

PART-1(UNIT-1)

1. Which of the following concurrent occupations could appear to subvert the ethical behavior of an internal auditor?

A. Internal auditor and adjunct faculty member of a local business college that educates potential employees.

B. Internal auditor and a well-known charitable organization's local in-house chairperson.

C. Internal auditor and part-time business insurance broker.

D. Internal auditor and landlord of multiple housing that publicly advertises for tenants in a local community newspaper listing monthly rental fees.

Answer (C) is correct

Rule of Conduct 2.1 under the objectivity principle states, "Internal auditors 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." As a business insurance broker, the internal auditor may lose his or her objectivity because (s)he might benefit from a change in the employer's insurance coverage.

A. Teaching is compatible with internal auditing.

B. The activities of a charity are unlikely to be contrary to the interests of the organization.

D. Whereas dealing in commercial properties might involve a conflict, renting residential units most likely does not.

2. A review of an organization's code of conduct revealed that it contained comprehensive guidelines designed to inspire high levels of ethical behavior. The review also revealed that employees were knowledgeable of its provisions. However, some employees still did not comply with the code. What element should a code of conduct contain to enhance its effectiveness?

A. Periodic review and acknowledgment by all employees.

B. Employee involvement in its development.

C. Provisions for disciplinary action in the event of violations.

D. Public knowledge of its contents and purpose.

Answer (C) is correct.

Penalties for violations of a code of conduct should enhance its effectiveness. Some individuals will be deterred from misconduct if they expect it to be detected and punished.

A.Periodic review and acknowledgment would ensure employee knowledge and acceptance of the code, which are not at issue.

B.Employee involvement in development would encourage employee acceptance, which is not at issue.

D.Public knowledge might affect the behavior of some individuals, but not to the same extent as the perceived likelihood of sanctions for wrongdoing.

3.According to The IIA's Code of Ethics, which of the following principles is relevant to the establishment of trust?

A.Confidentiality.

B.Competency.

C.Integrity.

D.Objectivity.

Answer (C) is correct.

The principle of integrity states that the integrity of the internal auditors establishes trust and thus provides the basis for reliance on their judgment. The four Core Principles included in The IIA's Code of Ethics are integrity, objectivity, confidentiality, and competency.

A.The principle of confidentiality states that internal auditors do not disclose information without appropriate authority. It does not include the establishment of trust.

B.The principle of competency states that internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services. It does not include the establishment of trust

D.The principle of objectivity states that internal auditors are not unduly influenced by their own interests or by others in forming judgments. It does not include the establishment of trust.

4.In their communication of results, internal auditors are required by The IIA's Code of Ethics to

A.Obtain factual information within the established time and budget parameters.

B.Disclose all material information obtained as of the date of the final engagement communication.

C.Reveal material facts that could distort communications if not revealed.

D.Present sufficient factual information without revealing confidential information that could be detrimental to the organization.

Answer (C) is correct.

Internal auditors should disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review (Rule of Conduct 2.3).

- A. Obtaining information pertains to performing the engagement, not communicating results.
- B. Disclosures by the internal auditors are not limited to information obtained as of the date of the final engagement communication.
- D. The Code of Ethics does not prohibit communicating confidential information to appropriate parties within the organization, e.g., senior management and the board

5. An internal auditor has uncovered facts that could be interpreted as indicating unlawful activity on the part of an engagement client. The internal auditor decides not to inform senior management and the board of these facts because of lack of proof. The internal auditor, however, decides that, if questions are raised regarding the omitted facts, they will be answered fully and truthfully. In taking this action, the internal auditor

- A. Has violated The IIA's Code of Ethics because unlawful acts should have been reported to the appropriate regulatory agency to avoid potential "aiding and abetting" by the internal auditor.
- B. Has not violated The IIA's Code of Ethics or the Standards because the internal auditor is committed to answering all questions fully and truthfully.
- C. Has violated the Standards because the internal auditor should inform the appropriate authorities in the organization if fraud may be indicated.
- D. Has not violated The IIA's Code of Ethics or the Standards because confidentiality takes precedence over all other standards.

Answer (C) is correct.

The internal auditor should inform the appropriate authorities in the organization if the indicators of the commission of a fraud are sufficient to recommend an investigation. Thus, the internal auditor has a duty to act even though the available facts do not prove that an irregularity has occurred. Moreover, Rule of Conduct 2.3 states, "Internal auditors shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review."

