

IPPF Basic

7 July 2012

- Code of Ethics - 1968
- Standards - first issued 1978
- Professional Practices Framework - 2000
- International Professional Practices Framework – January 2009

PPF

ELEMENTS
Definition
Code of Ethics
International Standards
Practice Advisories
Development and Practice Aids REMOVED



IPPF

ELEMENTS
Definition
Code of Ethics
International Standards
Practice Advisories
Position Papers
Practice Guides



Internal Auditing, Defined

“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.”

Part 1, Section 1, Introduction

Discussion Question

Identify whether the statement is related to the purpose, authority, or responsibility of the internal audit activity.

Answers:

- Responsibility** 1. Ensure that staff possesses sufficient expertise to fulfill the engagement charter.
- Authority** 2. Maintain access with the appropriate governing authority.
- Purpose** 3. Add value and improve operations.



International Professional Practices Framework (IPPF)

- | | | |
|---|---|---|
| ➤ Code of Ethics | } | Mandatory |
| ➤ <i>International Standards for the Professional Practice of Internal Auditing (Standards)</i> | | |
| ➤ Definition of Internal Auditing | | |
| ➤ Practice Advisories | } | Not mandatory (but endorsed and recommended by The IIA) |
| ➤ Practice Guides | | |
| ➤ Position Papers | | |

Discussion Question

During an internal audit, the **Standards** establish all of the following EXCEPT

- A. basic auditing principles.
- B. evaluation criteria for audit performance.
- C. considerations on how to plan and perform the engagement.
- D. a framework for a broad range of value-added internal audit activities.

Answer: C. Approach and methodology (but not detailed processes and procedures) are covered in the Practice Advisories.



Categories of Standards

Attribute

- Apply to all internal audit services and internal auditors, individually (organizations; parties performing internal audit activities)
- Provide guidance for the quality of the internal audit programs

Performance

- Apply to all internal audit services and internal auditors
- Describe the nature of internal audit activities
- Provide quality criteria for performance evaluation

Implementation

- Expand Attribute and Performance Standards
- Apply to specific engagements

Part 1, Section 1, Introduction

Discussion Question

Defining characteristics such as independence and objectivity or due professional care are covered in

- A. Attribute Standards.
- B. Performance Standards.
- C. Implementation Standards.
- D. Practice Guides and Position Papers.



Answer: A. Attribute Standards describe the characteristics of organizations and parties performing internal audit activities.

Types of Internal Audit Activity

Assurance Services

"An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization"

Consulting Services

"Advisory and related client service activities, the nature and scope of which are agreed to by the client and which are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility"

Discussion Question

Which parts of the International Professional Practices Framework are mandatory for IIA members? (Select all that apply.)

- I. Definition of internal auditing
- II. Code of Ethics
- III. *Standards*
- IV. Practice Advisories
- V. Practice Guides and Position Papers



Answer: I, II, and III

Discussion Question

Which list describes assurance audit services and which describes consulting audit services?

Answer:

Assurance

- Objective assessment of evidence.
- Independent opinion or conclusions about a process, system, etc.
- Internal auditor determines nature and scope.
- Three parties generally involved.

Consulting

- Advisory engagement.
- Requested by client.
- Nature and scope subject to client-auditor agreement.
- Two parties generally involved.



Engagement Examples

Assurance Engagements

- Financial assurance
- Controls assurance
- Information technology (IT)
- Compliance
- Operations
- Integrated

