

GLEIM®

**2023
EDITION**

CIA REVIEW

PART 1: ESSENTIALS OF INTERNAL AUDITING

by

Irvin N. Gleim, Ph.D., CPA, CIA, CMA, CFM

Aligned with the 2019 CIA exam reorganization

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ACCOUNTING TITLES FROM GLEIM PUBLICATIONS

CIA Review:

- Part 1: Essentials of Internal Auditing
- Part 2: Practice of Internal Auditing
- Part 3: Business Knowledge for Internal Auditing
- CIA Challenge Exam

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A MESSAGE FROM OUR AUTHORS

In 1980, we set out with one goal: to help **you** prepare to pass the CIA exam. We were **the first** CIA review course, and our mission was and continues to be to provide an affordable, effective, and easy-to-use study program. Gleim CIA Review materials comprehensively cover The IIA's CIA Exam Syllabus. While the delivery and technology have changed over the years and are always evolving, our mission and the core learning techniques that we have perfected over the last 40+ years remain the same.

The outline presentation, the spacing, and the question-and-answer formats in this book are designed to facilitate readability, learning, understanding, and your success on the CIA exam. Our most successful candidates use the Gleim Premium CIA Review System*, which includes this book, our innovative SmartAdapt technology, first-of-its-kind Gleim Instruct video lectures, the Gleim Access Until You Pass guarantee, and comprehensive exam-emulating test questions. Our course

- ✓ Teaches how to optimize your score through learning strategies and exam-taking techniques.
- ✓ Defines the subject matter tested on Part 1 of the CIA exam.
- ✓ Outlines all of the Part 1 subject matter in 8 easy-to-use study units, including all relevant authoritative pronouncements.
- ✓ Presents multiple-choice questions taken or modeled from past CIA examinations to prepare you for the types of questions you will see on your CIA exams.
 - In our book, our answer explanations are presented to the immediate right of each multiple-choice question for your convenience. Use a piece of paper to cover our detailed explanations as you answer the question and then review all answer choices to learn why the correct answer is correct and why the other choices are incorrect.
 - You also should practice answering questions through our online platform so you are comfortable answering questions online like you will do on test day. Our adaptive course will focus and target your weak areas.
- ✓ Contains The IIA Glossary and a cross-reference between The IIA CIA Exam Syllabus and the Gleim CIA materials.

Thank you for trusting us as your CIA review provider. Gleim continues to celebrate 40+ years of being the leading CIA review course. We look forward to helping you pass the CIA exam and achieve career success.

We appreciate any and all feedback from candidates like you. Please go to www.gleim.com/feedbackCIA1 to share suggestions on how we can improve this edition.

Please reach out to us immediately after the exam upon receipt of your exam scores. While the CIA exam is nondisclosed, and you must maintain confidentiality of any CIA questions or answers and agree not to divulge the nature of its content, we ask for you to provide information about our materials, such as the topics that need to be added or expanded, so that we are providing the best review materials possible.

Good Luck on the Exam,

Irvin N. Gleim

*Visit www.gleimcia.com or call (800) 874-5346 to order.

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READ THE CIA EXAM GUIDE: A SYSTEM FOR SUCCESS

In addition to this book, access the free Gleim **CIA Exam Guide** at www.gleim.com/passCIA and reference it as needed throughout your studying process to obtain a deeper understanding of the attributes that make up the CIA exam. This booklet is your system for success.

OVERVIEW OF THE CIA EXAMINATION

The total exam is 6.5 hours of testing (including 5 minutes per part for a survey). It is divided into three parts, as follows:

CIA Exam (3-Part)			
Part	Title	Exam Length	Number of Questions
1	Essentials of Internal Auditing	2.5 hrs	125 multiple-choice
2	Practice of Internal Auditing	2 hrs	100 multiple-choice
3	Business Knowledge for Internal Auditing	2 hrs	100 multiple-choice

All CIA questions are multiple-choice. The exam is offered continually throughout the year. The CIA exam is computerized to facilitate easier and more convenient testing. Pearson VUE, the testing company that The IIA contracts to proctor the exams, has hundreds of testing centers worldwide. Online testing is also available in select countries/territories, making testing more convenient. The online components of Gleim CIA Review provide exact exam emulations, or mirrors, of the Pearson VUE computer screens and procedures so you feel comfortable at the testing center on exam day.

SUBJECT MATTER FOR PART 1

Below, we have provided The IIA's abbreviated CIA Exam Syllabus for Part 1. This syllabus is for the revised CIA exam offered since January 1, 2019. The percentage coverage and approximate questions for each topic are indicated to its right. We adjust the content of our materials to any interim changes in The IIA's CIA Exam Syllabus announced by The IIA.

Part 1: Essentials of Internal Auditing

		Approximate Questions
I. Foundations of Internal Auditing	15%	19
II. Independence and Objectivity	15%	19
III. Proficiency and Due Professional Care	18%	23
IV. Quality Assurance and Improvement Program	7%	9
V. Governance, Risk Management, and Control	35%	43
VI. Fraud Risks	10%	12
		<hr/> 125

At the time of print, exams for the revised syllabus are currently available in Arabic, Simplified Chinese, Traditional Chinese, English, French, German, Japanese, Korean, Polish, Portuguese, Spanish, Thai, and Turkish. Candidates taking the exam in these languages should use this 2023 edition of Gleim CIA Review.

Appendix B contains the CIA Exam Syllabus in its entirety as well as cross-references to the subunits in our text where topics are covered. Remember that we have studied the syllabus in developing our CIA Review materials. Accordingly, you do not need to spend time with Appendix B. Rather, it should give you confidence that Gleim CIA Review is the best and most comprehensive review course available to help you PASS the CIA exam.



