1.1 The International Professional Practices Framework

1.2 Internal Audit’s Purpose, Authority, and Responsibility

1.3 Independence of the Internal Audit Activity

1.4 Objectivity of Internal Auditors

1.5 Impairment to Independence and Objectivity

The Institute of Internal Auditors (The IIA), headquartered in Altamonte Springs, Florida, governs the professional practice of internal auditing worldwide. Since its founding in 1941, The IIA has issued an extensive body of professional literature. This literature serves both to provide guidance for internal auditors in carrying out their job duties and a level of respect for the profession among businesspeople and the general public. Because internal auditing is a global profession, it is not subject to the same degree of regulation by national governments that, for instance, external auditing is.

1.1 THE INTERNATIONAL PROFESSIONAL PRACTICES FRAMEWORK

1. Mandatory Guidance

a. The IIA’s International Professional Practices Framework (IPPF) contains both mandatory guidance and strongly recommended guidance.

   1) The IIA considers adherence to the mandatory guidance essential for the professional practice of internal auditing.

b. The mandatory guidance consists of three parts: the Definition of Internal Auditing, the Code of Ethics, and the Standards.

   1) The Definition of Internal Auditing is a concise statement of the role of internal audit within the organization.

**Definition 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.

2) The full text of the Code of Ethics can be found in Study Unit 3, Subunits 2 through 6.

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

**Purpose of the Standards**

1. Delineate basic principles that represent the practice of internal auditing.
2. Provide a framework for performing and promoting a broad range of value-added internal auditing.
3. Establish the basis for the evaluation of internal audit performance.
4. Foster improved organizational processes and operations.
c. The Standards are of three types.

1) **Attribute Standards**, numbered in the 1000s, govern the responsibilities, attitudes, and actions of the organization’s internal audit function and the people who serve as internal auditors. (For a list of Attribute Standards covered in the Gleim CIA Review: Part 1, see Appendix C.)

2) **Performance Standards**, numbered in the 2000s, govern the nature of internal auditing and provide quality criteria for evaluating the internal audit function’s performance. (For a list of Performance Standards covered in the Gleim CIA Review: Part 1, see Appendix C.)

   a) **Interpretations** are provided by The IIA to clarify terms and concepts referred to in Attribute or Performance Standards.

3) **Implementation Standards** expand upon individual Attribute or Performance Standards.

   a) Attribute and Performance Standards apply to all internal audit engagements, but each Implementation Standard describes only the requirements of either an **assurance** or a **consulting** engagement.

2. **Strongly Recommended Guidance**

   a. The pronouncements that constitute strongly recommended guidance have been developed by The IIA through a formal approval process. They describe practices for effective implementation of the Definition of Internal Auditing, Code of Ethics, and Standards.

   1) The three strongly recommended elements of the IPPF are (a) Position Papers, (b) Practice Advisories, and (c) Practice Guides.

**The IIA’s International Professional Practices Framework**

![Figure 1-1](su1//images/1-1.jpg)
The IPPF contains a few broad definitions and a tremendous amount of detailed guidance. As a whole, this framework provides an invaluable aid to those engaged in the everyday practice of internal auditing. Only certain key provisions, however, are crucial for passing the CIA exam. The purpose of the Gleim CIA Review is to furnish you with only those parts of the IPPF that are pertinent to the areas most likely to be tested. Your chances of success will increase if you thoroughly absorb the Standards, Interpretations, and Practice Advisory excerpts presented in these outlines.

1.2 INTERNAL AUDIT’S PURPOSE, AUTHORITY, AND RESPONSIBILITY

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 Definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

1. Internal Audit Charter
   a. The importance of a formal written internal audit charter cannot be overstated. The IIA provides the following Interpretation to emphasize the point:

   **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.

   1) 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.
   b. Engagement clients must be informed of the internal audit activity’s purpose, authority, and responsibility. This will prevent misunderstandings about internal audit’s access to records and personnel.
   c. As described in the following Standard, the charter itself must refer to the mandatory guidance portion of the IPPF:

   **Attribute Standard 1010**
   Recognition of the Definition of Internal Auditing, the Code of Ethics, and the Standards in the Internal Audit Charter

