniority of the persons responsible is one of the items that should be considered when determining the strategy for assessing governance, risk management, and control.

C. The organizational culture is one of the items that should be considered when determining the strategy for assessing governance, risk management, and control.

12. When are governance, risk management, and control processes considered adequate?

A. When management has planned and designed them to provide reasonable assurance of achieving the organization’s objectives efficiently and economically.

B. When management has planned and designed them to provide absolute assurance of achieving the organization’s objectives efficiently and economically.

C. When the internal audit activity has planned and designed them to provide reasonable assurance of achieving the organization’s objectives efficiently and economically.

D. When the company is profitable.

Answer (A) is correct.

Governance, risk management, and control processes are adequate if management has planned and designed the processes to provide reasonable assurance of achieving the organization’s objectives efficiently and economically. Reasonable assurance is provided if the most cost-effective measures are taken in the design and implementation of controls to reduce risks and restrict expected deviations to a tolerable level. Efficient performance accomplishes objectives in an accurate, timely, and economical fashion while economical performance accomplishes objectives with minimal use of resources (i.e., cost) proportionate to the risk exposure.

B. Absolute assurance cannot be provided through governance, risk management, and control processes.

C. The internal audit activity may consult on the design of governance, risk management, and control processes. However, the adequacy of these processes is not contingent on the involvement of the internal audit activity in planning and designing such processes. Additionally, such involvement could potentially impair the independence of the internal audit activity.

D. A company’s profitability does not necessarily indicate that governance, risk management, and control processes are adequate.

13. Which of the following is most essential for guiding the internal audit staff?

A. Quality program assessments.

B. Position descriptions.

C. Performance appraisals.

D. Policies and procedures.

Answer (D) is correct.

The chief audit executive must establish policies and procedures to guide the internal audit activity (Perf. Std. 2040).

A. Quality program assessments do not provide specific daily guidance to the staff with respect to performance standards.

B. Position descriptions do not provide specific daily guidance to the staff with respect to performance standards.

C. Performance appraisals do not provide specific daily guidance to the staff with respect to performance standards.

14. The key factor in the success of an internal audit activity's human resources program is

A. An informal program for developing and counseling staff.

B. A compensation plan based on years of experience.

C. A well-developed set of selection criteria.

D. A program for recognizing the special interests of individual staff members.

Answer (C) is correct.

Internal auditors should be qualified and competent. Because the selection of a superior staff is dependent on the ability to evaluate applicants, selection criteria must be well-developed. Appropriate questions and forms should be prepared in advance to evaluate, among other things, the applicant's technical qualifications, educational background, personal appearance, ability to communicate, maturity, persuasiveness, self-confidence, intelligence, motivation, and potential to contribute to the organization.

A. The human resources program should be formal.

B. The quality of the human resources is more significant than compensation.

D. The quality of the human resources is more significant than special interests of the staff.

15. Written policies and procedures relative to managing the internal audit activity should

A. Ensure compliance with its performance standards.

B. Give consideration to its structure and the complexity of the work performed.

C. Result in consistent job performance.

D. Prescribe the format and distribution of engagement communications and the classification of observations.

Answer (B) is correct.

The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work (Inter. Std. 2040).

A. No written policy or procedure can ensure compliance with standards.

C. Consistent performance depends on various factors, especially adequate training and supervision.

D. The format and distribution of engagement communications and the classification of observations may vary from engagement to engagement.

16. Which of the following items would not be an appropriate staffing issue?

A. Selecting qualified and competent individuals.

B. Providing a competitive selection of employee benefits.

C. Providing continuing educational opportunities for each internal auditor.

D. Appraising each internal auditor's performance at least annually.

Answer (B) is correct.

Internal auditors must have the knowledge, skills, and other competencies to perform their responsibilities. For example, they (1) might use the competency framework for self-assessment and (2) should demonstrate proficiency by obtaining professional certifications and qualifications (IG 1210, Proficiency). But a professional development program for internal auditors does not address employee compensation.

A. Staffing addresses the proficiency of internal auditors individually and the internal audit activity as a whole.

C. Internal auditors should enhance their competencies through continuing professional development (Att. Std. 1230).

D. Regularly reviewing the performance of internal auditors provides insight regarding training requirements and feedback to aid in their professional development (IG 1210, Proficiency).

17. In most cases, an internal audit activity should document policies and procedures to ensure the consistency and quality of its work. The exception to this principle is directly related to

A. Departmentation.

B. Division of labor.

C. Size of the internal audit activity.

D. Authority.

Answer (C) is correct.

The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work (Inter. Std. 2040). Thus, all internal audit activities are not required to have a detailed policies and procedures manual.

A. Departmentation can improve communications among team members, but sufficient direct supervision may be lacking if spans of control are large.