SUCCESS TIP

The IIA has reported concerns from Part 1 candidates that Part 1 has tested topics that should be tested in Part 2 or Part 3. The IIA has clarified that while a Part 1 question may mention a Part 3 topic, such as IT terminology, the question is not testing the IT concept. Rather, it is testing a candidate's understanding and interpretation of a Part 1 concept, such as objectivity, using an industry-related scenario, such as IT.

The takeaway is that candidates should read each question carefully and focus on the concepts in Part 1 and how the material relates to ethics, proficiency, governance, risk management and control, and fraud.

WHICH PRONOUNCEMENTS ARE TESTED?

New pronouncements are eligible to be tested on the CIA exam beginning 6 months after a pronouncement's effective date. Rest assured that Gleim updates these materials as appropriate when any new standard is testable and will only cover what candidates need for the current CIA exam.

NONDISCLOSED EXAM

As part of The IIA's nondisclosure policy and to prove each candidate's willingness to adhere to this policy, a Nondisclosure Agreement and General Terms of Use must be accepted by each candidate before each part is taken. This statement is reproduced here to remind all CIA candidates about The IIA's strict policy of nondisclosure, which Gleim consistently supports and upholds.

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I have not accessed live questions that might appear on my exam. I agree not to discuss the content of the exam with anyone.

I will not record, copy, disclose, publish, or reproduce any exam questions or answers, in whole or in part, in any form or by any means before, during, or after I take an exam, including orally; in writing; in any internet chat room, message board, or forum; by SMS or text; or otherwise.

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I agree that The IIA has the right to withhold or invalidate any exam score when, in The IIA's judgment, there is a good faith basis to question the validity of a score for any reason, and I will forfeit my exam fee.

I understand that if I do not agree to this nondisclosure agreement and these conditions, I will not be permitted to take the exam, and I will forfeit my exam fee.

THE IIA'S REQUIREMENTS FOR CIA DESIGNATIONS

The CIA designation is granted only by The IIA. Candidates must complete the following steps to become a CIA®:

- ✓ Complete the appropriate certification application form and register for the part(s) you are going to take. Check the CIA blog at www.gleim.com/CIAApply for more information on the application and registration process. The CIA Review course provides a useful checklist to help you keep track of your progress and organize what you need for exam day.
- ✓ Pass all three parts of the CIA exam within 3 years of application approval (4 years if approved before September 1, 2019).
- ✓ Fulfill or expect to fulfill the education and experience requirements (see the free Gleim *CIA Exam Guide* for details).
- ✓ Provide a character reference proving you are of good moral character.
- ✓ Comply with The IIA's Code of Ethics.

ELIGIBILITY PERIOD

Credits for parts passed can be retained as long as the requirements are fulfilled. Candidates accepted into the certification program **on or after September 1, 2019**, must complete the program certification process within **3 years** of application approval. Candidates should note that this time period begins with application approval and not when they pass the first part. If a candidate has not completed the certification process within 3 years, all fees and previously passed exam parts will be forfeited. Candidates who received application approval **before September 1, 2019**, have **4 years** to complete the certification process.

Eligibility Extension: Candidates who have not successfully completed their exam(s), or who have been accepted into the program but have not taken their exam(s), have the opportunity to extend their program eligibility by 12 months. To take advantage of The IIA's one-time Certification Candidate Program Extension, candidates must pay a set fee per applicant and apply through the Candidate Management System.

Transition Information: Candidates who passed one or two parts of the exam prior to 2019 and still need to pass one or two parts will not lose credit for the part(s) already passed. Credit for any part(s) passed in the pre-2019 version of the exam remains valid for the 4-year eligibility window that begins with the application date.

MAINTAINING YOUR CIA DESIGNATION

After passing all three parts, you will receive an email confirming your certification. This email will let you know if any CPE has been awarded and what year you will need to submit information regarding CPE.

CIAs are required to take CPE to maintain and update their knowledge and skills. Practicing CIAs must complete and report 40 hours of Continuing Professional Education (CPE)—including 2 hours of ethics training—every year.

The reporting deadline is December 31. Complete your CPE Reporting Form through the online Certification Candidate Management System. Processing fees vary based on location, membership status, and the method you use to report. Contact Gleim for all of your CPE needs at www.gleim.com/cpe.

GLEIM CIA REVIEW WITH SMARTADAPT

Gleim Premium CIA Review features the most comprehensive coverage of exam content and employs learning techniques that help you prepare for the CIA exam with confidence. The Gleim CIA Review System is powered by our SmartAdapt technology, an innovative learning platform that continually identifies areas you should focus on and guides you through the learning process. Follow these steps for an optimized CIA review:

Step 1: Complete a Diagnostic Quiz.

As you work through this quiz, you will get immediate feedback on your answer choices. This allows you to learn by studying the detailed answer explanations while the quiz sets a baseline that our SmartAdapt technology will use to create a custom learning track.

Step 2: Read, watch, or listen based on your weak areas.

Study identified areas. Learn concepts from our streamlined outlines with detailed examples, topic summaries, tips, and color-coded standards. Watch selections identified from our highly acclaimed Gleim Instruct videos, featuring Dr. Joseph Mauriello, CIA, CPA, CMA. This will ensure you master the required skills.

Step 3: Practice answering multiple-choice questions.

Practice and perfect your question-answering techniques by taking the adaptive quizzes SmartAdapt has created for you to optimize your learning.

Final Review: Complete Mock Exams to complete your final review leading up to your exam.

After completing all study units, take the first Mock Exam, a full-length practice exam. Then, SmartAdapt will guide you through a Final Review based on your results. Finally, a few days before your exam date, take the second Mock Exam. SmartAdapt will tell you when you are ready so you can pass with confidence.

To facilitate your studies, the Gleim Premium CIA Review System uses the most comprehensive test bank of exam-quality CIA questions on the market. Our system's content and presentation are the most realistic representation of the whole exam environment allowing you to feel completely at ease on test day.

GLEIM KNOWLEDGE TRANSFER OUTLINES

This edition of the Gleim CIA Review books has the following features to make studying easier:

Examples

We use illustrative examples, set off in shaded boxes, to make the concepts more relatable.