Consulting Engagements

- Management requests
- Due diligence assignments in mergers and acquisitions

IIA Guidance and Materials

Practice Advisories

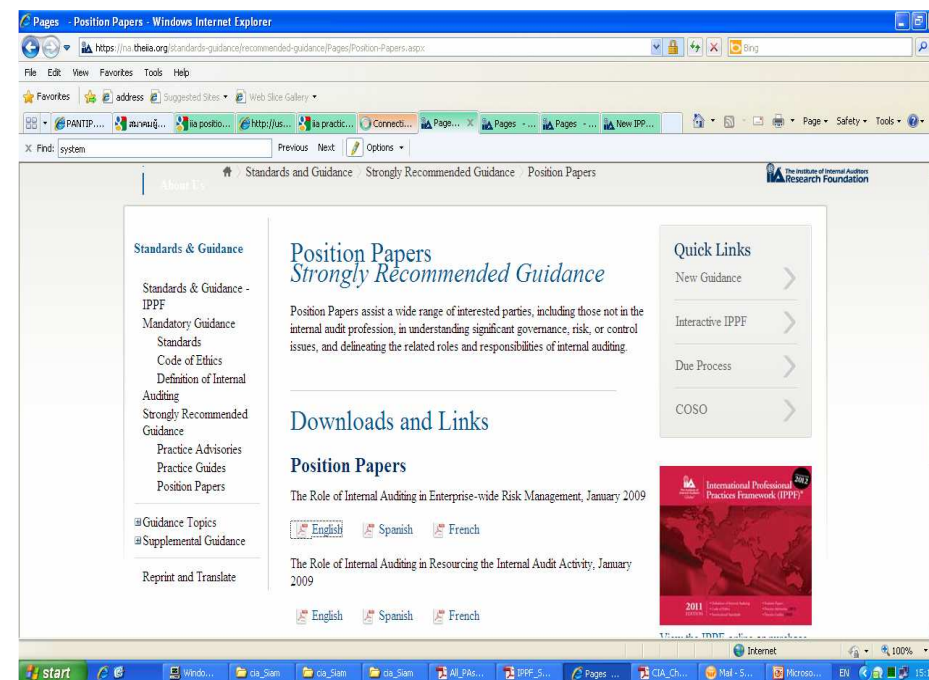
Strongly endorsed and recommended guidance on best practices for performance of the *Standards*

Practice Guides

Detailed processes and procedures, such as tools and techniques, programs, and step-by-step approaches

Position Papers

Statements to assist a wide range of interested parties



Downloads and Links

Practice Guides — General

Title	Date
NEW! Quality Assurance and Improvement Program	March 2012
NEW! Coordinating Risk Management and Assurance	March 2012
NEW! Reliance by Internal Audit on Other Assurance Providers	December 2011
NEW! Independence and Objectivity	October 2011
Interaction with the Board	August 2011
Auditing the Control Environment	April 2011
Assisting Small Internal Audit Activities in Implementing the International Standards for the Professional Practice of Internal Auditing	April 2011
Assessing the Adequacy of Risk Management Using ISO 31000	December 2010
Measuring Internal Audit Effectiveness and Efficiency	December 2010
Chief Audit Executives — Appointment, Performance, Evaluation, and Termination	May 2010
Auditing Executive Compensation and Benefits	April 2010
Evaluating Corporate Social Responsibility/Sustainable Development	February 2010
Formulating and Expressing Internal Audit Opinions	April 2009
Auditing External Business Relationships	May 2009
Internal Auditing and Fraud	December 2009

Practice Guides — GTAG® Global Technology Audit Guides (GTAG)

GTAGs are written in straightforward business language and address timely issues related to information technology (IT) management, control, and security.

Title	Date
GTAG 16: Data Analysis Technologies	August 2011
GTAG 15: Information Security Governance	June 2010
GTAG 14: Auditing User-developed Applications	June 2010
GTAG 13: Fraud Prevention and Detection in an Automated World	December 2009
GTAG 12: Auditing IT Projects	March 2009
GTAG 11: Developing the IT Audit Plan	January 2009
GTAG 10: Business Continuity Management	January 2009
GTAG 9: Identity and Access Management	January 2009
GTAG 8: Auditing Application Controls	January 2009
NEW EDITION! GTAG 7: Information Technology Outsourcing, 2nd Edition	June 2012
GTAG 6: Managing and Auditing IT Vulnerabilities	Update Coming Soon
GTAG 5: Managing and Auditing Privacy Risks	Update Coming Soon
GTAG 4: Management of IT Auditing	Update Coming Soon
GTAG 3: Continuous Auditing: Implications for Assurance, Monitoring, and Risk Assessment	Update Coming Soon
NEW EDITION! GTAG 2: Change and Patch Management Controls: Critical for Organizational Success, 2nd Edition	March 2012
NEW EDITION! GTAG 1: Information Technology Risk and Controls, 2nd Edition	March 2012

