CIA Part 1
Essentials of Internal Auditing

Part 1, Domain I
Foundations of Internal Auditing

Section A: The IIA's Authoritative Guidance System

Learning Outcomes:

1. Interpret The IIA's Mission of Internal Audit, Definition of Internal Auditing, and Core Principles for the Professional Practice of Internal Auditing, and the purpose, authority, and responsibility of the internal audit activity. Tested at Proficiency level.

A. **The Institute of Internal Auditors (IIA)** is an international professional association that provides leadership and guidance for the global profession of internal auditing.

   1. Amongst the objectives of The IIA are the following:

      a. Advocating and promoting the value internal audit professionals add to their organizations.

      b. Providing comprehensive professional educational and development opportunities, standards and other professional practice guidance, and certification programs.

      c. Researching, disseminating, and promoting knowledge concerning internal auditing and its appropriate role in control, risk management, and governance to practitioners and stakeholders.

      d. Educating practitioners and other relevant audiences on best practices in internal auditing.

      e. Bringing together internal auditors from all countries to share information and experiences.

   2. The IIA has promoted the professionalization of internal auditing primarily through:

      a. Adopting a common body of knowledge identifying the related disciplines and the various competencies that are to be possessed by internal auditors.

      b. Establishing a certification program (the CIA Program) including an examination.

      c. Administering a Continuing Professional Education (CPE) program and requiring CIAs to adhere to CPE requirements.

d. Establishing an International Professional Practices Framework that includes the IIA's authoritative guidance for the global profession of internal auditing.

e. Publishing a technical journal and making it available to its members.

B. **International Professional Practices Framework (IPPF)** is the conceptual framework that organizes guidance promulgated by The IIA. Its scope only includes authoritative guidance developed by the IIA international technical boards and committees following due process. The IPPF includes the following elements:

1. **Mission of Internal Audit** – The Mission of Internal Audit is a statement that describes what internal audit aspires to accomplish within an organization. The ultimate purpose of the IPPF is to guide internal auditors in achieving the Mission of Internal Audit. As stated in the IPPF, the mission of internal audit is:

   "To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight."

2. **Mandatory Guidance –** Conformance with the mandatory guidance is required and essential for the professional practice of internal auditing. Mandatory guidance is developed following an established due diligence process, which includes a period of public exposure for stakeholder input. The mandatory elements of the IPPF are the:

   a. **Core Principles for the Professional Practice of Internal Auditing** – The Core Principles are the key elements that describe internal audit effectiveness. All the following core principles should be achieved for an internal audit function to be considered effective

      i. Demonstrates integrity.

      ii. Demonstrates competence and due professional care.

      iii. Is objective and free from undue influence (independent).

      iv. Aligns with the strategies, objectives, and risks of the organization.

      v. Is appropriately positioned and adequately resourced.

      vi. Demonstrates quality and continuous improvement.

      vii. Communicates effectively.

      viii. Provides risk-based assurance.

      ix. Is insightful, proactive, and future-focused.

      x. Promotes organizational improvement.

   b. **Definition of Internal Auditing** – will be discussed in the following pages.

   c. **Code of Ethics** – will be discussed in detail in the following pages.

   d. **International Standards for the Professional Practice of Internal Auditin**g (the Standards) – The Standards will be discussed in detail in the following pages and throughout the material.

3. **Recommended Guidance –** Recommended guidance is endorsed by the IIA through a formal approval process. It describes practices for effective implementation of the IIA's Core Principles, Definition of Internal Auditing, Code of Ethics, and Standards. The recommended elements of the IPPF are:
    a. **Implementation Guidance –** Assists internal auditors in applying the Standards as well as promoting good practices. Implementation Guides address internal audit approach, methodologies, and consideration, but do not detail processes or procedures. Prior to January 1, 2017, implementation guidance was referred to as "Practice Advisories."
    b. **Supplemental Guidance –** Provides detailed guidance for conducting internal audit activities. They include topical areas, sector-specific issues, as well as processes and procedures, tools and techniques, programs, step-by-step approaches, and examples of deliverables. Currently, the Supplemental Guidance includes the following series:
        i. Practice Guides – General.
        ii. Practice Guides – Public Sector.
        iii. Global Technology Audit Guides (GTAGs).
        iv. Guides to the Assessment of IT Risk (GAIT).

C. Definition of Internal Auditing – As defined by the Institute of Internal Auditors,

"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 governance, risk management, and control processes."

Passing Tip:	Internal auditing is: – Independent – Objective – Assurance and consulting – Designed to add value – Improve an organization's operations – Helps an organization accomplish its objectives – Evaluate and improve effectiveness of governance, risk management, and control processes.