B. Division of labor produces highly specialized individuals, but formalized guidance is necessary for newer employees if the internal audit activity is large.

D. Regardless of the degree of authority wielded by the chief audit executive, formal policies are needed in a large internal audit activity.

18. Policies and procedures must be established to guide the internal audit activity. Which of the following statements is false with respect to this requirement?

A. The form and content of written policies and procedures depend on the size of the internal audit activity.

B. All internal audit activities must have a detailed policies and procedures manual.

C. Formal administrative and technical manuals may not be needed by all internal audit activities.

D. A small internal audit activity may be managed informally through close supervision and memoranda.

Answer (B) is correct.

The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work (Inter. Std. 2040). Thus, all internal audit activities are not required to have a detailed policies and procedures manual.

A. The form and content of policies and procedures depend on the size of the internal audit activity.

C. Formal administrative and technical manuals may not be needed by all internal audit activities.

D. A small internal audit activity may be managed informally through close supervision and memos

19. Which of the items below most likely reflects differences between the policies of a relatively large and a relatively small internal audit activity? The policies for the large activity should

A. Define the scope of internal auditing.

B. Contain the authority to carry out engagements.

C. Be specific as to activities to be carried out.

D. Be in considerable detail.

Answer (D) is correct.

The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work (Inter. Std. 2040). Thus, the policies of a relatively large internal audit activity are likely to be more detailed than those of a relatively small internal audit activity.

A. The scope of internal auditing is covered in the charter.

B. The authority to carry out engagements is covered in the charter.

C. Whether the internal audit activity is large or small, it must have policies that specifically state its functions.

20. The chief audit executive for a large decentralized organization has developed a manual containing comprehensive detailed written procedures as a guide for the decentralized engagement work groups, each of which has 20 to 30 internal auditors. The organization recently acquired a small organization that has an internal audit activity consisting of a supervisor and two staff personnel. Which of the following actions is the most practical in providing administrative guidance for this new internal audit activity?

A. Select key procedures from the manual and use informal supervisory direction for other engagement management issues.

B. Use informal supervisory direction for engagement management issues.

C. Use the already developed manual.

D. Adopt the administrative procedures being followed by the internal auditors of the acquired organization.

Answer (A) is correct.

Orientation to acquaint the acquired organization's staff with the established environment should be through exposure to selected key procedures from the formal manual. The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work (Inter. Std. 2040). Thus, a small internal audit activity may be managed informally, for example, through daily close supervision and written memoranda.

B. The use of informal supervisory direction alone for new staff is inadequate.

C. Complete reliance on the existing manual would require more formal management than is necessary for a small internal audit activity.

D. Management of the new internal auditing organization should not be inconsistent with the rest of the organization.

21. Which of the following, though not appropriate for use with a large internal audit activity, is an acceptable approach for managing a small internal audit activity?

A. Preparing comprehensive policies and procedures.

B. Writing detailed instructions and guidelines for each engagement area.

C. Using only daily, close supervision and written memoranda.

D. Developing technical manuals to guide performance.

Answer (C) is correct.

Formal administrative and technical audit manuals may not be needed by all internal audit entities. A small internal audit activity may be managed informally. Its audit staff may be directed and controlled through daily, close supervision and written memoranda. In a large internal audit activity, more formal and comprehensive policies and procedures are essential to guide the internal audit staff in the execution of the internal audit plan.

A. Preparing comprehensive policies and procedures is more appropriate for managing a large internal audit activity.

B. Writing detailed instructions and guidelines for each engagement area is more appropriate for managing a large internal audit activity.

D. Developing technical manuals to guide performance is more appropriate for managing a large internal audit activity.

22. Any program for selecting and developing the human resources of the internal audit activity will fail unless compensation is adequate at all levels of responsibility. Policies concerning compensation should

A. Link internal auditors' compensation to the pay for comparable positions in the controller's department.

B. Provide for cost-of-living, longevity, and merit increases annually.

C. Be informal and as flexible as possible to allow the chief audit executive to respond to unusual situations.

D. Be clearly stated and based on evaluations of position requirements and individual performance.

Answer (D) is correct.

Internal auditing job descriptions are important because, among other things, they may be used to justify adequate salaries. As part of an overall personnel management and development program, they should be used together with periodic, formal performance appraisals as a basis for compensation adjustments and promotions.

A. No necessary correlation exists between the work of internal auditors and of the controller's staff.

B. Increases need not necessarily be annual.

C. Formal, well-defined policies are preferable to avoid misunderstandings.

23. Inquiring how an employment candidate handled situations in their past is an example of which interview method?

A. Behavioral.

B. Stress.

C. Structured.

D. Unstructured.

Answer (A) is correct.