EXAMPLE 2-1 Scope Limitation

An internal audit activity was recently engaged to audit the final balance of inventory for the financial statements. During the audit, senior management contacted the lead auditor and stated that the internal audit activity would not be given access to the physical inventory.

The denial of access to the inventory is a scope limitation. The internal audit activity needs to communicate the nature of the scope limitation and its potential effects to the board. This communication should preferably be in writing.

Gleim Success Tips

These tips supplement the core exam material by suggesting how certain topics might be presented on the exam or how you should prepare for an issue.



SUCCESS TIP

Knowledge of the IPPF is important for understanding and distinguishing among the elements of the authoritative guidance on internal auditing. But it is more important that you **understand** and can accurately **apply** the **content** contained in the IPPF. Parts 1 and 2 of the CIA exam primarily test understanding and application of IPPF content.

Flowcharts and Visuals

These images help to conceptualize ideas and make procedures clear.

- Governance does not exist independently of risk management and control. Rather, governance, risk management, and control (collectively referred to as GRC) are interrelated.

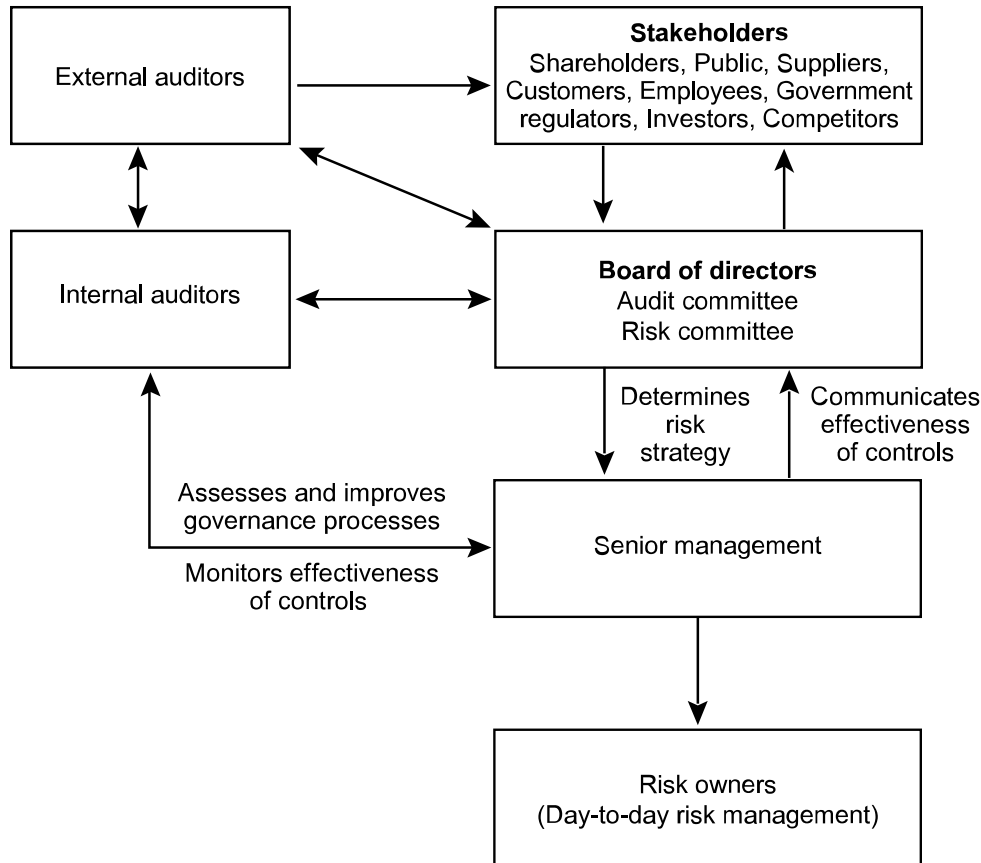


Figure 4-1

Memory Aids

We offer mnemonic devices to help you remember important concepts.

- A useful memory aid for the COSO components of internal control is “Controls stop **CRIME**.”

C	Control activities
R	Risk assessment
I	Information and communication
M	Monitoring
E	Control environment

Guidance Designations

In an effort to help CIA candidates better grasp The IIA's authoritative literature, we have come up with visual indicators to help candidates easily identify each type of guidance.



Attribute Standard 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.



Performance Standard 2120 **Risk Management**

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.



Interpretation of Standard 1000

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, 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. Final approval of the internal audit charter resides with the board.



Implementation Standard 1110.A1

The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The chief audit executive must disclose such interference to the board and discuss the implications.

TIME-BUDGETING AND QUESTION-ANSWERING TECHNIQUES FOR THE EXAM

Having a solid multiple-choice answering technique will help you maximize your score on each part of the CIA exam. Remember, knowing how to take the exam and how to answer individual questions is as important as studying/reviewing the subject matter tested on the exam. Competency in both will reduce your stress and the number of surprises you experience on exam day.

- **Budget your time so you can finish before time expires.**
 - Spend about 1 minute per question. This would result in completing 125 questions in 125 minutes to give you 25 minutes to review your answers and questions that you have marked.
- **Ignore the answer choices so that they will not affect your precise reading of the question.**
 - Only one answer option is best. In the MCQs, four answer choices are presented, and you know one of them is correct. The remaining choices are distractors and are meant to appear correct at first glance. *They are called distractors for a reason.* Eliminate them as quickly as you can.
 - In computational items, the distractors are carefully calculated to be the result of common mistakes. Be careful and double-check your computations if time permits.
- **Read the question carefully to discover exactly what is being asked.**
 - Focusing on what is required allows you to
 - ✓ Reject extraneous information
 - ✓ Concentrate on relevant facts
 - ✓ Proceed directly to determining the best answer
 - Be careful! The requirement may be an **exception** that features a negative word.
- **Decide the correct answer before looking at the answer choices.**
- **Read the answer choices, paying attention to small details.**
 - Even if an answer choice appears to be correct, do not skip the remaining answer choices. Each choice requires consideration because you are looking for the best answer provided.
 - Tip: Treat each answer choice like a true/false question as you analyze it.
 - Be careful choosing answer choices that include absolutes such as “always” or “never.”
 - Often an answer choice is a correct statement but is outside the scope of the question. For example, a question may ask for procedures, and the incorrect answer choices are procedures, albeit not the correct procedures for the topic.