1. The following functions represent the objectives of internal auditing and typical activities within the scope of internal auditing:
   a. Assisting members of the organization in the effective discharge of their responsibilities.
   b. Assessing an operating department's effectiveness in achieving stated organizational goals.
   c. Checking for compliance with laws and regulations.
   d. Evaluating established objectives and goals.
2. While the following functions "may" be carried out by internal auditing upon management's request, they are not typically amongst the objectives of internal auditing:
   a. Assist management with the design and implementation of accounting and control systems.
   b. Examine and evaluate the organization's accounting system as a service to management.
   c. Monitor the organization's internal control system for the external auditors.
   d. Assist the external auditor in order to reduce external audit fees.
   e. Perform studies to assist in the attainment of more efficient operations.
   f. Serve as the investigative arm of the audit committee.
   g. Safeguarding of assets.

Passing Tip:	Generally, internal auditors – Review – Assess – Provide assurance Internal auditors **DO NOT** – Design – Secure – Implement – Manage – Take responsibility for controls

D. **The International Standards**

1. **The Standards** are a set of principles-based mandatory requirements that provide a framework for performing and promoting internal auditing.
   a. The Standards refer to:
      i. Criteria by which the operations of an internal auditing department are evaluated and measured.
      ii. Statements intended to represent the practice of internal auditing as it must be.
      iii. Criteria that is applicable to all types of internal auditing services.
   b. They are numbered using a four-digit code and consist of:
      i. **Statements of core requirements** for the professional practice of internal auditing and for evaluating the effectiveness of its performance. The requirements are internationally applicable at organizational and individual levels.
      ii. **Interpretations** clarifying terms or concepts within the Standards. Interpretations, where needed, will immediately follow the associated standard.
   c. The structure of the Standards is divided between Attribute and Performance Standards:
      i. **Attribute Standards** address the attributes of organizations and individuals performing internal auditing.
      ii. **Performance Standards** describe the nature of internal auditing and provide quality criteria against which the performance of these services can be measured.
      iii. **Implementation Standards** are also provided to expand upon the Attribute and Performance standards, by providing the requirements applicable to assurance (A) or consulting (C) activities. Implementation Standards are denoted by a point and a standard number using A# for assurance and C# for consulting. For example, Implementation Standard 1000.A1 or 1000.C1.
   d. The Standards employ terms as defined specifically in the Glossary. To understand and apply the Standards correctly, it is necessary to consider the specific meanings from the Glossary. Specifically, the Standards use the word “must” to specify an unconditional requirement and the word “should” where conformance is expected unless, when applying professional judgment, circumstances justify deviation.

Passing Tip:	When an internal auditor is operating in an environment that is subject to additional standards, the internal auditor should follow both the IIA Standards and any additional governmental, statutory, or other standards.

2. **Purpose** – According to the IPPF, the purpose of the Standards is to:
   a. Guide adherence with the mandatory elements of the International Professional Practices Framework.
   b. Provide a framework for performing and promoting a broad range of value-added internal auditing services.
   c. Establish the basis for the evaluation of internal audit performance.
   d. Foster improved organizational processes and operations.
3. **The IIA's Attribute Standards**
   a. **1000–Purpose, Authority, and Responsibility –** The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the Standards, and the Definition of Internal Auditing). The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.
   b. **1100–Independence and Objectivity –** The internal audit activity must be independent, and internal auditors must be objective in performing their work.
   c. **1200–Proficiency and Due Professional Care –** Engagements must be performed with proficiency and due professional care.
   d. **1300–Quality Assurance and Improvement Program –** The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.
4. **The IIA's Performance Standards**
   a. **2000–Managing the Internal Audit Activity –** The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.
   b. **2100–Nature of Work –** The internal audit activity must evaluate and contribute to the improvement of the organization's governance, risk management, and control processes using a systematic, disciplined, and risk-based approach. Internal audit credibility and value are enhanced when auditors are proactive and their evaluations offer new insights and consider future impact.
   c. **2200–Engagement Planning –** Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations. The plan must consider the organization's strategies, objectives, and risks relevant to the engagement.
   d. **2300–Performing the Engagement –** Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives.

e. **2400–Communicating Results –** Internal auditors must communicate the results of engagements.

f. **2500–Monitoring Progress –** The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

g. **2600–Communicating the Acceptance of Risks –** When the chief audit executive concludes that management has accepted a level of risk that may be unacceptable to the organization, the chief audit executive must discuss the matter with senior management. If the chief audit executive determines that the matter has not been resolved, the chief audit executive must communicate the matter to the board.

Studying Tip:	Both the Attribute Standards and the Performance Standards are discussed in greater detail in the relevant sections of the material. Questions in this domain may only be answered after completing the other sections. The complete Standards are presented in the Appendix of Part 1.