Behavioral interviews determine how candidates handled situations in their past. It is based on the belief that past performance is generally indicative of future performance. The behavioral interview is a widely-used interview method and may include questions that ask the candidate to describe a past situation and how it was handled.

B. Stress interviews deliberately place candidates in a stressful situation to see how they react. For example, the interviewer may appear distracted or contrary, the questions may be strange, or candidates may be placed in an uncomfortable situation. The interviewer is looking for candidates who will remain calm and keep their composure.

C. Structured interviews use a set of job-related questions with standardized answers, which are then scored. This type of interview is more formal. Questions may focus on job knowledge, job sample simulations, worker requirements, and hypothetical situational inquiries.

D. Unstructured interviews are informal and more conversational in nature. For example, the candidate may be asked to talk about themselves and their hobbies. Employers may intentionally use this casual interview style to put the candidate at ease, and the candidate may say more than they intended. In this situation, the candidate provides the structure of the conversation and should be sure to convey his or her skills and qualifications.

24. According to the International Professional Practices Framework, the internal audit activity is effectively managed when

A. Policies on responsibilities of the internal audit activity are included in the organization's operations manual.

B. Its individual members conform with the Code of Ethics and the Standards.

C. Management oversees the day-to-day operations of the internal audit activity.

D. It has the skill set and knowledge to help the organization achieve its objectives.

Answer (B) is correct.

According to the Interpretation of Standard 2000, the internal audit activity is effectively managed when

It achieves the purpose and responsibility included in the internal audit charter.

It conforms with the Standards.

Its individual members conform with the Code of Ethics and the Standards.

It considers trends and emerging issues that could impact the organization.

The internal audit activity adds value to the organization and its stakeholders when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management, and control processes; and objectively provides relevant assurance.

A. A large, mature internal audit activity may have a formal operations manual that includes policies and procedures. A smaller and less mature internal audit activity’s policies and procedures may reside in separate documents or in audit management software. The organization is not required to have an operations manual to be effectively managed by the internal audit activity.

C. Day-to-day operations of the internal audit activity are overseen by management. However, management overseeing the day-to-day operations does not ensure that the internal audit activity is effectively managed.

D. Internal auditors should be qualified and competent and possess a diverse set of skills to perform their jobs effectively. However, merely having the necessary skill set and knowledge does not ensure that the internal audit activity is effectively managed.

25. Which of the following statements is false regarding the administration of the internal audit activity?

A. Management oversees the day-to-day operations of the internal audit activity.

B. An internal audit manager may be assigned to monitor internal audit processes and emerging issues.

C. The audit committee is responsible for creating the operating and financial budget for the internal audit function.

D. Selection criteria for hiring internal auditors should be well-developed.

Answer (C) is correct.

Budgeting is included in the administrative activities of the internal audit activity. The CAE, not the audit committee, is responsible for creating the operating and financial budget for the internal audit function. Generally, the CAE, audit managers, and the internal audit activity work together to develop the budget annually. The budget is then submitted to management and the board for their review and approval.

A. Management oversees the day-to-day operations of the internal audit activity, including some administrative activities.

B. Administration of the internal audit activity's policies and procedures is included in the administrative activities of the internal audit activity. According to the Interpretation of Standard 2040, "The form and content of the organization's policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work."

D. Human resource administration, including personnel evaluations and compensation, are included in the administrative activities of the internal audit activity. Additionally, internal auditors need to possess a diverse set of skills to perform their jobs effectively. These skills are not always apparent in a standard resume. Selection of superior staff is dependent on the ability to evaluate applicants and selection criteria must be well-developed.

26. An audit committee should be designed to enhance the independence of both the internal and external auditing functions and to insulate these functions from undue management pressures. Using this criterion, audit committees should be composed of

A. A rotating subcommittee of the board of directors or its equivalent.

B. Only members from the relevant outside regulatory agencies.

C. Members from all important constituencies, specifically including representatives from banking, labor, regulatory agencies, shareholders, and officers.

D. Only external members of the board of directors or its equivalent.

Answer (D) is correct.

The audit committee of the board of directors should be composed entirely of outside directors. Outside directors are members of the board who are independent of internal management. Because the primary purpose of the audit committee is to promote the independence of the internal and external auditors from management, an audit committee composed of inside directors would be ineffective.

A. The audit committee is not required to be rotated periodically.

B. Regulators ordinarily do not serve as directors.

C. Officers are not outside directors.

27. Audit committees have been identified as a major factor in promoting the independence of both internal and external auditors. Which of the following is the most important limitation on the effectiveness of audit committees?

A. Audit committees may be composed of independent directors. However, those directors may have close personal and professional friendships with management.

B. Audit committee members are compensated by the organization and thus favor an owner's view.

C. Audit committees devote most of their efforts to external audit concerns and do not pay much attention to the internal audit activity and the overall control environment.