- **Click on the best answer.**
 - You have a 25% chance of answering the question correctly by guessing blindly, but you can improve your odds with an educated guess.
 - For many MCQs, you can eliminate two answer choices with minimal effort and increase your educated guess to a 50/50 proposition.
 - ▶ Rule out answers that you think are incorrect.
 - ▶ Speculate what The IIA is looking for and/or why the question is being asked.
 - ▶ Select the best answer or guess between equally appealing answers. Your first guess is usually the most intuitive.
- **Answer the questions in consecutive order.**
 - Do **not** agonize over any one item or question. Stay within your time budget.
 - Never leave a multiple-choice question (MCQ) unanswered. Your score is based on the number of correct responses. You will not be penalized for answering incorrectly. If you are unsure about a question, do the following:
 - ✓ Make an educated guess,
 - ✓ Mark it for review at the bottom of the screen, and
 - ✓ Return to it before you submit your exam as time allows.

LEARNING FROM YOUR MISTAKES

During your studies, do not get frustrated if you score low on a practice quiz. It is an opportunity to learn, and learning from questions you answer incorrectly is very important. Each question you answer incorrectly is an **opportunity** to avoid missing actual test questions on your CIA exam. Thus, you should carefully study the answer explanations provided until you understand why the original answer you chose is wrong, as well as why the correct answer indicated is correct. This study technique is clearly the difference between passing and failing for many CIA candidates.

Also, you **must** determine why you answered questions incorrectly and learn how to avoid the same error in the future. Reasons for missing questions include

- ⊗ Misreading the requirement (stem)
- ⊗ Not understanding what is required
- ⊗ Making a math error
- ⊗ Applying the wrong rule or concept
- ⊗ Being distracted by one or more of the answers
- ⊗ Incorrectly eliminating answers from consideration
- ⊗ Not having any knowledge of the topic tested
- ⊗ Employing bad intuition when guessing

It is also important to verify that you answered correctly for the right reasons. Otherwise, if the material is tested on the CIA exam in a different manner, you may not answer it correctly.

HOW TO BE IN CONTROL WHILE TAKING THE EXAM

You have to be in control to be successful during exam preparation and execution. Control can also contribute greatly to your personal and other professional goals. Control is a process whereby you

- ✓ Develop expectations, standards, budgets, and plans
- ✓ Undertake activity, production, study, and learning
- ✓ Measure the activity, production, output, and knowledge
- ✓ Compare actual activity with expected and budgeted activity
- ✓ Modify the activity, behavior, or study to better achieve the desired outcome
- ✓ Revise expectations and standards in light of actual experience
- ✓ Continue the process or restart the process in the future

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STUDY UNIT ONE

FOUNDATIONS OF INTERNAL AUDITING

(26 pages of outline)

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This study unit covers **Domain I: Foundations of Internal Auditing** from The IIA's CIA Exam Syllabus. This domain makes up 15% of Part 1 of the CIA exam and is tested at the **basic** and **proficient** cognitive levels.

The **learning objectives** of Study Unit 1 are

- Interpret The IIA's Mission of Internal Audit, Definition of Internal Auditing, and Core Principles for the Professional Practice of Internal Auditing, as well as the purpose, authority, and responsibility of the internal audit activity
- Explain the requirements of an internal audit charter (required components, board approval, communication of the charter, etc.)
- Interpret the difference between assurance and consulting services provided by the internal audit activity
- Demonstrate conformance with The IIA Code of Ethics

Internal auditors perform assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes using a systematic, disciplined, and risk-based approach. This may include evaluation of internal control, examination of financial and operating information, review of compliance with laws and regulations, and the assessment of fraud risk.

1.1 APPLICABLE GUIDANCE

International Professional Practices Framework (IPPF)

The Institute of Internal Auditors (The IIA) defines the **mission** of internal audit as follows:

- “To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.”
- Facilitating the achievement of this mission is the IPPF.

The IPPF contains **mandatory** guidance and **recommended** guidance.



Figure 1-1

Mandatory Guidance

Adherence to the mandatory guidance is essential for the professional practice of internal auditing.

- The mandatory guidance consists of four elements:
 1. The **Core Principles** for the Professional Practice of Internal Auditing
 2. The **Definition of Internal Auditing**
 3. The **Code of Ethics**
 4. The **Standards**
- The Core Principles and the Definition of Internal Auditing are reflected in the Code of Ethics and the *Standards*. Thus, conformance with the Code and the *Standards* demonstrates conformance with all mandatory elements of the IPPF.
- If the *Standards* are used with requirements of other authoritative bodies, internal audit communications also may cite the other requirements. But, if the *Standards* and other requirements are inconsistent, internal auditors must conform with the *Standards* and may conform with the other requirements if they are more restrictive.