E. **IIA's Glossary of Terms** – The complete list of the IIA Glossary is included below. These definitions do not need to be memorized, however, understanding them is very important for the exam candidates.

1. **Add Value –** The internal audit activity adds value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.
2. **Adequate Control –** Present if management has planned and organized (designed) in a manner that provides reasonable assurance that the organization's risks have been managed effectively and that the organization's goals and objectives will be achieved efficiently and economically.
3. **Assurance Services –** An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.
4. **Board –** The highest-level governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the Standards refers to a group or person charged with governance of the organization. Furthermore, "board" in the Standards may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee).

5. **Charter –** The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities.
6. **Chief Audit Executive –** Chief audit executive describes the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the International Professional Practices Framework. The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications. The specific job title and/or responsibilities of the chief audit executive may vary across organizations.
7. **Code of Ethics –** The Code of Ethics of The Institute of Internal Auditors (IIA) are Principles relevant to the profession and practice of internal auditing, and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in the global profession of internal auditing.
8. **Compliance –** Adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.
9. **Conflict of Interest –** Any relationship that is, or appears to be, not in the best interest of the organization. A conflict of interest would prejudice an individual's ability to perform his or her duties and responsibilities objectively.
10. **Consulting Services –** Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation and training.
11. **Control –** 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.

12. **Control Environment –** The attitude and actions of the board and management regarding the importance of control within the organization. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:
    a. Integrity and ethical values.
    b. Management's philosophy and operating style.
    c. Organizational structure.
    d. Assignment of authority and responsibility.
    e. Human resource policies and practices.
    f. Competence of personnel.
13. **Control Processes –** The policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organization is willing to accept.
14. **Core Principles for the Professional Practice of Internal Auditing –** are the foundation for the International Professional Practices Framework and support internal audit effectiveness.
15. **Engagement –** A specific internal audit assignment, task, or review activity, such as an internal audit, Control Self-Assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.
16. **Engagement Objectives –** Broad statements developed by internal auditors that define intended engagement accomplishments.
17. **Engagement Opinion –** The rating, conclusion, and/or other description of results of an individual internal audit engagement, relating to those aspects within the objectives and scope of the engagement.
18. **Engagement Work Program –** A document that lists the procedures to be followed during an engagement, designed to achieve the engagement plan.
19. **External Service Provider –** A person or firm outside of the organization that has special knowledge, skill, and experience in a particular discipline.
20. **Fraud –** Any illegal act characterized by deceit, concealment or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property or services; to avoid payment or loss of services; or to secure personal or business advantage.
21. **Governance –** 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.

22. **Impairment –** Impairment to organizational independence and individual objectivity may include personal conflicts of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations (funding).
23. **Independence –** The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.
24. **Information Technology Controls –** Controls that support business management and governance as well as provide general and technical controls over information technology infrastructures such as applications, information, infrastructure, and people.
25. **Information Technology Governance –** Consists of the leadership, organizational structures, and processes that ensure that the enterprise's information technology supports the organization's strategies and objectives.
26. **Internal Audit Activity –** A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.
27. **International Professional Practices Framework –** The conceptual framework that organizes the authoritative guidance promulgated by The IIA. Authoritative guidance is composed of two categories – (1) mandatory and (2) recommended.
28. **Must –** The Standards use the word "must" to specify an unconditional requirement.
29. **Objectivity –** An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.
30. **Overall Opinion –** The rating, conclusion, and/or other description of results provided by the chief audit executive addressing, at a broad level, governance, risk management, and/or control processes of the organization. An overall opinion is the professional judgment of the chief audit executive based on the results of a number of individual engagements and other activities for a specific time interval.
31. **Risk –** The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.
32. **Risk Appetite –** The level of risk that an organization is willing to accept.
33. **Risk Management –** A process to identify, assess, manage, and control potential events or situations, to provide reasonable assurance regarding the achievement of the organization's objectives.
34. **Should –** The Standards use the word "should" where conformance is expected unless, when applying professional judgment, circumstances justify deviation.

35. **Significance –** The relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors, such as magnitude, nature, effect, relevance, and impact. Professional judgment assists internal auditors when evaluating the significance of matters within the context of the relevant objectives.
36. **Standard –** A professional pronouncement promulgated by the Internal Audit Standards Board that delineates the requirements for performing a broad range of internal audit activities, and for evaluating internal audit performance.
37. **Technology-based Audit Techniques –** Any automated audit tool, such as generalized audit software, test data generators, computerized audit programs, specialized audit utilities, and computer-assisted audit techniques (CAATs).