D. Audit committee members do not normally have degrees in the accounting or auditing fields.

Answer (A) is correct.

The audit committee is a subcommittee made up of outside directors who are independent of management. Its purpose is to help keep external and internal auditors independent of management and to ensure that the directors are exercising due care. However, if independence is impaired by personal and professional friendships, the effectiveness of the audit committee may be limited.

B. The compensation audit committee members receive is usually minimal. They should be independent and therefore not limited to an owner's perspective.

C. Although audit committees are concerned with external audits, they also devote attention to the internal audit activity.

D. Audit committee members do not need degrees in accounting or auditing to understand engagement communications.

28. The audit committee strengthens the control processes of an organization by

A. Assigning the internal audit activity responsibility for interaction with governmental agencies.

B. Using the chief audit executive as a major resource in selecting the external auditors.

C. Following up on recommendations made by the chief audit executive.

D. Approving internal audit activity policies.

Answer (C) is correct.

Among the audit committee's functions are ensuring that engagement results are given due consideration and overseeing appropriate corrective action for deficiencies noted by the internal audit activity, which includes following up on recommendations by the CAE.

A. A direct strengthening of controls does not result from this activity.

B. A direct strengthening of controls does not result from this activity.

D. A direct strengthening of controls does not result from this activity.

29. The audit committee may serve several important purposes, some of which directly benefit the internal audit activity. The most significant benefit provided by the audit committee to the internal audit activity is

A. Protecting the independence of the internal audit activity from undue management influence.

B. Reviewing annual engagement work schedules and monitoring engagement results.

C. Approving engagement work schedules, scheduling, staffing, and meeting with the internal auditors as needed.

D. Reviewing copies of the procedures manuals for selected organizational operations and meeting with organizational officials to discuss them.

Answer (A) is correct.

The audit committee is a subcommittee of the board of directors composed of outside directors who are independent of corporate management. Its purpose is to help keep external and internal auditors independent of management and to ensure that the directors are exercising due care. This committee often selects the external auditors, reviews their overall audit plan, and examines the results of external and internal audits.

B. Reviewing the audit plan and the results can be performed by the entire board.

C. Reviewing the audit plan and staffing requirements can be performed by the entire board.

D. Reviewing procedures manuals can be performed by the entire board.

30. To avoid creating conflict between the chief executive officer (CEO) and the audit committee, the chief audit executive (CAE) should

A. Submit copies of all engagement communications to the CEO and audit committee.

B. Strengthen independence through organizational status.

C. Discuss all pending engagement communications to the CEO with the audit committee.

D. Request board establishment of policies covering the internal audit activity's relationships with the audit committee.

Answer (D) is correct.

Independence is not sufficient to prevent conflict unless reporting relationships are well defined.

A. The CEO and audit committee most likely should receive summary reports. Senior management and the board ordinarily are not involved in the details of internal audit work.

B. Independence is not sufficient to prevent conflict unless reporting relationships are well defined.

C. The CEO and audit committee most likely should receive summary reports. Senior management and the board ordinarily are not involved in the details of internal audit work.

31. Which of the following actions is an appropriate response by organizations wishing to improve the public's perception of their financial reporting?

A. Increased adoption of audit committees composed of outside directors.

B. Viewing internal auditing as a transient profession—a stepping stone to managerial positions.

C. Requiring internal auditors to report all significant observations of illegal activity to the chief executive officer.

D. Keeping external and internal auditing work separated to maintain independence.

Answer (A) is correct.

The audit committee consists of outside directors who are independent of management. Its purpose is to help keep external and internal auditors independent of management and to assure that the directors are exercising due care. This committee (1) selects the external auditors; (2) reviews their overall audit plan; (3) examines the results of external and internal auditing engagements; (4) meets regularly with the CAE; and (5) reviews the internal audit activity's engagement work schedule, staffing plan, and financial budget. These functions should increase public confidence that financial statements are fairly presented.

B. Transience of internal auditors impairs the proficiency of the internal audit activity.

c. If illegal activities involve senior management, distribution of engagement communications should be to the audit committee, not the CEO.

D. The work of the internal and external auditors should be coordinated to minimize duplicate efforts. Coordination does not impair independence or reduce public confidence.

32. Which of the following is not an appropriate member of an audit committee?

A. The vice president of the local bank used by the organization.

B. An academic specializing in business administration.

C. A retired executive of a firm that had been associated with the organization.

D. The organization's vice president of operations.

Answer (D) is correct.

The audit committee consists of outside directors who are independent of management. Its purpose is to help keep external and internal auditors independent of management and to assure that the directors are exercising due care. The organization's vice president is not an outside director. The vice president of the local bank used by the organization, an academic specializing in business administration, and a retired executive of a firm that had been associated with the organization are all external parties who are usually independent of the organization's internal operations.