Practice Guides — GAIT Guide to the Assessment of IT Risk (GAIT)

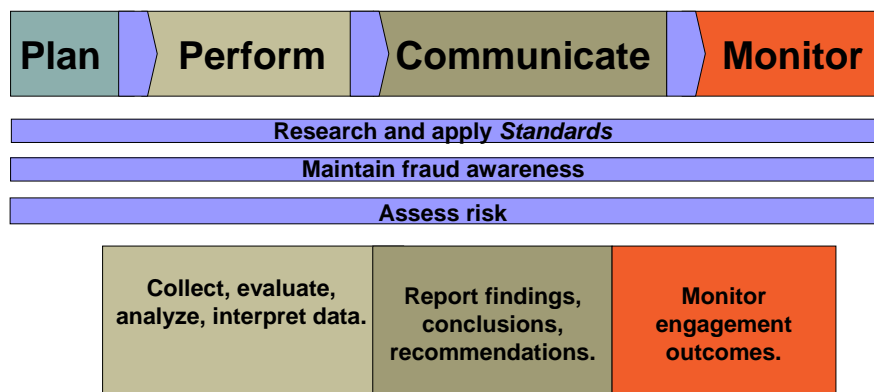
The GAIT series of Practice Guides describes the relationships among business risk, key controls within business processes, automated controls and other critical IT functionality, and key controls within IT general controls. Each guide addresses a specific aspect of IT risk and control assessment.

Title	Date
GAIT Methodology	January 2009
GAIT for IT General Control Deficiency Assessment	January 2009
GAIT for Business and IT Risk	January 2009

■ Study Unit Eight

□ Planning and Supervising The Engagement

Audit Engagement Overview



Engagement, Defined

“A specific internal audit assignment, task, or review activity, such as an internal audit, control self-assessment review, fraud examination, or consultancy”

Engagement planning helps to ensure that:

- Meaningful work is performed.
- Audit deliverables add value to the organization.
- Audit resources are used efficiently and effectively.

2200 – Engagement Planning

Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations.

Elements of the Engagement Program

The engagement program should:

- ▶ State the engagement objectives.
- ▶ Identify technical requirements, objectives, risks, processes, and transactions that are to be examined (i.e., audit scope).
- ▶ State the nature and extent of testing required.
- ▶ Document the internal auditor's procedures.
- ▶ Be prepared prior to the start of engagement work and modified, as appropriate, during its course, with the approval of the CAE or designee.

Practice Advisory 2200-1, "Engagement Planning"

Initial Client Communication

Practice Advisory 2200-1, "Engagement Planning"

- ▶ Planned objectives and scope
- ▶ Resources and timing of work
- ▶ Internal auditor assignments
- ▶ Communication methods, time frames, and individuals who will be responsible
- ▶ Business conditions and operations of the areas being reviewed, including recent changes
- ▶ Concerns and/or requests of management

...Plus practical considerations, logistics, and tactical aspects

Practice Advisory 2200-2: Using a Top down, Risk based Approach to Identify the Controls to Be Assessed in an Internal Audit Engagement

Why Conduct a Preliminary Survey?