- A. The possibility of unlawful activities should be reported to the appropriate personnel within the organization.
- B. The internal auditor has an affirmative duty to report the results of his or her work.
- D. Reporting a possible irregularity to the appropriate organizational authorities is not a breach of the duty of confidentiality owed to the organization.

6. Which Standards expand upon the other categories of Standards?

- A. Attribute Standards.
- B. Implementation Standards.
- C. Performance Standards.
- D. All of the choices are correct.

Answer (B) is correct.

Implementation Standards expand upon the Attribute and Performance Standards. They provide requirements applicable to assurance or consulting engagements.

A. Attribute Standards apply to all internal audit services

C. Performance Standards apply to all internal audit services.

D. Only Implementation Standards expand upon the standards in other categories.

7. The types of services provided by the internal audit activity can best be described as

A. Auditing and consulting.

B. Auditing and assurance.

C. Assurance and consulting.

D. Auditing and engagement.

Answer (C) is correct.

The internal audit activity provides independent, objective assurance and consulting services designed to add value and improve an organization's operations (Definition of Internal Auditing).

A. The IIA Glossary defines assurance and consulting, not auditing and consulting, as the types of services provided by the internal audit activity.

B. The IIA Glossary defines assurance and consulting, not auditing and assurance, as the types of services provided by the internal audit activity.

D. Engagement is not a type of internal audit service.

8. Which of the following is permissible under The IIA's Code of Ethics?

A. An auditor used audit-related information in a decision to buy stock issued by the employer corporation.

B. In response to a subpoena, an auditor appeared in a court of law and disclosed confidential, audit-related information that could potentially damage the auditor's organization.

C. An auditor did not report significant observations about illegal activity to the board because management indicated that it would resolve the issue.

D. After praising an employee in a recent audit engagement communication, an auditor accepted a gift from the employee.

Answer (B) is correct.

Rule of Conduct 1.2 under the integrity principle states, "Internal auditors shall observe the law and make disclosures expected by the law and the profession." Thus, auditors must comply with subpoenas.

A. Rule of Conduct 3.2 prohibits auditors from using audit information for personal gain

C. Rule of Conduct 1.3 prohibits auditors from knowingly being a party to any illegal or improper activity. Significant observations of illegal activity should be reported to the board.

D. Rule of Conduct 2.2 prohibits an auditor from accepting anything that might be presumed to impair the auditor's professional judgment.

9. During an engagement performed at a manufacturing division of a defense contractor, the internal auditor discovered that the organization apparently was inappropriately adding costs to a cost-plus governmental contract. The internal auditor discussed the matter with senior management, who suggested that the internal auditor seek an opinion from legal counsel. Upon review, legal counsel indicated that the practice was questionable but was not technically in violation of the government contract. Based on legal counsel's decision, the internal auditor decided to omit any discussion of the practice in the final engagement communication sent to senior management and the board. However, the internal auditor did informally communicate legal counsel's decision to senior management. Did the internal auditor violate The IIA's Code of Ethics?

A. No. The internal auditor followed up the matter with appropriate personnel within the organization and reached a conclusion that no fraud was involved.

B. Yes. Internal legal counsel's opinion is not sufficient. The internal auditor should have sought advice from outside legal counsel.

C. No. If a fraud is suspected, it should be resolved at the divisional level where it is taking place.

D. Yes. It is a violation because all important information, even if resolved, should be reported to the board.

Answer (A) is correct.

Although an argument can be made that the internal auditor should report the matter to the board and senior management, there is no indication that the internal auditor is deliberately withholding material facts that, if not disclosed, may distort reports of activities under review (Rule of Conduct 2.3). Hence, no violation of the Code occurred.

B. The internal auditor has gathered sufficient information. Internal legal counsel's opinion appears to be sufficient.

C. Material fraud, if suspected, should be brought to the attention of management. However, in this case, the internal auditor gathered sufficient information to dispel the suspicion of fraud.

D. The internal auditor did not deliberately withhold important information.

10.An internal auditor discovered some material inefficiencies in a purchasing function. The purchasing manager is the internal auditor's next-door neighbor and best friend. In accordance with The IIA's Code of Ethics, the internal auditor should

- A. Not report the incident because of loyalty to the friend.
- B. Include the facts of the case in a special communication submitted only to the friend.
- C. Objectively include the facts of the case in the engagement communications.
- D. Not report the friend unless the activity is illegal.

Answer (C) is correct.

Rule of Conduct 2.3 under the objectivity principle states, "Internal auditors shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review."