Section B: Internal Audit Charter

Learning Outcomes:

1. Explain the requirements of an internal audit charter (required components, board approval, communication of the charter, etc.). Tested at Basic level.

According to the Standards, the **purpose, authority, and responsibility** of the internal audit activity must be **formally defined in an internal audit charter**, consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the Standards, and the Definition of Internal Auditing). The chief audit executive must periodically review the internal audit charter and present it to senior management and the **board** for approval.

A. Internal Audit Activity Charter

1. The internal audit charter is a formal document that:
    a. Defines the internal audit activity's purpose, authority, and responsibility.
    b. Establishes the internal audit activity's position within the organization.
    c. Authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and
    d. Defines the scope of internal audit activities.
2. The internal audit activity charter must recognize the mandatory nature of the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the Standards, and the Definition of Internal Auditing.
3. The nature of both assurance and consulting services provided to the organization must be defined in the internal audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances must also be defined in the internal audit charter.

Passing Tip:	The internal audit charter does **NOT** specify the resources needed or available for the internal audit activity.

4. The charter is:
   a. **Prepared** by the Chief Audit Executive (**CAE**).
   b. **Approved** by the Chief Executive Officer (**CEO**) or other senior management officer.
   c. **Accepted** by the board of directors (**BOD**), **audit committee**, and/or other appropriate governing authority. The audit committee is discussed in more detail in the following pages.
   d. **Communicated** to engagement clients.

Passing Tip:	The internal audit charter is: Prepared ⇔ CAE Approved ⇔ Management Accepted ⇔ Board or Audit Committee Communicated ⇔ Engagement Clients

5. The CAE must periodically assess whether the purpose, authority, and responsibility, as defined in the charter, continue to be adequate to enable the internal audit activity to accomplish its objectives. The result of this periodic assessment must be communicated to senior management and the board for approval.
6. The nature of the work performed by the internal audit activity is defined in the charter. Any significant changes to the nature of work performed by the internal audit activity must be agreed with the audit committee and the changes must also be made to the charter. For example,
   a. If the internal audit activity performed only audits that provide cost-savings for the organization, this would normally constitute a significant change that requires the change to be agreed with the audit committee and the charter must be changed accordingly.
   b. If the internal audit activity was requested by management to perform services outside the scope identified in the charter, such change must be agreed with the audit committee in order to amend the charter accordingly.
7. **Advantages of a Formally Written Charter**
   a. It provides formal communication for review and approval by management and for acceptance by the board.
   b. It facilitates a periodic assessment of the adequacy of the internal audit activity's purpose, authority, and responsibility.

c. It establishes the role of the internal audit activity and provides a basis for management and the board to use in evaluating the operations of the function.

d. It provides a formal written agreement with management and the board about the role and responsibilities of the internal audit activity within the organization should a conflict arise.

B. The internal audit charter documents the following as they pertain to the internal audit activity:

- Purpose and Mission of the Internal Audit Activity
- Recognizing Mandatory Guidance
- Authority
- Scope of the Internal Audit Activity
- Independence and Objectivity
- Responsibility
- Quality Assurance and Improvement Program
- Sign-offs

The following is a model internal audit activity charter obtained from the IIA's guidance system. Studying this model charter is recommended as it illustrates the purpose, authority, and responsibility of the internal audit activity along with other elements typically included in an internal audit charter. Many of the aspects mentioned in this charter will be explained further throughout this book.

Sample Internal Audit Charter (Source IIA Website)

Purpose and Mission

Purpose

The purpose of the internal audit activity is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. The mission of internal audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight. The internal audit activity helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

Recognizing Mandatory Guidance

Guidance

The internal audit activity will govern itself by adherence to the mandatory elements of The Institute of Internal Auditors' IPPF, including the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing, and the Definition of Internal Auditing. The CAE will report periodically to senior management and the board regarding the internal audit activity's conformance with the Code of Ethics and the Standards.

Authority

Authority

The CAE will report functionally to the board and administratively to the chief executive officer. To establish, maintain, and assure that the internal audit activity has sufficient authority to fulfill its duties, the board will:

1. Approve the internal audit activity's charter.
2. Approve the risk-based internal audit plan.
3. Approve the internal audit activity's budget and resource plan.
4. Receive communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters.
5. Approve decisions regarding the appointment and removal of the chief audit executive.
6. Approve the remuneration of the chief audit executive.
7. Make appropriate inquiries of management and the chief audit executive to determine whether there is inappropriate scope or resource limitations.

The CAE will have unrestricted access to, and communicate and interact directly with, the board, including private meetings without management present.