Main purposes

- To become familiar with the activities, risks, and controls
- To identify areas for engagement emphasis
- To invite comments and suggestions from engagement clients

Realistic outcomes

Clarification of:

- Purpose of the internal audit
- Engagement objectives, scope, and timing
- Processes to be audited
- Area objectives, related risks, and controls
- Internal audit resources to be used
- Relevant standards

Preliminary Survey Element—Engagement Client Input

Description	Considerations
<p>Discussions about:</p> <ul style="list-style-type: none"> ■ Operational objectives or goals ■ Level of compliance ■ Key processes ■ Organizational structure ■ Information systems ■ Identified key risks ■ Current controls 	<p>Can be helpful with subsequent analytical reviews, testing, and benchmarking</p>

2320 – Analysis and Evaluation

Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations

Preliminary Survey Element—Analytical Reviews

Description	Considerations
<ul style="list-style-type: none"> ■ Examine relationships among information. ■ Identify discrepancies in information: <ul style="list-style-type: none"> □ Unexpected differences. □ No differences. 	<p>Apply the concept of “reasonableness.”</p>

Discussion Question

Identify the analytical review technique described in the example.

Answers:

Ratio analysis

1. Examines sales of inventory across four quarters

Variance analysis

2. Compares the liquidity position of different divisions

Variance analysis

3. Evaluates retention goals with employee turnover statistics

Trend analysis

4. Compares data from repetitive audits



Discussion Question

Comparing the liquidity ratio of a small entry firm with an industry giant shows significant deviation. The most probable determination by the internal audit based on this data finds the deviation to be reasonable.

A. True

B. False

Answer: A. The difference is to be expected. Further, the comparison is not particularly meaningful because the one party is so dominant.



Preliminary Survey Element—Benchmarking

Description	Considerations
<ul style="list-style-type: none">■ Compares performance measures against those of an internal or external group■ Determines areas for potential improvement and identifies best practices	<ul style="list-style-type: none">■ Numerous sources■ Choice influenced by:<ul style="list-style-type: none">□ Ease of access to the information□ Caliber of information sought

Levels of Benchmarking

Internal	Compares similar information within an entity.
Competitive	Compares measures with similar measures of direct competitors, either locally, nationally, or worldwide.
Functional	Compares processes to organizations with similar processes in the same function but in a different industry.
Generic	Compares measures with those of organizations that are best in class.

Discussion Question

Identify the levels of benchmarking described below.

Answers:

- Competitive** 1. Compares management career paths between two computer manufacturers
- Internal** 2. Compares domestic and international operations
- Functional** 3. Compares disaster recovery plans for a television station and a newspaper
- Generic** 4. Compares internal performance to best in class



Preliminary Survey Element—Interviews

Description	Considerations
Structured discussion to: <ul style="list-style-type: none"> ■ Facilitate a high-level dialogue. ■ Secure management perspective. ■ Clarify information about the area to be audited. ■ Collect additional necessary information. ■ Provide an observation of activities to be audited. 	Allow an internal auditor to: <ul style="list-style-type: none"> ■ Explain the internal audit process. ■ Build rapport with the client. ■ Request the client's buy-in.

Face-to-Face Meeting Guidelines

Schedule in advance.	Begin with	Ask for self-assessment.	Give honest appraisal.	End with a summary.
"How's Thursday at 4:00 p.m.?"	an outline. "You did a very professional job, for the most part..."	"What do you think were your strong points and what are your areas for development?"	"Can we talk about a few more effective techniques you can use in the future?"	"Let's review main points and commitments for development."

Discussion Question

If you are interviewing (not interrogating) an audit client, why do you establish rapport? What are some methods of doing so?

Sample answer:

Why—To make client comfortable with providing information.

Methods—Agree on convenient time and place; keep number of interviewers to a minimum; dress appropriately for client and situation; use open, attentive body language.



Discussion Question

What are some hallmarks of active listening?

Sample answer:

- Soft eye contact.
- Facial expressions showing interest.
- Brief silences to allow for more information.
- Paraphrasing.
- Unobtrusive note-taking.



Discussion Question

What are some examples of open and closed questions?