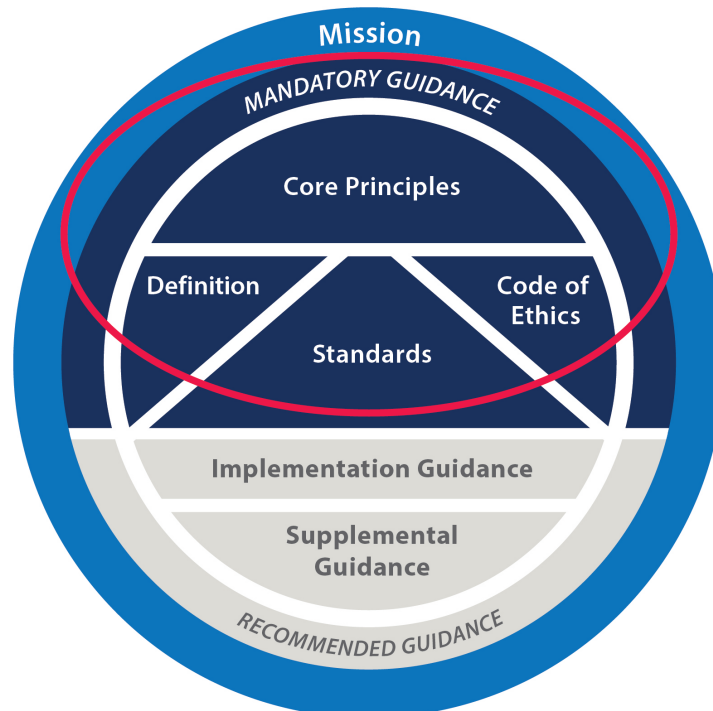


Figure 1-2

Element 1 of 4

The **Core Principles** are the basis for internal audit effectiveness. The internal audit function is effective if all principles are present and operating effectively. The following are the 10 Core Principles:

1. “Demonstrates integrity.
2. Demonstrates competence and due professional care.
3. Is objective and free from undue influence (independent).
4. Aligns with the strategies, objectives, and risks of the organization.
5. Is appropriately positioned and adequately resourced.
6. Demonstrates quality and continuous improvement.
7. Communicates effectively.
8. Provides risk-based assurance.
9. Is insightful, proactive, and future-focused.
10. Promotes organizational improvement.”



Figure 1-3

Element 2 of 4

The **Definition of Internal Auditing** is a concise statement of the role of the internal audit activity in the organization.

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of **risk management, control, and governance processes.**”



Figure 1-4

Element 3 of 4

The **Code of Ethics** is covered in detail in later subunits.



Figure 1-5

Element 4 of 4

The **Standards** (known formally as the *International Standards for the Professional Practice of Internal Auditing*) serve the following four purposes described by The IIA:

1. “Guide adherence with the mandatory elements of the International Professional Practices Framework.
2. Provide a framework for performing and promoting a broad range of value-added internal auditing services.
3. Establish the basis for the evaluation of internal audit performance.
4. Foster improved organizational processes and operations.”

The *Standards* are vital to the practice of internal auditing, but CIA candidates need not memorize them. However, the principles they establish should be thoroughly understood and appropriately applied.



Figure 1-6

Types of Standards

Attribute Standards describe the characteristics of organizations and parties providing internal auditing services. They govern the responsibilities, attitudes, and actions of the organization's internal audit activity and the people who serve as internal auditors. Attribute Standards are displayed in green boxes throughout this text to emphasize their importance.

Performance Standards describe the nature of internal auditing and provide quality criteria for evaluation of internal audit performance. They govern the nature of internal auditing and provide quality criteria for evaluating the internal audit function's performance.

Interpretations of Attribute or Performance Standards are provided by The IIA to clarify terms and concepts. They are displayed in blue boxes.

Implementation Standards apply to specific types of engagements. They expand upon the individual Attribute or Performance Standards by providing the requirements applicable to assurance (A) or consulting (C) services. They are displayed in gray boxes throughout this text.

Recommended Guidance

Implementation Guidance and Supplemental Guidance constitute recommended guidance. They describe practices for effective implementation of the mandatory elements of the IPPF: (1) the Core Principles, (2) the Definition of Internal Auditing, (3) the Code of Ethics, and (4) the *Standards*.



Figure 1-7

Purpose, Authority, and Responsibility of the Internal Audit Activity

Each organization's internal audit charter lays out the purpose, authority, and responsibility of the internal audit activity for that organization.

Purpose

The purpose of the internal audit activity is to provide "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" (The IIA Glossary).

There are two general types of internal audit activities: assurance services and consulting services.

1. **Assurance services** involve the internal auditor's objective assessment of evidence to provide opinions or conclusions regarding an entity, operation, function, process, system, or other subject matters. It is an objective examination of evidence for the purpose of providing an independent assessment of governance, risk management, and control processes for the organization.
 - The **nature and scope** of an assurance engagement are determined by the internal auditor.
 - Generally, the process owner, the internal auditor, and the user are the three participants in assurance services.
 1. The **process owner** is the person or group directly involved with the entity, operation, function, process, system, or other subject matter.
 2. The **internal auditor** is the person or group making the assessment).
 3. The **user** is the person or group using the assessment.
 - Examples of assurance services include
 - ▶ Financial
 - ▶ Performance
 - ▶ Compliance
 - ▶ System security
 - ▶ Due diligence

2. **Consulting services** are advisory in nature and generally are performed at the specific request of an engagement client. Consulting services are activities intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor's assumption of management responsibility.
- The **nature and scope** of the consulting engagement are subject to agreement with the engagement client.
 - Generally, the internal auditor and the engagement client are the two participants in consulting services.
 1. The **internal auditor** is the person or group offering the advice.
 - When performing consulting services, the internal auditor should maintain objectivity and not assume management responsibility.
 2. The **engagement client** is the person or group seeking and receiving the advice.
 - Consulting services include providing counsel, advice, facilitation, and training.

Authority

The board of directors adopts a formal charter that grants sufficient authority to a chief audit executive and the internal audit activity.

The support of management and the board is crucial when inevitable conflicts arise between the internal audit activity and the department or function under review. Thus, the internal audit activity should be empowered to require auditees to grant access to all records, personnel, and physical properties relevant to the performance of every engagement.

- A formal **charter** that defines the internal audit activity's authority must be adopted. The authority granted should be sufficient. Final approval of the charter resides with the board.

Responsibility

The internal audit activity's responsibility also is defined in the charter. It should provide the organization with assurance and consulting services that will add value and improve the organization's operations.