The board authorizes the internal audit activity to:

1. Have full, free, and unrestricted access to all functions, records, property, and personnel pertinent to carrying out any engagement, subject to accountability for confidentiality and safeguarding of records and information.
2. Allocate resources, set frequencies, select subjects, determine scopes of work, apply techniques required to accomplish audit objectives, and issue reports.

Obtain assistance from the necessary personnel of the organization, as well as other specialized services from within or outside the organization, in order to complete the engagement.

Scope

Scope of Internal Audit Activities

The scope of the internal audit activities encompasses, but is not limited to, objective examinations of evidence for the purpose of providing independent assessments to the board, management, and outside parties on the adequacy and effectiveness of governance, risk management, and control processes for the organization. Internal audit assessments include evaluating whether:

1. Risks relating to the achievement of the organization's strategic objectives are appropriately identified and managed.
2. The actions of the organization's officers, directors, employees, and contractors are in compliance with the organization's policies, procedures, and applicable laws, regulations, and governance standards.
3. The results of operations or programs are consistent with established goals and objectives.
4. Operations or programs are being carried out effectively and efficiently.
5. Established processes and systems enable compliance with the policies, procedures, laws, and regulations that could significantly impact the organization.
6. Information and the means used to identify, measure, analyze, classify, and report such information are reliable and have integrity.
7. Resources and assets are acquired economically, used efficiently, and protected adequately.

The CAE will report periodically to senior management and the board regarding:

1. The internal audit activity's purpose, authority, and responsibility.
2. The internal audit activity's plan and performance relative to its plan.
3. Significant risk exposures and control issues, including fraud risks, governance issues, and other matters requiring the attention of, or requested by, the board.
4. Results of audit engagements or other activities.
5. Resource requirements.
6. Any response to risk by management that may be unacceptable to the organization.

The CAE also coordinates activities, where possible, and considers relying upon the work of other internal and external assurance and consulting service providers as needed. The internal audit activity may perform advisory and related client service activities, the nature and scope of which will be agreed with the client, provided the internal audit activity does not assume management responsibility.

All opportunities for improving management control, profitability, and the organization's image that are identified during audits must be communicated to the appropriate level of management.

Independence and Objectivity

Independence and Objectivity

The CAE will ensure that the internal audit activity remains free from all conditions that threaten the ability of internal auditors to carry out their responsibilities in an unbiased manner, including matters of audit selection, scope, procedures, frequency, timing, and report content. If the CAE determines that independence or objectivity may be impaired in fact or appearance, the details of impairment will be disclosed to appropriate parties.

Internal auditors will maintain an unbiased mental attitude that allows them to perform engagements objectively and in such a manner that they believe in their work product, that no quality compromises are made, and that they do not subordinate their judgment on audit matters to others.

Internal auditors will have no direct operational responsibility or authority over any of the activities audited. Accordingly, internal auditors will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair their judgment, including:

1. Assessing specific operations for which they had responsibility within the previous year.
2. Performing any operational duties for the organization or its affiliates.
3. Initiating or approving transactions external to the internal audit activity.
4. Directing the activities of any employee not employed by the internal audit activity, except to the extent that such employees have been appropriately assigned to auditing teams or to otherwise assist internal auditors.

Where the CAE has or is expected to have roles and/or responsibilities that fall outside of internal auditing, safeguards will be established to limit impairments to independence or objectivity.

Internal auditors will:

1. Disclose any impairment of independence or objectivity, in fact or appearance, to appropriate parties.
2. Exhibit professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined.
3. Make balanced assessments of all available and relevant facts and circumstances.
4. Take necessary precautions to avoid being unduly influenced by their own interests or by others in forming judgments.

The CAE will confirm to the board, at least annually, the organizational independence of the internal audit activity.

The CAE will disclose to the board any interference and related implications in determining the scope of internal auditing, performing work, and/or communicating results.

Responsibility

Responsibility

The CAE has the responsibility to:

1. Submit, at least annually, to senior management and the board a risk-based internal audit plan for review and approval.
2. Communicate to senior management and the board the impact of resource limitations on the internal audit plan.
3. Review and adjust the internal audit plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls.
4. Communicate to senior management and the board any significant interim changes to the internal audit plan.
5. Ensure each engagement of the internal audit plan is executed, including the establishment of objectives and scope, the assignment of appropriate and adequately supervised resources, the documentation of work programs and testing results, and the communication of engagement results with applicable conclusions and recommendations to appropriate parties.
6. Follow up on engagement findings and corrective actions, and report periodically to senior management and the board any corrective actions not effectively implemented.
7. Ensure the principles of integrity, objectivity, confidentiality, and competency are applied and upheld.
8. Ensure the internal audit activity collectively possesses or obtains the knowledge, skills, and other competencies needed to meet the requirements of the internal audit charter.
9. Ensure trends and emerging issues that could impact the organization are considered and communicated to senior management and the board as appropriate.
10. Ensure emerging trends and successful practices of internal auditing are considered.
11. Establish and ensure adherence to policies and procedures designed to guide the internal audit activity.
12. Ensure adherence to the organization's relevant policies and procedures, unless such policies and procedures conflict with the internal audit charter. Any such conflicts will be resolved or otherwise communicated to senior management and the board.
13. Ensure conformance of the internal audit activity with the Standards, with the following qualifications:
    a. If the internal audit activity is prohibited by law or regulation from conformance with certain parts of the Standards, the CAE will ensure appropriate disclosures and will ensure conformance with all other parts of the Standards.
    b. If the Standards are used in conjunction with requirements issued by other authoritative bodies, the CAE will ensure that the internal audit activity conforms to the Standards, even if the internal audit activity also conforms to the more restrictive requirements of other authoritative bodies.

Quality Assurance and Improvement Program

Quality Assurance

The internal audit activity will maintain a quality assurance and improvement program that covers all aspects of the internal audit activity. The program will include an evaluation of the internal audit activity's conformance with the Standards and an evaluation of whether internal auditors apply The IIA's Code of Ethics. The program will also assess the efficiency and effectiveness of the internal audit activity and identify opportunities for improvement.

The CAE will communicate to senior management and the board on the internal audit activity's quality assurance and improvement program, including results of internal assessments (both ongoing and periodic) and external assessments conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization.

Sign-offs

Prepared	*Accepted*
Chief Audit Executive	Audit Committee Chair

Approved

Senior Management

Must be regularly updated to remain valid

Date

The Audit Committee

Audit Committee is usually a subcommittee of the board of directors. It is composed of independent and financially literate members (as defined by any applicable regulation or the board of directors) with at least one member having expertise in financial reporting. The committee will include board members and outsiders that are appointed by a nominating committee.

A. **Purpose** – the purpose of the audit committee is to assist the board of directors (or other governing authority) in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control over financial reporting, the audit process, and the company's process for monitoring compliance with laws and regulations and the code of conduct.

B. **Authority** – the audit committee has authority to conduct or authorize investigations into any matters within its scope of responsibility. It is empowered to:

   1. Retain outside counsel, accountants, or others to advise the committee or assist in the conduct of an investigation.
   2. Seek any information it requires from employees – all of whom are directed to cooperate with the committee's requests – or external parties.
   3. Meet with company officers, external auditors, or outside counsel, as necessary.

C. **Responsibility** – the audit committee's responsibilities are summarized as follows:

   1. **Financial statements**

      a. Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, and recent professional and regulatory pronouncements, and understand their impact on the financial statements.

      b. Review with management and the external auditors the results of the audit, including any difficulties encountered.

      c. Review the annual financial statements, and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting principles.

      d. Review other sections of the annual report and related regulatory filings before release and consider the accuracy and completeness of the information.

      e. Review with management and the external auditors all matters required to be communicated to the committee under generally accepted auditing standards.

      f. Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement.

g. Review interim financial reports with management and the external auditors before filing with regulators and consider whether they are complete and consistent with the information known to committee members.

2. **Internal control**

   a. Consider the effectiveness of the company's internal control over annual and interim financial reporting, including information technology security and control.

   b. Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.

3. **Internal audit**

   a. Review with management and the internal audit director the charter, plans, activities, staffing, and organizational structure of the internal audit function.

   b. Ensure there are no unjustified restrictions or limitations, and review and **concur in the appointment, replacement, or dismissal of the CAE**.

   c. Review the effectiveness of the internal audit function, including compliance with the IIA's *Standards for the Professional Practice of Internal Auditing*.

   d. On a regular basis, meet separately with the director of internal audit to discuss any matters that the committee or internal audit believes should be discussed privately.

4. **External audit**

   a. Review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit.

   b. Review the performance of the external auditors, and exercise final approval on the appointment or discharge of the auditors.

   c. Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the auditors and the company, including non-audit services, and discussing the relationships with the auditors.

   d. On a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately.

5. **Compliance**

   a. Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of noncompliance.

   b. Review the findings of any examinations by regulatory agencies, and any auditor observations.

c. Review the process for communicating the code of conduct to company personnel, and for monitoring compliance therewith.

d. Obtain regular updates from management and company legal counsel regarding compliance matters.

6. **Reporting**

a. Regularly report to the board of directors about committee activities, issues, and related recommendations.

b. Provide an open avenue of communication between internal audit, the external auditors, and the board of directors.

c. Report annually to the shareholders, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rule.

d. Review any other reports the company issues that relate to committee responsibilities.