   The mandatory nature of the Definition of Internal Auditing, the Code of Ethics, and the Standards must be recognized in the internal audit charter. The chief audit executive should discuss the Definition of Internal Auditing, the Code of Ethics, and the Standards with senior management and the board.

   d. The IIA’s model internal audit charter can be downloaded from www.globaliia.org/standards-guidance/Public%20Documents/ModelCharter.pdf.
2. Definitions from the Glossary (see Appendix A for the complete IIA Glossary)
a. Chief audit executive (CAE) describes a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the Definition of Internal Auditing, the Code of Ethics, and the Standards.
   1) The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications.
   2) The specific job title of the chief audit executive may vary across organizations.

b. A board is an organization’s governing body, such as a board of directors; supervisory board; head of an agency or legislative body; board of governors or trustees of a nonprofit organization; or any other designated body of the organization, including the audit committee, to whom the chief audit executive may functionally report.

1.3 INDEPENDENCE OF THE INTERNAL AUDIT ACTIVITY

Attribute Standard 1100
Independence and Objectivity
The internal audit activity must be independent, and internal auditors must be objective in performing their work.

1. Independence
   a. Independence is an organizational attribute of the internal audit activity as a whole. The IIA clarifies this distinction with the following Interpretation (objectivity is discussed in Subunit 1.4):

   **Interpretation of Standard 1100 (para. 1)**
   Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels.

   1) Note that this Interpretation endorses the concept of “dual reporting,” a practice that separates functional reporting and administrative reporting. This concept is explained in item 3. on the next page.

2. Achieving Independence through Reporting to the Board
   a. In this Standard, the reporting level that assures independence is identified in general terms:

   **Attribute Standard 1110
   Organizational Independence**
   The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.
b. The related Interpretation specifies a particular reporting relationship that inherently achieves independence:

### Interpretation of Standard 1110

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- Approving the internal audit charter;
- Approving the risk based internal audit plan;
- Receiving communications from the chief audit executive on the internal audit activity’s performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

1) The components of functional reporting are described in item 3.a.2) below.

3. **Facilitating Independence through Dual Reporting**

   a. The features of the dual-reporting relationship mentioned in the Interpretation of Standard 1100 are described in Practice Advisory 1110-1, *Organizational Independence*:

   1) “The chief audit executive (CAE), reporting functionally to the board and administratively to the organization’s chief executive officer, facilitates organizational independence. At a minimum the CAE needs to report to an individual in the organization with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate action on engagement recommendations” (para. 2).

   2) “Functional reporting to the board typically involves the board:

      a) Approving the internal audit activity’s overall charter.
      b) Approving the internal audit risk assessment and related audit plan.
      c) Receiving communications from the CAE on the results of the internal audit activities or other matters that the CAE determines are necessary, including private meetings with the CAE without management present, as well as annual confirmation of the internal audit activity’s organizational independence.
      d) Approving all decisions regarding the performance evaluation, appointment, or removal of the CAE.
      e) Approving the annual compensation and salary adjustment of the CAE.
      f) Making appropriate inquiries of management and the CAE to determine whether audit scope or budgetary limitations impede the ability of the internal audit activity to execute its responsibilities” (para. 3).

   3) “Administrative reporting is the reporting relationship within the organization’s management structure that facilitates the day-to-day operations of the internal audit activity. Administrative reporting typically includes:

      a) Budgeting and management accounting.
      b) Human resource administration, including personnel evaluations and compensation.
      c) Internal communications and information flows.
      d) Administration of the internal audit activity’s policies and procedures” (para. 4).
b. Graphical depiction of dual reporting:

![Diagram showing dual reporting]

Figure 1-2

c. As the following standard makes clear, limits may not be placed on the chief audit executive’s access to the board:

**Attribute Standard 1111**

**Direct Interaction with the Board**

The chief audit executive must communicate and interact directly with the board.

1.4 OBJECTIVITY OF INTERNAL AUDITORS

1. Objectivity

a. Internal auditors must be objective in performing their work.