A. The vice president of the local bank used by the organization is an external party who is usually independent of the organization's internal operations.

B. An academic specializing in business administration is an external party who is usually independent of the organization's internal operations.

C. A retired executive of a firm that had been associated with the organization is an external party who is usually independent of the organization's internal operations.

33. Which of the following audit committee activities is of the greatest benefit to the internal audit activity?

A. Review and approval of engagement work programs.

B. Assurance that the external auditor will rely on the work of the internal audit activity whenever possible.

C. Review and endorsement of all internal auditing engagement communications prior to their release.

D. Determine whether scope limitations impede the ability of the internal audit activity to execute its responsibilities.

Answer (D) is correct.

The CAE should report functionally to the board (audit committee) to achieve organizational independence and allow the internal audit activity to fulfill its responsibilities. Functional reporting to the board typically involves, among other things, making appropriate inquiries of management and the CAE to determine whether audit scope or budgetary limitations impede the ability of the internal audit activity to fulfill its responsibilities.

A. Review and approval of engagement work programs is the responsibility of internal audit supervisors.

B. Whether the external auditor will make use of the work of internal auditing is not for the audit committee to decide.

C. Review and approval of internal audit engagement communications is the responsibility of the chief audit executive or his or her designee.

34. Which of the following features of a large manufacturer's organizational structure is a control weakness?

A. The information systems department is headed by a vice president who reports directly to the president.

B. The chief financial officer is a vice president who reports to the chief executive officer.

C. The audit committee of the board consists of the chief executive officer, the chief financial officer, and a major shareholder.

D. The controller reports to the chief financial officer.

Answer (C) is correct.

The audit committee has a control function because of its oversight of internal as well as external auditing. It should be made up of directors who are independent of management. The authority and independence of the audit committee strengthen the position of the internal audit activity.

A. This reporting relationship is a strength. It prevents the information systems operation from being dominated by a user.

B. It is a normal and appropriate reporting relationship.

D. It is a normal and appropriate reporting relationship.

35. An audit committee of the board of directors of an organization is being established. Which of the following is normally a responsibility of the committee with regard to the internal audit activity?

A. Approval of the selection and dismissal of the chief audit executive.

B. Development of the annual engagement work schedule.

C. Approval of engagement work programs.

D. Determination of engagement observations appropriate for specific engagement communications.

Answer (A) is correct.

Independence is enhanced when the board concurs in the appointment or removal of the CAE. The audit committee is a subcommittee of outside directors who are independent of management. The term "board" includes the audit committee.

B. Development of the annual engagement work schedule is an operational function of the CAE and the internal audit activity staff. A summary of the (1) audit plan, (2) work schedule, (3) staffing plan, and (4) financial budget is submitted annually to senior management and the board.

C. Approval of engagement work programs is a technical responsibility of the internal audit activity staff.

D. The determination of engagement observations appropriate for specific engagement communications is a field operation of the internal audit activity staff.

36. What is the reason the CAE must have direct and unrestricted access to the board?

A. The board is composed of financial experts and are a great resource for collaboration on financial decisions.

B. The internal audit activity needs to achieve organizational independence.

C. Stock exchanges require that all listed organizations have an audit committee.

D. The CAE must build and maintain strong constructive relationships with managers and other stakeholders.

Answer (B) is correct.

The CAE must have direct and unrestricted access to senior management and the board for the internal audit activity to achieve organizational independence. The CAE should report functionally to the board. The IIA defines a board, in part, as "[t]he highest level governing body . . . charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable."

A. Being a financial expert is not a requirement to serve on a board. Boards are often made up of a diverse group of individuals. The board is the highest level governing body for the organization and is not a resource for the CAE to assist with the making of financial decisions.

C. Many stock exchanges require that all listed organizations have an audit committee. However, this is not the reason the CAE must have direct and unrestricted access to senior management and the board.

D. According to Sawyer's Guide for Internal Auditors, 6th edition, for internal auditors to be effective, they must build and maintain strong constructive relationships with managers and other stakeholders within the organization. But this does not explain why the CAE must have direct and unrestricted access to senior management and the board.

37. Which of the following statements regarding the external auditor is true?

A. Disputes between the external auditor and management are resolved through an arbitrator.

B. Review of the external auditor's internal control and audit reports during each engagement is done by a different accounting firm.

C. The external auditor's work is overseen and reviewed by the audit committee.

D. Negotiation of the external auditor's fee is the responsibility of the corporate officers.

Answer (C) is correct.

The most important function of the audit committee is to promote the independence of the internal and external auditors by protecting them from management's influence. The audit committee (1) selects the external auditing firm and negotiates its fee, (2) oversees and reviews the work of the external auditor, (3) resolves disputes between the external auditor and management, and (4) reviews the external auditor's internal control and audit reports.