Answer:

Type	Use	Examples
Open	To invite opinions, descriptions, narratives, etc.	Please describe your unit's step-by-step recycling procedure.
Closed	To uncover facts in brief statements; to get to yes or no.	How often do employees skip a step in the approved process?



Discussion Question

What are some interview behaviors that you would consider indicators of fraud?

Sample answer:

- ✦ Restlessness.
- ✦ Anxiety
- ✦ Leaning away
- ✦ Attitude change
- ✦ No eye contact
- ✦ Changing answers
- ✦ Inappropriate attitude



Discussion Question

Match the questioning method on the right to the appropriate context for using that method on the left.

Answers:

- A You don't already know the answers.
- B You are a specialized fraud investigator.
- A You want to confirm or eliminate suspicion of fraud.
- B You want a confession.

- A. Interview
- B. Interrogation



Elements of the Audit Interview

Preparation	Production	Review
<ul style="list-style-type: none">• Planning	<ul style="list-style-type: none">• Opening• Conducting• Closing	<ul style="list-style-type: none">• Documenting• Evaluating

Discussion Question

What are some steps to take when planning the audit interview?

Sample answer:

- Step 1** Obtain background information.
- Step 2** Define purpose and specific objectives.
- Step 3** Prepare open and closed questions.
- Step 4** Organize questions in logical sequence.
- Step 5** Prepare a written agenda.
- Step 6** Tailor objectives and questions to the person.
- Step 7** Schedule a convenient, agreed-upon time.



Discussion Question

What are some effective ways to open an audit interview?

Sample answer:

- Step 1** Start on time.
- Step 2** Build rapport with a warm introduction.
- Step 3** Get the interviewee's name right.
- Step 4** After the warm-up, state objectives and purpose.
- Step 5** Continue building rapport, if possible.



Discussion Question

What are some do's and don'ts for conducting the interview?

Sample answers:

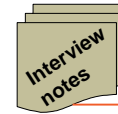
- Be confident but not intimidating.
- Avoid offensive or confusing language, humor, etc.
- Watch the interviewee's body language/behavior; don't focus on note-taking.
- Stay focused; prompt for feelings as well as facts.
- Question, summarize, and rephrase for clarity.
- Don't confuse opinion with fact.
- Bring a second interviewer if necessary.
- Be professional in action and appearance.
- Take appropriate notes.



Closing the Interview

- ✓ Stop at the promised time.
- ✓ Ask for permission to return if questions remain.
- ✓ Summarize key points from notes.
- ✓ Describe the next step.
- ✓ Provide contact information.
- ✓ Thank the interviewee.

After the Interview



Document the interview.

- Put notes in final written form.
- Do it right away.



Evaluate your performance.

- Surprises?
- Right balance of open and closed questions?
- Organized and logical process?
- Right time and place?
- Rapport?
- Objectives and purpose explained?

Discussion Question



What are some advantages and disadvantages of using questionnaires?

Sample answer:

Advantages—Easy to administer; uniform information for comparison; can go to large numbers of informants anywhere

Disadvantages—Not appropriate for some situations; not good for in-depth information; can't observe informants

Branch: _____	Supervisor: _____		
Area: _____	Date completed: _____		
Question	Yes	No	Comments
1. Are all credit sales approved by the Credit Department before shipping?			
2. Is the Credit Department independent of the sales department?			
3. Are sales priced on the basis of approved price lists?			
4. Are prenumbered sales invoice forms used?			
5. Are all sales invoice forms properly controlled?			
6. Are prenumbered shipping orders used to authorize shipments to customers?			

Discussion Question

What are some appropriate ways to use a checklist for data-gathering?