1) Objectivity is an individual attribute of each internal auditor. The IIA clarifies this distinction with the following Interpretation:

**Interpretation of Standard 1100 (para. 2)**

Objectivity is 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. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.

b. The importance of objectivity as an attribute of individual internal auditors is embodied in its own Standard:

**Attribute Standard 1120**

**Individual Objectivity**

Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.
2. **Definition of Conflict of Interest**
   a. The importance of identifying potential conflicts of interest of individual internal auditors is clarified in the following Interpretation:

   **Interpretation of Standard 1120**
   Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfill his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity, and the profession. A conflict of interest could impair an individual’s ability to perform his or her duties and responsibilities objectively.

   b. The Glossary defines **conflict of interest** as 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/her duties and responsibilities objectively.

3. **Specific Guidelines**
   a. The IIA provides guidelines for ensuring objectivity in specific cases in Practice Advisory 1120-1, **Individual Objectivity**:

   1) “Individual objectivity involves the chief audit executive (CAE) organizing staff assignments that prevent potential and actual conflict of interest and bias, periodically obtaining information from the internal audit staff concerning potential conflict of interest and bias, and, when practicable, rotating internal audit staff assignments periodically” (para. 2).

   2) “The internal auditor’s objectivity is not adversely affected when the auditor recommends standards of control for systems or reviews procedures before they are implemented. The auditor’s objectivity is considered to be impaired if the auditor designs, installs, drafts procedures for, or operates such systems” (para. 4).

1.5 **IMPAIRED TO INDEPENDENCE AND OBJECTIVITY**

   **Attribute Standard 1130**
   **Impairment to Independence or Objectivity**

   If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

   **Interpretation of Standard 1130**
   Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest; scope limitations; restrictions on access to records, personnel; and properties; and resource limitations, such as funding.

   The determination of appropriate parties to which the details of an impairment to independence or objectivity must be disclosed is dependent upon the expectations of the internal audit activity’s and the chief audit executive’s responsibilities to senior management and the board as described in the internal audit charter, as well as the nature of the impairment.
1. **Specific Circumstances**

   a. The IIA provides examples of and responses to impairments in Practice Advisory 1130-1, *Impairment to Independence or Objectivity*:

   1) “Internal auditors are to report to the chief audit executive (CAE) any situations in which an actual or potential impairment to independence or objectivity may reasonably be inferred, or if they have questions about whether a situation constitutes an impairment to objectivity or independence. If the CAE determines that impairment exists or may be inferred, he or she needs to reassign the auditor(s)” (para. 1).

   2) “A scope limitation is a restriction placed on the internal audit activity that precludes the activity from accomplishing its objectives and plans. Among other things, a scope limitation may restrict the:

   a) Scope defined in the internal audit charter.
   b) Internal audit activity’s access to records, personnel, and physical properties relevant to the performance of engagements.
   c) Approved engagement work schedule.
   d) Performance of necessary engagement procedures.
   e) Approved staffing plan and financial budget” (para. 2).

   3) “A scope limitation, along with its potential effect, needs to be communicated, preferably in writing, to the board. The CAE needs to consider whether it is appropriate to inform the board regarding scope limitations that were previously communicated to and accepted by the board. This may be necessary particularly when there have been organization, board, senior management, or other changes” (para. 3).

   4) “Internal auditors are not to accept fees, gifts, or entertainment from an employee, client, customer, supplier, or business associate that may create the appearance that the auditor’s objectivity has been impaired. The appearance that objectivity has been impaired may apply to current and future engagements conducted by the auditor. The status of engagements is not to be considered as justification for receiving fees, gifts, or entertainment. The receipt of promotional items (such as pens, calendars, or samples) that are available to employees and the general public and have minimal value do not hinder internal auditors’ professional judgments. Internal auditors are to report immediately the offer of all material fees or gifts to their supervisors” (para. 4).


   1) “Persons transferred to, or temporarily engaged by, the internal audit activity should not be assigned to audit those activities they previously performed or for which they had management responsibility until at least one year has elapsed. Such assignments are presumed to impair objectivity, and additional consideration should be exercised when supervising the engagement work and communicating engagement results” (para. 1).