A. Disputes between the external auditor and management are resolved through the audit committee, not an arbitrator.

B. The audit committee, not a different accounting firm, is responsible for reviewing the external auditor’s internal control and audit reports. However, accounting firms often perform peer reviews on a periodic basis.

C. The audit committee, not the corporate officers, is responsible for negotiating the external audit fee.

38. Johnny Hagert, Chief Audit Executive, is determining the sufficiency of his resource allocation. Mr. Hagert must consider all of the following except

A. Communication received from management and the board.

B. The audit universe.

C. Knowledge of the internal audit staff.

D. Consequences of not completing the engagement on time.

Answer (B) is correct.

Sufficiency relates to the quantity of resources needed to accomplish the audit plan. The audit universe includes all possible audits within an organization. The audit plan only includes a portion of those audits.

A. To determine the sufficiency of resource allocation, the CAE must consider all relevant factors, including (1) communications received from management and the board; (2) information about ongoing and new engagements; (3) consequences of not completing an engagement on time; and (4) knowledge, skills, and competencies of the internal audit staff.

C. To determine the sufficiency of resource allocation, the CAE must consider all relevant factors, including (1) communications received from management and the board; (2) information about ongoing and new engagements; (3) consequences of not completing an engagement on time; and (4) knowledge, skills, and competencies of the internal audit staff.

D. To determine the sufficiency of resource allocation, the CAE must consider all relevant factors, including (1) communications received from management and the board; (2) information about ongoing and new engagements; (3) consequences of not completing an engagement on time; and (4) knowledge, skills, and competencies of the internal audit staff.

39. Gator Financial Service is considering outsourcing its internal audit activity. Gator Financial Service

A. Cannot outsource the activity because it will impair the effectiveness of the engagement.

B. Can outsource the services as long as it places responsibility for maintaining effective internal controls in the hands of the external auditor.

C. Must outsource all internal audit activity to maintain independence.

D. Can outsource the services as long as Gator Financial Service continues to have the responsibility for maintaining effective internal controls.

Answer (D) is correct.

An organization's governing body may decide that an external service provider is the most effective means of obtaining internal audit services. In these cases, Performance Standard 2070 requires that the external audit service provider remind the organization that the responsibility for maintaining effective internal controls lies with the organization.

A. An organization's governing body may decide that an external service provider is the most effective means of obtaining internal audit services.

B. An organization's governing body may decide that an external service provider is the most effective means of obtaining internal audit services. In these cases, the external audit service provider must remind the organization that the responsibility for maintaining effective internal controls lies with the organization.

C. The internal audit function is most often performed through internal sources and does not impair the independence of the engagement.

40. Which of the following parties is (are) primarily responsible for resource management in an internal auditing engagement?

1. The chief audit executive

2. Senior management

3. The board of directors

A. 1 and 2.

B. 2 and 3.

C. 1 only.

D. 1 and 3.

Answer (C) is correct.

The CAE is primarily responsible for the sufficiency and management of resources of the internal audit activity, including communication of needs and status to senior management and the board. These parties must ensure the adequacy of resources.

A. Senior management is not primarily responsible for the sufficiency and management of resources of the internal audit activity. Senior management and the board must ensure the adequacy of resources.

B. Senior management and the board of directors are not primarily responsible for the sufficiency and management of resources of the internal audit activity. These parties must ensure the adequacy of resources.

D. The board of directors is not primarily responsible for the sufficiency and management of resources of the internal audit activity. Senior management and the board must ensure the adequacy of resources.

41. Which of the following statements about the chief audit executive's responsibilities for internal audit resources is most accurate?

A. The CAE is responsible for ensuring that audit coverage is based on the skills of the internal audit activity.

B. The CAE is responsible for presenting a detailed summary of audit resources to management.

C. The CAE is responsible for the effective deployment of resources to achieve the approved audit plan.

D. The CAE is responsible for administering the organization's compensation program.

Answer (C) is correct.

The CAE must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved audit plan. This responsibility includes the effective communication of resource needs and reporting of status to senior management and the board.

A. The CAE has responsibility for ensuring that the skills assessment is driven by the needs of the audit coverage, not by the capabilities already present in the internal audit activity.

B. The CAE has responsibility for presenting a detailed summary of the status and adequacy of internal audit resources to the board.

D. The human resources (personnel) department ordinarily is responsible for administering the organization's compensation program.

42. Internal audit resources should be appropriate, sufficient, and effectively deployed. Consequently,

A. Resource planning should be limited to expected activities.

B. The chief audit executive should perform a periodic skills assessment.

C. Only members of the internal audit staff should perform internal audit activities.

D. The chief audit executive ultimately must ensure the adequacy of resources.

Answer (B) is correct.