Sample answer:



As a reminder of questions to ask



As a data sheet for respondents to fill out quickly



As a control to ensure complete audit



Third-party Confirmation

Obtains direct written verification of the accuracy of information from independent third parties

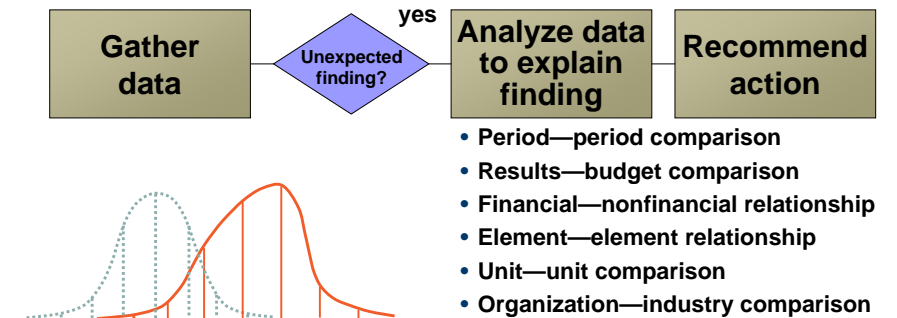
Positive confirmation

Asks recipients to respond regardless of whether or not they believe the information is correct

Negative confirmation

Asks recipients to respond only when they believe the information is incorrect

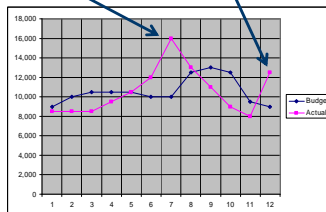
Analytical Review Techniques



Discussion Question (Variance Analysis)

What are the unreasonable relationships in the chart?

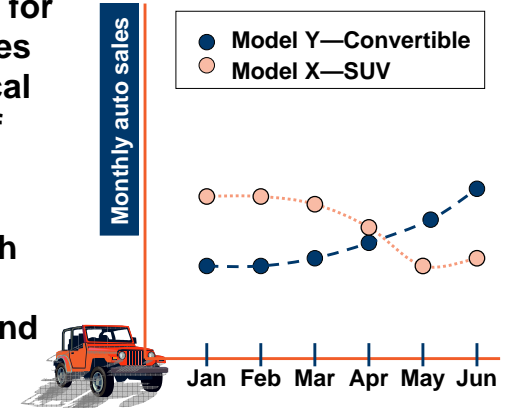
Answer: Divergence is especially large in July and December.



Period	Budgeted expense	Actual expense
January	\$9,000	\$8,500
February	10,000	8,500
March	10,500	8,500
April	10,500	9,500
May	10,500	10,500
June	10,000	12,000
July	10,000	16,000
August	12,500	13,000
September	13,000	11,000
October	12,500	9,000
November	9,500	8,000
December	9,000	12,500
Total	127,000	127,000

Trend Analysis

Trend analysis looks for unreasonable changes in a series of historical data. A typical use of trend analysis is to track changes in financial data through periods of time—monthly, quarterly, and annually.



Ratio Analysis

By definition, ratio analysis is the measurement of relationships between quantities, such as debt to equity or all statement items to gross revenue.

$$\frac{A}{B}$$

Ratio of A to B where A is any quantity of interest and B is any other related quantity.

Discussion Question



What is the main benefit of common-size statement analysis?

Answer: Expressing all items as percentages of sales enables comparison with statements of any size.

Sample Common-Size Statement		
Revenue		
Net sales	\$3,000,000	= 100.00%
Rent revenue	35,000	= 5.46%
Interest revenue	9,000	= 0.03%
Total revenue	3,044,000	= 101.47%
Expenses		
Cost of goods sold	1,750,000	= 58.33%
Selling expenses	400,000	= 13.33%
Administrative expenses	325,000	= 10.83%
Interest expense	40,000	= 0.01%
Total expenses	2,515,000	= 83.83%
Income before taxes	429,000	= 14.30%
Income taxes	127,700	= 0.04%
Net income	\$302,000	= 10.07%

Financial Ratios

How They Work	General Types	Users
By comparing relationships of various financial statement items to assess organizational or unit performance	<ul style="list-style-type: none"> Activity ratios Liquidity ratios Leverage (debt) ratios Profitability ratios 	<ul style="list-style-type: none"> Auditors Investors Lenders Managers

Discussion Question



What do activity ratios measure?