7. **Other**

a. Perform other activities related to the audit committee charter as requested by the board of directors.

b. Institute and oversee special investigations as needed.

c. Review and assess the adequacy of the committee charter annually, requesting board approval for proposed changes.

d. Confirm annually that all responsibilities outlined in this charter have been carried out.

e. Evaluate the committee's and individual members' performance on a regular basis.

Section C: Assurance and Consulting Services

Learning Outcomes:

1. Interpret the difference between assurance and consulting services provided by the internal audit activity. Tested at Proficiency level.

A. As stated in the Definition of Internal Auditing, internal auditing is an "assurance and consulting activity". Therefore, internal auditing performs two major categories of services:

   1. **Assurance Services** involve the internal auditor's objective assessment of evidence to provide opinions or conclusions regarding an entity, operation, function, process, or systems. The purpose of assurance services is to provide an independent assessment on governance, risk management, and control processes for the organization. Examples of assurance engagements include financial, performance, compliance, system security, and due diligence engagements. The nature and scope of an assurance engagement are determined by the internal auditor. Parties involved in assurance services are:

      a. **The Process Owner** (auditee) – the person or group directly involved with the entity, operation, function, process, system or other subject matter.

      b. **The Internal Auditor** – the person or group making the assessment.

      c. **Users** (report recipients) – the person or group using the assessment.

   2. **Consulting Services** are advisory in nature and are generally performed at the specific request of an engagement client. The purpose of consulting services is to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. The nature and scope of the consulting engagement are subject to agreement with the engagement client. Examples of consulting engagements include counsel, advice, facilitation, and training. Parties involved in consulting services are

      a. **The Internal Auditor** – the person or group offering the advice.

      b. **The Engagement Client** – the person or group seeking and receiving the advice.

B. **Types of Audits** – contrary to public misconception, internal auditors do not only perform financial audits. There are several types of audits that are performed by internal auditors:

   1. **Compliance Audit** is an audit to test whether the organization is operating in accordance with **conditions imposed** on the organization by **law** or **regulation**, **contractual agreement**, and/or the **policies** and **procedures** set by the organization's management.

   2. **Operational Audit** is an audit to test whether the functions within the organization are **effective** in achieving their **objectives** and are operating **efficiently** and economically.

3. **Financial Audit** is an audit of the economic activity to test the reliability and integrity of reported information and to ascertain that the company's assets are safeguarded.
4. **Information Systems Audit** is an audit to test the security and integrity of data processing systems in addition to the data generated by those systems. This includes determining that financial and operating records and reports contain accurate, reliable, timely, complete, and useful information.
5. **Performance Audits** include:
    a. **Economy and Efficiency Audit** is an audit of a certain program or activity concentrating primarily on the **economy and efficiency** of the function to test:
        i. Whether the entity is obtaining and using its resources economically and efficiently.
        ii. The reasons for inefficiencies, if applicable; and
        iii. Compliance with related laws and regulations pertaining to issues of economy and efficiency.
    b. **Program (Program-results) Audit** is an audit of a certain program or activity concentrating primarily on the **output (thus effectiveness)** to test:
        i. The achievement of the desired objectives that are preset.
        ii. The effectiveness of the programs or activities in achieving the desired objectives; and
        iii. Compliance with related laws and regulations pertaining to the program or function under audit.
6. **Environmental Audits include**:
    a. **Compliance audit** is a site-specific, detailed audit of on-going operations, past practices, and/or planned future operations to test for compliance with environmental laws.
    b. **Environmental management system audit** ascertains that the systems are operating properly to curtail any future environmental risk.
    c. **Transactional audit** is an audit to assess the potential risk/liability of a real property as a result of environmental contamination. *(Also referred to as Acquisition and Divestiture Audits, Property Transfer Site Assessments, Property Transfer Evaluations, and/or Due Diligence Audits)*
    d. **Treatment, storage, and disposal facility audit** is the audit of the tracking (cradle-to-grave) of hazardous materials documents and treatments. Any party involved with such hazardous materials may ultimately become liable if such materials cause any future environmental damage.

e. **Pollution prevention audit** refers to the elimination of the pollution at source through the following hierarchy:
   i. Recovery as a useable product
   ii. Elimination at source
   iii. Recycling and reusing
   iv. Conserving energy
   v. Treatment
   vi. Disposal
   vii. Release

f. **Environmental liability accrual audit** is the process of recognizing, quantifying, and reporting **liability accruals for environmental issues.**

g. **Product audit** is the audit of a product to ensure that it is in compliance with current environmental requirements.

Section D: Code of Ethics

Learning Outcomes:
1. Demonstrate conformance with the IIA Code of Ethics. Tested at Proficiency level.