The skills, technical knowledge, and capabilities of the internal audit staff should be appropriate for the planned work. Thus, the chief audit executive should perform a periodic skills assessment based on the needs identified in the risk assessment and the audit plan.

A. Resource planning considers (1) the audit universe, (2) relevant risks, (3) the internal audit plan, (4) coverage expectations, and (5) an estimate of unexpected activities.

C. The CAE's consideration of resourcing needs and available resources should address whether needed skills are present. If not, other appropriate ways to meet needs include (1) external service providers, (2) specialized consultants, or (3) other employees of the organization.

D. The CAE is primarily responsible for the sufficiency and management of internal audit resources, including communication of needs and status, to senior management and the board. These parties ultimately must ensure the adequacy of internal audit resources.

43. When determining the number and experience level of an internal audit staff to be assigned to an engagement, the chief audit executive should consider which of the following?

1. Complexity of the engagement.

2. Length of the engagement.

3. Available internal audit activity resources.

4. Lapsed time since the last engagement.

A. 1 and 2 only.

B. 2 and 3 only.

C. 1 and 3 only.

D. 1, 2, 3, and 4.

Answer (C) is correct.

The complexity of the engagement determines the experience and skills required of the assigned staff. Available resources also are a factor in a staffing decision.

A. Length of the engagement is not a factor affecting engagement staffing.

B. Length of the engagement is not a factor affecting engagement staffing.

D. Length of the engagement is not a factor affecting engagement staffing. Lapsed time since the last engagement is a factor affecting engagement scheduling, not staffing.

44. Which of the following statements most accurately reflects the chief audit executive's responsibilities for internal audit resources?

A. The CAE is responsible for ensuring that audit coverage is based on the periodic skills assessment.

B. The CAE is responsible for evaluating the detailed summary of audit resources presented by management to the board.

C. The CAE is not responsible for such human resource functions as evaluation and development.

D. The CAE is responsible for communicating resource needs to the board but has no explicit responsibility for administering the organization's compensation program.

Answer (D) is correct.

The CAE must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. This includes the effective communication of resource needs and reporting of status to senior management and the board. Responsibility for administering the organization’s compensation program normally resides in the human resources (personnel) area.

A. The CAE has responsibility for ensuring that the skills assessment is driven by the needs of the audit coverage, not by the capabilities already present in the internal audit activity.

B. The CAE has responsibility for presenting a detailed summary of the status and adequacy of internal audit resources to the board.

C. The CAE has responsibility for considering human resource disciplines, such as succession planning and staff evaluation and development programs.

45. The most important reason for the chief audit executive to ensure that the internal audit department has adequate and sufficient resources is to

A. Ensure that the function is adequately protected from outsourcing.

B. Demonstrate sufficient capability to meet the audit plan requirements.

C. Establish credibility with the audit committee and management.

D. Fulfill the need for effective succession planning.

Answer (B) is correct.

The CAE must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan (Perf. Std. 2030).

A. The decision to outsource the internal audit function is not primarily based on existing resources.

C. The amount of resources is not a significant factor in establishing credibility.

D. Succession planning is not related to the amount of audit resources.

46. The internal audit activity has recently experienced the departure of two internal auditors who cannot be immediately replaced due to budget constraints. Which of the following is the least desirable option for efficiently completing future engagements, given this reduction in resources?

A. Using self-assessment questionnaires to address audit objectives.

B. Employing information technology in audit planning, sampling, and documentation.

C. Eliminating consulting engagements from the engagement work schedule.

D. Filling vacancies with personnel from operating departments that are not being audited.

Answer (C) is correct.

The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan (Perf. Std. 2030). The audit schedule is reduced as a last resort once all other alternatives have been explored, including the request for additional resources.

A. Using self-assessment questionnaires is an efficient means of addressing the objectives of certain internal audits.

B. Use of technology is an appropriate means of achieving efficiencies in audit execution.

D. Using operating personnel with internal audit expertise and corporate experience is an appropriate way to enhance internal audit resources.

47. Numerous environmental laws and regulations have recently changed. Senior management has asked the chief audit executive to perform an environmental audit to be completed as soon as possible. The internal audit activity currently is performing an operational audit. As a result, the chief audit executive must make difficult decisions about resource allocation. Which of the following is the least significant issue in determining whether to reallocate audit resources?

A. The potential fraud discovered during the operational audit.

B. Potential cost to the organization for noncompliance with the new environmental laws and regulations.

C. The knowledge, skills, and competencies of the internal audit staff.

D. The results from the prior financial audits.

Answer (D) is correct.