Answer:

Ratio	Calculation	What It Measures
Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$	Number of times during the year inventory is replaced
Days' Sales Outstanding	$\frac{\text{Accounts Receivable}}{\text{Sales} / 360 \text{ Days}}$	Effectiveness in collecting receivables (small is good)
Accounts Payable Turnover	$\frac{\text{Accounts Payable}}{\text{Purchases} / 360 \text{ Days}}$	Effectiveness in managing all obligations to creditors
Fixed Assets Turnover	$\frac{\text{Sales}}{\text{Average Net Fixed Assets}}$	Efficiency in use of fixed assets to generate sales
Total Assets Turnover	$\frac{\text{Sales}}{\text{Average Total Assets}}$	Effectiveness in using total assets to produce revenues

Liquidity Ratios

Ratio	Formula	What It Measures
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Measures potential to pay down current liabilities; larger number = more assets available to pay debts
Quick Ratio	$\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$	Like current ratio except current assets exclude inventory as least liquid (least available) current asset
Net Working Capital	$\text{Current Assets} - \text{Current Liabilities}$	Not a ratio; subtracts current liabilities from current assets to gauge potential to pay debts

Discussion Question: Leverage (Debt) Ratios



Ratio	Formula	Is Higher or Lower Better?
Debt Ratio	$\frac{\text{Total Liabilities}}{\text{Total Assets}}$	Answer: Lower. A higher ratio generally indicates greater debt relative to assets and more risk.
Debt to Equity Ratio	$\frac{\text{Long-term Debt}}{\text{Total Equity}}$	Answer: Lower, generally. But the organization should carry some reasonable debt relative to equity.
Times Interest Earned Ratio	$\frac{\text{Earnings Before Interest and Taxes (EBIT)}}{\text{Interest}}$	Answer: Higher. A higher ratio indicates greater ability to cover obligations with earnings (EBIT).
Fixed Payment Coverage Ratio	$\frac{\text{Earnings Before Interest and Taxes (EBIT)}}{\text{Interest} + (\text{Principal} + \text{Preferred Dividends}) \times [1 / (1 - \text{Taxes})]}$	Answer: Higher. A higher ratio indicates greater ability to cover fixed obligations within a set time.

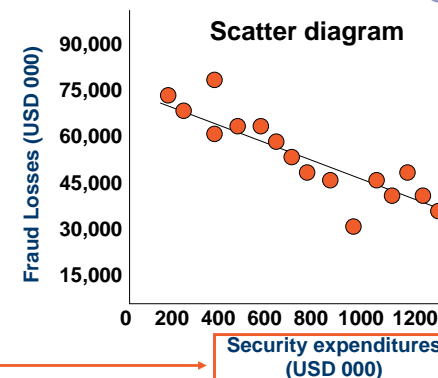
Profitability Ratios

Ratio	Calculation	What It Measures
Gross Profit Margin	$\frac{\text{Sales} - \text{Cost of Goods Sold}}{\text{Sales}}$	Effectiveness of pricing and cost control
Operating Profit Margin	$\frac{\text{Operating Profits}}{\text{Sales}}$	Operational efficiency and effective pricing
Net Profit Margin	$\frac{\text{Net Profits}}{\text{Sales}}$	Effective managing of pricing, cost, operations, debt, and taxes
Return on Investment (ROI)	$\text{Total Asset Turnover} \times \text{Net Profit Margin}$	Effective use of assets to generate profit
Return on Equity (ROE)	$\frac{\text{Net Profits}}{\text{Shareholders' Equity}}$	Success in generating net profits relative to equity
Return on Capital	$\frac{\text{ROE}}{1 + \text{Debt/Equity Ratio}}$	Ability to use equity and debt to generate profits
Earnings per Share	$\frac{\text{Total Earnings}}{\text{No. of Shares Outstanding}}$	Organization's value to investors

Discussion Question



Regression analysis traces the impact of one condition (independent variable) on another condition (dependent variable). Which is the independent variable in the scatter diagram?