INTRODUCTION

The purpose of The IIA's *Code of Ethics* is to promote an ethical culture in the profession of internal auditing.

> ***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 governance, risk management and control processes.*

A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about governance, risk management, and control.

The Institute's *Code of Ethics* extends beyond the Definition of Internal Auditing to include two essential components:

1. **Principles** that are relevant to the profession and practice of internal auditing. The four principles are integrity, objectivity, confidentiality, and competency.
2. **Rules of Conduct** that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.

"Internal auditors" refers to Institute members, recipients of or candidates for IIA professional certifications, and those who provide internal audit services within the Definition of Internal Auditing.

APPLICABILITY AND ENFORCEMENT

This *Code of Ethics* applies to both individuals and entities that provide internal auditing services.

For IIA 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 Directives. 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.

Passing Tip:	When an internal auditor encounters a situation that is not explicitly addressed by the IIA Code of Ethics, the auditor must apply individual judgment and take action consistent with the principles embodied in the IIA Code of Ethics, even if this action violates the loyalty to the auditor's employer (role conflict).

The following tables include the four principles of the *Code of Ethics* along with the rules of conduct for each principle. Examples of acceptable and unacceptable behaviors under each principle are also provided.

INTEGRITY

Principle

The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

Rules of Conduct

Internal auditors:

1. Shall perform their work with honesty, diligence, and responsibility.
2. Shall observe the law and make disclosures expected by the law and the profession.
3. Shall not knowingly be a party to any illegal activity or engage in acts that are discreditable to the profession of internal auditing or to the organization.
4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

Unacceptable Behavior

- Late arrivals and early departures from work because this practice is common in the organization.
- Respect and contribute to the objectives of the organization even if it is engaged in illegal activities.
- An auditor did not report significant observations about illegal activity to the board because management indicated that it would resolve the issue.
- Knowing that management was aware of the situation, an internal auditor purposely left a description of an unlawful practice out of the report.

Acceptable Behavior

- Comply with the Standards for the International Professional Practice Framework of Internal Auditing.
- Observe the law even in their personal lives.
- Respect and contribute to the legitimate and ethical objectives of the organization.
- An auditor reports significant observations about illegal activity to the board even if management indicated that it would resolve the issue.

OBJECTIVITY

Principle

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.

Rules of Conduct

Internal auditors:

1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

Unacceptable Behavior

- Preparing the personal tax return, for a fee, for one of the company's division managers.
- Frequent luncheons and other socializing with major suppliers of the company without the consent of senior management.
- Acceptance of a material gift from a supplier even if it was customary in the industry and/or function.
- The CAE decides to delay the audit of a branch so that his nephew, the branch manager, will have time to "clean things up".
- Acceptance of airline tickets from an auditee.
- Serving as a consultant to suppliers.
- Serving as a consultant to competing organizations.
- Failing to report to management information that would be material to management's judgment.

Acceptable Behavior

- Disclosing material facts known to the auditor that could distort the report if not revealed.
- An internal auditor, with the knowledge and consent of management, accepted a token gift from a customer of the organization that was not presumed to impair and did not impair judgment.
- Writing a tax guide intended for publication and sale to the general public.
- Teaching an evening tax seminar, for a fee, at a local university.
- Preparing tax returns for elderly citizens, regardless of their associations, as a public service.
- Conducting an unrelated business outside of office hours with management's knowledge.

CONFIDENTIALITY

Principle

Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

Rules of Conduct

Internal auditors:

1. Shall be prudent in the use and protection of information acquired in the course of their duties.
2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

Unacceptable Behavior

- An auditor used audit-related information in a decision to buy stock issued by the employer corporation.
- Purchasing stock in a target company after overhearing a company executive's discussion of a possible acquisition.
- Discussing audit plans or results with external parties.
- Promise a whistle blower absolute anonymity when they disclose sensitive information to the auditor, because the auditor may try to protect whistle blowers, they must act on any information received in the best interests of the organization.
- Bypass the CAE and discuss matters with the external auditors.
- Discussing and/or sharing findings/recommendations with auditors from another organization.

Acceptable Behavior

- An auditor was subpoenaed in a court case in which a merger partner claimed to have been defrauded by the auditor's company. The auditor divulged confidential audit information to the court.
- An auditor gave a speech at a local IIA chapter meeting outlining the contents of a program the auditor had developed for auditing electronic data interchange (EDI) connections. Several auditors from major competitors were in the audience.
- The CAE refuses to provide information about company operations to his father, who is a shareholder.
- An internal auditor shared audit techniques and/or organizational controls with auditors from another company.
- Based upon knowledge of the probable success of the employer's business, an internal auditor invested in a mutual fund that specialized in the same industry.