- A. This action is at variance with the internal auditor's duties.
- B. This action is at variance with the internal auditor's duties.
- D. This action is at variance with the internal auditor's duties.

11. Which of the following most likely constitutes a violation of The IIA's Code of Ethics?

- A. Auditor C is content as an internal auditor and has come to look at it as a regular 9-to-5 job. Auditor C has not engaged in continuing professional education or other activities to improve effectiveness during the last 3 years. However, Auditor C feels performance of quality work is the same as before.
- B. Auditor A has accepted an assignment to perform an engagement at the electronics manufacturing division. Auditor A has recently joined the internal audit activity. But Auditor A was senior auditor for the external audit of that division and has audited many electronics organizations during the past 2 years.
- C. Auditor B has been assigned to perform an engagement at the warehousing function 6 months from now. Auditor B has no expertise in that area but accepted the assignment anyway. Auditor B has signed up for continuing professional education courses in warehousing that will be completed before the assignment begins.
- D. Auditor D discovered an internal financial fraud during the year. The books were adjusted to properly reflect the loss associated with the fraud. Auditor D discussed the fraud with the external auditor when the external auditor reviewed working papers detailing the incident.

Answer (A) is correct.

Rule of Conduct 4.3 under the competency principle states, "Internal auditors shall continually improve their proficiency and the effectiveness and quality of their services."

B.No professional conflict of interest exists per se, especially given that the internal auditor was previously in public accounting. However, the internal auditor should be aware of potential conflicts.

C.An internal auditor must possess the necessary knowledge, skills, and competencies at the time an engagement is conducted, not the time it is accepted.

D.The information was disclosed as part of the normal process of cooperation between the internal and external auditor. Because the books were adjusted, the external auditor was expected to inquire as to the nature of the adjustment.

12.Fact Pattern: The chief audit executive (CAE) of a mid-sized internal audit activity was concerned that management might outsource the internal auditing function. Thus, the CAE adopted a very aggressive program to promote the internal audit activity within the organization. The CAE planned to present the results to senior management and the board and recommend modification of the internal audit activity's charter after using the new program. The following lists six actions the CAE took to promote a positive image within the organization:

Engagement assignments concentrated on efficiency. The engagements focused solely on cost savings, and each engagement communication highlighted potential costs to be saved. Negative observations were omitted. The focus on efficiency was new, but the engagement clients seemed very happy.

Drafts of all engagement communications were carefully reviewed with the engagement clients to get their input. Their comments were carefully considered when developing the final engagement communication.

The information technology internal auditor participated as part of a development team to review the control procedures to be incorporated into a major computer application under development.

Given limited resources, the engagement manager performed a risk assessment to establish engagement work schedule priorities. This was a marked departure from the previous approach of ensuring that all operations are evaluated on at least a 3-year interval.

To save time, the CAE no longer required that a standard internal control questionnaire be completed for each engagement.

When the internal auditors found that the engagement client had not developed specific criteria or data to evaluate operations, the internal auditors were instructed to perform research, develop specific criteria, review the criteria with the engagement client, and, if acceptable, use them to evaluate the engagement client's operations. If the engagement client disagreed with the criteria, a negotiation took place until acceptable criteria could be agreed upon. The engagement communication commented on the engagement client's operations in conjunction with the agreed-upon criteria.

Which of the following elements of Action 1 taken by the CAE would be considered inappropriate?

- The type of engagements was changed before modifying the internal audit activity's charter and going to the audit committee.
- Negative observations were omitted from the engagement communications.
- Cost savings and recommendations were highlighted in the engagement communication.

A.1 and 3.

B.1 and 2.

C.1 only.

D.2 and 3.

Answer (B) is correct.

The CAE dramatically changed internal audit's scope of work without consulting with the board. A second violation is the omission of negative observations. Under The IIA's Code of Ethics, the auditors must disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review (Rule of Conduct 2.3).

A. Highlighting potential cost savings is appropriate for an engagement communication, and material negative observations must not be omitted.

C. Omitting negative observations is also a violation.

D. The CAE dramatically changed internal audit's scope of work without consulting with the board. Moreover, highlighting potential cost savings is appropriate for an engagement communication.

13. The board of an organization has charged the chief audit executive (CAE) with upgrading the internal audit activity. The CAE's first task is to develop a charter. What item should be included in the statement of objectives?