- Specifically, the internal audit activity must evaluate and improve the effectiveness of the organization's governance, risk management, and control processes.



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 1 through 3 on page 39.

1.2 ETHICS -- INTRODUCTION AND PRINCIPLES

Author's Note: The gray boxes throughout the rest of this study unit are quotes from The IIA's Code of Ethics.

Introduction

The IIA incorporates the Definition of Internal Auditing into the Introduction to the Code of Ethics and specifies the reasons for establishing the Code.

Introduction to The IIA's Code of Ethics

The purpose of The Institute'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 risk management, control, and governance 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.
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 perform internal audit services within the Definition of Internal Auditing.

Applicability

The provisions of the Code are applied broadly to all organizations and persons who perform internal audit services, not just CIAs and members of The IIA.

Applicability and Enforcement of the Code of Ethics

This Code of Ethics applies to both entities and individuals that perform internal audit 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.

- Violations of rules of ethics should be reported to The IIA's board of directors.

Principles

The Rules of Conduct in the Code are organized based on the principles of integrity, objectivity, confidentiality, and competency.

Principles

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

1. Integrity

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

2. Objectivity

Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

3. Confidentiality

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

4. Competency

Internal auditors apply the knowledge, skills, and experience needed in the performance of internal audit services.

Rules of Conduct**1. Integrity**

Internal auditors:

- 1.1. Shall perform their work with honesty, diligence, and responsibility.
- 1.2. Shall observe the law and make disclosures expected by the law and the profession.
- 1.3. 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.
- 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

2. Objectivity

Internal auditors:

- 2.1. 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.
- 2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

3. Confidentiality

Internal auditors:

- 3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2. 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.

4. Competency

Internal auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- 4.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing*.
- 4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.

To remember the above principles on the CIA exam, use the memory aid **I Only Carry Cash**.



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 4 and 5 on page 40.

1.3 ETHICS -- INTEGRITY

Rules of Conduct – Integrity

Integrity

Internal auditors:

- 1.1. Shall perform their work with honesty, diligence, and responsibility.
- 1.2. Shall observe the law and make disclosures expected by the law and the profession.
- 1.3. 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.
- 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

Further guidance on integrity is provided in Implementation Guide, *Code of Ethics: Integrity*.

- “Integrity is the **foundation** of the other three principles in The IIA’s Code of Ethics. Objectivity, confidentiality, and competency all depend on integrity. Integrity also underpins the *Standards*.”
- The chief audit executive’s (CAE’s) responsibility for implementing integrity includes the following:
 - “[T]he CAE should cultivate a culture of integrity by acting with integrity and adhering to the Code of Ethics.”
 - “The CAE also establishes policies and procedures to guide the internal audit activity . . . to show diligence and responsibility.”
 - “[T]he CAE also may emphasize the importance of integrity by providing training that demonstrates integrity and other ethical principles in action.”
- For internal auditors, “the best attempts to identify and measure integrity likely involve astute awareness and understanding of the Code of Ethics’ rules of conduct for integrity, the IPPF’s Mandatory Guidance, and supporting practices.”
- “For internal auditors, behaviors that may not be illegal but may be **discreditable** include:
 - Behavior that may be considered bullying, harassing, or discriminatory.
 - Failing to accept responsibility for making mistakes.
 - Issuing false reports or permitting others to do so.
 - Lying.
 - Making claims about one’s competency in a manner that is deceptive, false, or misleading.
 - Making disparaging comments about the organization, fellow employees, or its stakeholders, either in person or via media (e.g., in publications or social media posts).

- Minimizing, concealing, or omitting observations or unsatisfactory conclusions and ratings from engagement reports or overall assessments.
- Noncompliance with the *Standards* and other IPPF Mandatory Guidance.
 - ▶ Performing internal audit services with undeclared impairments to independence and objectivity.
 - ▶ Performing internal audit services for which one is not competent.
 - ▶ Soliciting or disclosing confidential information without proper authorization.
 - ▶ Stating that the internal audit activity is operating in conformance with the *Standards* when the assertion is not supported by the results of the quality assurance and improvement program.
- Overlooking illegal activities that the organization may tolerate or condone.
- Using the CIA designation or other credentials after they have expired or been revoked.”

How to Comply with the Integrity Rule

Maintenance, and reporting on, a quality assurance and improvement program (QAIP) by the CAE and participation of internal auditors in continuing professional education (CPE)

Internal auditor accountability demonstrated by the following:

- The organization’s ethics policies or code of conduct
- Relevant laws and regulations
- The IIA’s Code of Ethics
- IPPF Mandatory Guidance

Diligent supervision of engagements and performance of the self-assessments required by the *Standards* demonstrate the integrity of the internal audit activity as a whole.

EXAMPLE 1-1 Conformance with the Integrity Rule

An internal auditor is working for a cosmetics manufacturer that may be inappropriately testing cosmetics on animals. If, out of loyalty to the employer, no information about the testing is gathered, the auditor violated the Rules of Conduct by

- Knowingly becoming a party to an illegal act,
- Engaging in an act discreditable to the profession,
- Failing to make disclosures expected by the law, and
- Not performing the work diligently.



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 6 and 7 on page 41.

1.4 ETHICS -- OBJECTIVITY

Rules of Conduct – Objectivity

Objectivity

Internal auditors:

- 2.1. 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.
- 2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.
- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.



SUCCESS TIP

The objectivity principle is a frequently tested ethics topic. Being able to apply the rules of conduct related to objectivity to scenarios will increase your success on the exam. To do this, a higher level of understanding beyond memorization is required.

A material ownership interest in a competitor is allowable. An internal auditor seldom can during the course of employment take action to enhance the value of the ownership interest.

For example, if management override of an important control creates exposure to a material risk, the internal auditor is ethically obligated to report the matter to senior officials charged with performing the governance function. Disclosure is not limited by time constraints.