When determining resource allocation under time constraints, the auditor must consider all relevant factors. Relevant factors include (1) information about both the ongoing and new engagement; (2) the consequences of not completing either engagement in a timely manner; and (3) the knowledge, skills, and competencies of the internal audit staff. Information about other unrelated engagements, such as prior financial audits, is irrelevant.

A. The potential fraud or other illegal actions discovered during the operational audit are relevant. Fraud always must be evaluated for its effect on achievement of organizational objectives.

B. Potential consequences, such as fines, penalties, and legal action, may be material.

C. The knowledge, skills, and competencies of the internal audit staff are crucial. Proficiency is an ethical obligation of internal auditors.

48. When assigning individual staff members to actual engagements, internal auditing managers are faced with a number of important considerations related to needs, abilities, and skills. Which of the following is the least appropriate criterion for assigning a staff internal auditor to a specific engagement?

A. The staff internal auditor’s desire for training in the area.

B. The complexity of the engagement.

C. The experience level of the internal auditor.

D. Special skills possessed by the staff internal auditor.

Answer (A) is correct.

A staff internal auditor’s desire for specific training is necessarily secondary to carrying out the responsibilities of the internal audit activity with regard to proper staffing.

B. The complexity of the engagement determines the experience and skills required of the assigned staff.

C. Experience is a factor in a staffing decision.

D. Special expertise is a factor in a staffing decision.

49. Staff members of the internal audit activity should be assigned to engagements and training projects that will enable them to develop their potential. Which of the following should be the most important consideration in making assignments that will allow staff members to develop properly?

A. The skills and experience levels of individual auditors.

B. Specific training requirements imposed by the Standards.

C. The importance of giving all staff members extensive supervisory experience.

D. Special interests of individual staff members.

Answer (A) is correct.

The program for selecting and developing the human resources of the internal audit activity should provide for written job descriptions for each level of the staff, selection of qualified and competent individuals, training and continuing educational opportunities, performance appraisals at least annually, and counsel on performance and professional development. Obviously, work assignments inconsistent with an internal auditor’s abilities will defeat the purposes of human resources development.

B. The Standards contain no specific requirements.

C. All staff members may not be ready for supervisory responsibility.

D. Although interests are not irrelevant, they are secondary to skills and experience.

50. In selecting an instructional strategy for developing internal audit staff, a chief audit executive begins by reviewing

A. Organizational objectives.

B. Learning content.

C. Learners' readiness.

D. Budget constraints.

Answer (A) is correct.

The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan (Perf. Std. 2030). The approved plan must be consistent with the goals of the organization.

B. The learning content cannot be prepared without first reviewing the organizational objectives.

C. Learners' readiness should be considered later in the program development process.

D. Budget constraints should be considered later in the process.

51. The advantage attributed to the establishment of internal auditing field offices for work at foreign locations is best described as

A. The possibility of increased objectivity of personnel assigned to a field office.

B. A reduction of travel time and related travel expense.

C. The increased ease of maintaining uniform organization-wide standards.

D. More contact with senior personnel leading to an increase in control.

Answer (B) is correct.

The advantages of field offices compared with sending internal auditors from the home office include (1) reduced travel time and expense, (2) improved service in the operating locations served by the field offices, (3) better morale of internal auditors as a result of increased authority, and (4) the possibility of employing persons who do not wish to travel.

A. Field office personnel are more likely to lose objectivity through increased contact with engagement client personnel in the area served.

C. Maintenance of organization-wide standards is more difficult after decentralization.

D. Contact with and control over field office personnel will be reduced.

52. According to the International Professional Practices Framework, the CAE must ensure that internal audit resources are

A. Relevant, adequate, and practical.

B. Applicable, competent, and well-founded.

C. Appropriate, sufficient, and effectively deployed.

D. Suitable, satisfactory, and competently displayed.

Answer (C) is correct.

According to Performance Standard 2030, Resource Management, "The chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan." As stated in the Interpretation of Standard 2030, "Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan."

A. "Relevant, adequate, and practical" are not attributes of the internal audit resources defined in the IPPF.

B. "Applicable, competent, and well-founded" are not attributes of the internal audit resources defined in the IPPF.

D. "Suitable, satisfactory, and competently displayed" are not attributes of the internal audit resources defined in the IPPF.

53. According to the International Professional Practices Framework, internal audit resources are effectively deployed when

A. The internal audit staff has the necessary attributes for the planned activities.

B. The resources needed to accomplish the plan are adequate.

C. There are more opportunities to achieve operating benefits for the engagement client.

D. They are used in a way that optimizes the achievement of the approved plan.

Answer (D) is correct.

According to the Interpretation of Standard 2030, "Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan." The CAE is primarily responsible for the sufficiency and management of resources, including communication of needs and status to senior management and the board. Resources are effectively deployed by assigning qualified auditors and developing an appropriate resourcing approach and organizational structure.