A. Report all engagement results to the board every quarter.

B. Notify governmental regulatory agencies of unethical business practices by organization management.

C. Evaluate the adequacy and effectiveness of the organization's controls.

D. Submit budget variance reports to management every month.

Answer (C) is correct.

The charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities (Inter. Std. 1000). Internal auditing brings a systematic, disciplined approach to evaluating and improving risk management, control, and governance processes (Definition of Internal Auditing).

A. Only significant engagement results are discussed with the board.

B. Internal auditors ordinarily are not required to report deficiencies in regulatory compliance to the appropriate agencies. However, they must observe the law and make disclosures expected by the law and profession (Rule of Conduct 1.2).

D. Submission of budgetary variance reports is not a primary objective of internal auditing. It is a budgetary control that management may require on a periodic basis.

14. An internal auditor is performing services in a division in which the chief financial officer is a close personal friend, and the internal auditor learns that the friend is to be replaced after a series of critical

labor negotiations. The internal auditor relays this information to the friend. Has a violation of The IIA's Code of Ethics occurred?

- A.No. The use of the confidential information resulted in no personal gain to the internal auditor.
- B.Yes. The internal auditor was not prudent in the use of information acquired in the course of his or her duties.
- C.No. The internal auditor was just being honest with his or her friend.
- D.Yes. The internal auditor had a conflict of interest with the organization.

Answer (B) is correct.

Rule of Conduct 3.1 under the confidentiality principle states, "Internal auditors shall be prudent in the use and protection of information acquired in the course of their duties." Rule of Conduct 3.2 states, "Internal auditors 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." In this case, the decision whether to notify the financial officer of his or her replacement was properly the organization's. Accordingly, the internal auditor was bound not to tell his or her friend.

- A.The Rules of Conduct specifically prohibit using information in a manner that would be detrimental to the legitimate and ethical objectives of the organization.
- C.The Rules of Conduct specifically prohibit using information in a manner that would be detrimental to the legitimate and ethical objectives of the organization.
- D.The facts do not suggest that a conflict of interest existed. However, such a conflict would be present, for example, if the internal auditor used confidential information to seize a business opportunity that rightfully belonged to the organization.

15. Which situation is most likely a violation of The IIA's Code of Ethics?

- A.Immediately reporting a violent crime observed at work to local law enforcement agencies.
- B.Reporting apparent violations of antitrust statutes by officers to government regulators.
- C.Reporting apparent violations of antitrust statutes by officers to the board of directors.
- D.Cooperating with the government's criminal investigation of the organization.

Answer (B) is correct.

An internal auditor must (1) not knowingly be a party to any illegal activity (Rule of Conduct 1.3); (2) disclose all material facts known to him or her that, if not disclosed, might distort the reporting of activities under review (Rule of Conduct 2.3); and (3) respect and contribute to the legitimate and ethical objectives of the organization (Rule of Conduct 1.4). Thus, when apparent violations of antitrust statutes by officers come to the internal auditor's attention, (s)he should report to the board of directors rather than directly to the government regulators. An internal auditor also must observe the law and make any disclosures required by the law or by the profession (Rule of Conduct 1.2)

A. Everyone has a legal and moral obligation to report violent crimes immediately.

C. An internal auditor should report apparent improprieties to the board.

D. Everyone has a legal obligation to cooperate with a criminal investigation. An internal auditor must observe the law and make any disclosures required by the law or by the profession (Rule of Conduct 1.2).

16. During an engagement to evaluate the organization's accounts payable function, an internal auditor plans to confirm balances with suppliers. What is the source of authority for such contacts with units outside the organization?

A. The internal audit activity's charter.

B. The Standards.

C. Internal audit activity policies and procedures.

D. The Code of Ethics.

Answer (A) is correct.

The charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities (Inter. Std. 1000). Thus, the charter prescribes the internal audit activity's relationships with other units within the organization and with those outside.

B. The internal audit activity's authority is defined in a charter approved by the board.

C. Policies and procedures guide the internal auditors in their consistent compliance with the internal audit activity's standards of performance.

D. The purpose of the Code of Ethics is to promote an ethical culture in the profession of internal auditing.

17. According to The IIA Code of Ethics, the principle of integrity requires internal auditors to do which of the following?

A. Not accept anything that may impair or be presumed to impair their professional judgment.

B. Respect and contribute to the legitimate and ethical objectives of the organization.

C. Continually improve their proficiency, effectiveness, and quality of services.

D. Be prudent in the use and protection of the information acquired in the course of their duties.

Answer (B) is correct.