An internal auditor cannot assure anonymity. Information communicated to an internal auditor is not deemed to be privileged. However, promising merely to attempt to keep the source of the information confidential is allowed.

Disclosure is not required when the internal auditor gathers sufficient information to dispel the suspicion of fraud.

The CAE should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services.

Conflict of Interest Policy

A conflict of interest policy should prohibit the transfer of benefits between an employee and those with whom the organization deals.

Examples of violations of Rules 2.1., 2.2., and 2.3. include the following:

- **Rule of Conduct 2.1.**
 1. Excessive individual fraternizing outside of work with the organization's employees, management, third-party suppliers, and vendors.
 2. Certain dealings in commercial properties (excluding rental activity).
 3. Sales of services or products by the internal auditor to the organization.
 4. Participation in non-public service organizations may not be allowed, for example, serving as a consultant to third parties (vendors, suppliers, etc.) with which the organization conducts business.
 5. Performing an audit in a department managed by a family member.
 6. Accepting a bonus based on work accomplished during an audit.
 7. Assuming management responsibilities and auditing an area in which the auditor had such responsibilities within 1 year.
- **Rule of Conduct 2.2.**
 1. Accepting gifts, meals, trips, and special treatment that exceed policy limits or are not disclosed and approved
 2. Working in a non-audit position and accepting gifts not permitted by IIA code of conduct
- **Rule of Conduct 2.3.**
 1. Intentional omission of disclosures of illegal activity from final engagement communications
 2. Withholding pertinent information
 3. Not communicating pertinent information to the chief audit executive
 4. Distorting facts reported in final engagement communications

Conformance with objectivity is demonstrated by the following:

- The CAE provides relevant policies and procedures for the internal audit activity.
- The CAE requires internal auditors attend meetings or training sessions about objectivity (for example, CPE).
- The CAE documents the rationale for allocation of resources to the internal audit plan, including potential impairments.
- Other evidence may include documentation of research into potential conflicts of interest involving outsourced and cosourced activities.
- Approval of the CAE or a designated engagement supervisor of engagement workpapers may evidence that internal auditors have conducted a balanced assessment.
- Feedback from post-engagement surveys and supervisory reviews of engagements may provide additional evidence that the internal auditors' work appeared to be performed objectively.
- Assessments as part of the internal audit activity's quality assurance and improvement program also lend support that appropriate objectivity was used in arriving at internal audit conclusions and opinions.

EXAMPLE 1-2 Conformance with the Objectivity Rule

At the end of the year, an internal auditing team made observations and recommendations that an organization can use to improve operating efficiency. To express gratitude, the division manager presented the internal audit team with a gift of moderate value. The internal audit team meets to discuss whether to accept the gift. The following reasons for accepting or not accepting the gift were discussed:

One auditor said, "we *should* accept the gift because its value is insignificant."

Another auditor said, "we *should not* accept the gift until after we submit our final engagement communication."

A third auditor said, "we *should not* accept the gift."

The lead auditor considered the opinions of the other auditors and the intent of the Rules of Conduct. The lead auditor then decided that acceptance of the gift would be inappropriate because of the presumed impairment of the internal auditor's professional judgment.



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 8 through 12 beginning on page 42.

1.5 ETHICS -- CONFIDENTIALITY

Rules of Conduct – Confidentiality

Confidentiality

Internal auditors:

- 3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2. 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.

Further guidance on confidentiality is provided in Implementation Guide, *Code of Ethics: Confidentiality*:

- “Organizations usually issue **information security policies** to protect the data they acquire, use, and produce and to ensure compliance with the laws and regulations that pertain to the industry and jurisdiction within which they operate.”
 - “To protect proprietary information, policies and procedures may require internal auditors to take the following precautions, even when handling information internally:
 - ▶ Collect only the data required to perform the assigned engagement and use this information only for the engagement’s intended purposes.
 - ▶ Protect information from intentional or unintentional disclosure through the use of controls such as data encryption, email distribution restrictions, and restriction of physical access to the information.
 - ▶ Eliminate copies of or access to such data when it is no longer needed.”
- “To better understand the effects of legal and regulatory requirements and protections (e.g., legal privilege or attorney-client privilege), the chief audit executive (CAE) should **consult with legal counsel**. The organization’s policies and procedures may require that specific authorities review and approve business information before external release.”
- “Rule of Conduct 3.2 emphasizes that internal auditors must not use any information for personal gain.
- For example, internal auditors should not use insider financial, strategic, or operational knowledge of an organization to bring about personal financial gain by purchasing or selling shares in the organization.
- Another example is releasing insider knowledge to journalists or via other media without proper authorization. Using **insider information** to develop a competitive product or selling proprietary information to a competitor also violates this confidentiality rule.

- Furthermore, internal auditors should not abuse their privilege to access information, such as using access to customer records to look up a neighbor's recent purchases or to view the health records of a celebrity."
- Conformance with confidentiality is demonstrated as follows:
 - "The CAE may demonstrate support of internal audit confidentiality through evidence of policies, processes, procedures, and training materials implemented to cover confidentiality as it applies to the internal audit activity and the organization."
 - "Regarding the release of engagement results, reports, or related information, the CAE demonstrates conformance with the confidentiality principle and rules of conduct by documenting and retaining records of disclosures approved by legal counsel, if applicable, and by senior management and the board."
 - "Internal auditors demonstrate conformance with engagement record confidentiality by documenting distribution restrictions in engagement workpapers and reports and by retaining authorizations of all disclosures and approved distribution lists."
 - Given no reports or investigations of individual auditors' violations of policies, procedures, and rules related to confidentiality, the internal audit activity as a whole most likely is in conformance with the principle.

EXAMPLE 1-3 Conformance with the Confidentiality Rule

Which of the following violate(s) The IIA's Code of Ethics?

- Investigating a lead sales person's expense reports based on rumors of overstatement.
 - Investigating potential instances of fraud is within the internal auditor's normal responsibilities. It is not a violation.
- Purchasing stock in a target organization after reading company reports that it may be acquired.
 - Rule of Conduct 3.2 states, "Internal auditors shall not use information for any personal gain." The stock purchase is a violation.
- Disclosing confidential information in response to a court order.
 - The principle of confidentiality permits the disclosure of confidential information given a legal or professional obligation to do so. This disclosure is not a violation.



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 13 and 14 on page 44.

1.6 ETHICS -- COMPETENCY

Rules of Conduct – Competency

Competency

Internal auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- 4.2. Shall perform internal audit services in accordance with the *International Standards for the Professional Practice of Internal Auditing*.
- 4.3. Shall continually improve their proficiency and the effectiveness and quality of their services.

Further guidance on competency is provided in Implementation Guide, *Code of Ethics: Competency*:

- Conformance with competency is demonstrated by the following:
 - “The CAE may demonstrate a culture supportive of competency and the continual improvement of proficiency, effectiveness, and quality through evidence that:
 - ▶ Engagements have been properly resourced and supervised.
 - ▶ Feedback has been solicited from internal audit stakeholders and sufficiently considered.
 - ▶ Performance reviews of internal auditors have been conducted regularly.
 - ▶ Opportunities for training, mentoring, and professional education have been provided.
 - ▶ A quality assurance and improvement program is active.
 - ▶ Internal audit services are performed in conformance with the IPPF’s Mandatory Guidance.”
- “The knowledge, skills, and experience of individual internal auditors may be evidenced, in part, through
 1. Credentialed qualifications, such as university degrees and certifications, and
 2. Relevant work history as detailed on the internal auditor’s resume, which the CAE or the organization’s human resources department should have on file.”
- “[I]nternal auditors may maintain documentation of a skills self-assessment, a plan for professional development, and the completion of continuing professional education/development courses or trainings.”

- To expand their competencies, internal auditors may provide evidence of experiences undertaken, for example, specific work assignments (that is, on-the-job training) or volunteering in professional organizations.
- Also, pursuing and completing professional education, whether for new certifications or continuing professional education, further evidences internal auditors' commitment to continual improvement of their proficiency and the effectiveness and quality of their services.

EXAMPLE 1-4 Conformance with the Competency Rule

Which of the following violate(s) The IIA's Code of Ethics?

- After obtaining evidence that an employee is embezzling funds, the internal auditor interrogates the suspect. The organization has a security department.
 - Internal auditors generally lack the knowledge, skills, or experience regarding interrogation of suspects possessed by security specialists. The lack of proficiency most likely is a violation.
- An internal auditor has been assigned to perform an engagement in the warehousing department next year. The auditor currently has no expertise in this area but accepted the assignment and plans to take continuing professional education courses in warehousing.
 - The internal auditor plans to acquire the required knowledge and skills prior to the start of this engagement. The internal auditor most likely did not violate the Code of Ethics.



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 15 through 17 beginning on page 45.

1.7 INTERNAL AUDIT CHARTER

Internal Audit Charter



Attribute Standard 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.

The following Interpretation was issued by The IIA:



Interpretation of Standard 1000

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, 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. Final approval of the internal audit charter resides with the board.

Engagement clients must be informed of the internal audit activity's purpose, authority, and responsibility to prevent misunderstandings about access to records and personnel.

An auditee must not be able to place a **scope limitation** on the internal audit activity by refusing to make relevant records, personnel, and physical properties available to the internal auditors.

Implementation Guide 1000, *Purpose, Authority, and Responsibility*, further addresses the charter.

- “To create [the internal audit charter], the chief audit executive (CAE) must understand the Mission of Internal Audit and the mandatory elements of The IIA’s International Professional Practices Framework (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 charter is the understanding that provides the foundation for a discussion among the CAE, senior management, and the board to **mutually agree upon**
 - Internal audit objectives and responsibilities
 - The expectations for the internal audit activity
 - The CAE’s functional and administrative reporting lines
 - The level of authority (including access to physical property, personnel, and records) required for the internal audit activity to perform engagements and fulfill its agreed-upon objectives and responsibilities”
- “The CAE may need to confer with the organization’s legal counsel or the board secretary regarding the preferred format for charters and how to effectively and efficiently submit the proposed internal audit charter for board approval.
- Once **drafted**, the proposed internal audit charter should be discussed with senior management and the board to confirm that it accurately describes the agreed-upon role and expectations or to identify desired changes. Once the draft has been **accepted**, the CAE **formally presents** it during a board meeting to be discussed and approve.
- The **minutes** of the board meetings during which the CAE initially discusses and then formally presents the internal audit charter provide documentation of conformance. In addition, the **CAE retains the approved charter.**”

The charter must define the nature of assurance and consulting services provided by the internal audit activity. Two Implementation Standards state this.

**Implementation Standard 1000.A1**

The nature of assurance 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.

Implementation Standard 1000.C1

The nature of consulting services must be defined in the internal audit charter.

The charter also must refer to the four elements of the mandatory guidance portion of the IPPF: (1) the Core Principles, (2) the Code of Ethics, (3) the *Standards*, and (4) the Definition of Internal Auditing.

**Attribute Standard 1010****Recognizing Mandatory Guidance in the Internal Audit Charter**

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 must be recognized in the internal audit charter. The chief audit executive should discuss the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework with senior management and the board.

The IIA's model internal audit charter is available from The IIA; however, it is restricted to IIA members only.

Key Definitions from the Glossary

The complete IIA Glossary is in Appendix A. The definitions do not need to be memorized, but they should be understood so candidates can apply them to multiple-choice questions.

Chief audit executive (CAE) 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 or responsibilities of the chief audit executive may vary across organizations.

The **board** is 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 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).



STOP & REVIEW

You have completed the outline for this subunit.
Study multiple-choice questions 18 through 21 beginning on page 46.