Answer: Security expenditures (x axis) is the independent variable.

Discussion Question

What are some limitations of regression analysis?

Sample answer:

- Can show correlation, but not causation.
- Cannot be the basis for concluding that change in the independent variable caused change in the dependent variable. Other factors may have been responsible.



Discussion Question

Assumed: Variety of techniques for gathering data; solid basis for determining conclusions.

Question: What are some conditions the internal auditor discovers by using analytical procedures?

Sample answer:

- Unexpected differences
- Absence of expected differences
- Potential errors
- Potential irregularities or illegal acts
- Other unusual or nonrecurring transactions and events



Discussion Question

The heart of analysis is comparison. What are some types of comparisons used to analyze and interpret audit evidence?

Sample answer:

- Comparison of current to prior period
- Comparison of current period to budget or forecast
- Comparison of financial data to nonfinancial data
- Study of relationships among elements of information (e.g., interest expense to debt balance)
- Comparison of one organizational unit's performance to another unit's
- Comparison of organization to industry benchmark



Discussion Question

What are some common types of analytical comparisons?

Sample answer:

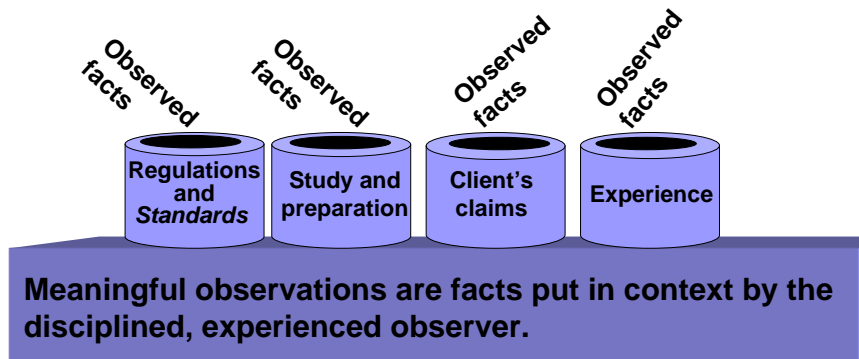
Period-to-period comparisons of performance—quarter to quarter, etc.

Comparisons of actual revenues, profits, etc. to budgets and forecasts

Comparisons with other causal factors such as benchmarks or best practices



Observation



Discussion Question

What are some drawbacks or pitfalls to watch for when using observation as an audit tool?

Sample answer:

- Observations are generally weak evidence that need backup.
- Being observed may change the behavior of the audit client, leading to wrong conclusions.



Preliminary Survey Element— Prior Audit Reports and Relevant Documents

Description	Considerations
Study of permanent files and previous internal audit working papers findings, reports, replies, auditor comments, photographs, and other related information relevant to the current audit.	Can include documentation in any format.

Preliminary Survey Element—Map Processes

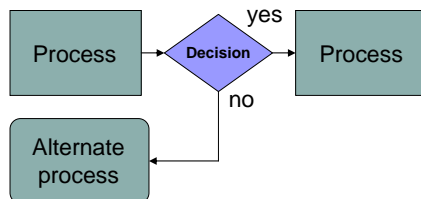
Description	Considerations
Documentation of operational processes: <ul style="list-style-type: none"> ■ Flowcharts ■ Narratives ■ Internal control questionnaires (ICQs) ■ Block diagrams 	<ul style="list-style-type: none"> ■ Reveal the physical flow of material and documents ■ Promote an understanding of the operation's processes and process control points

Standard Flowchart Symbols

Although flowcharts can be penciled onto napkins or drawn, erased, and re-drawn on chalk boards, they are most efficiently produced by software.

PowerPoint, for example, has a set of flow chart symbols in "AutoShapes" on the drawing toolbar.

Flowchart symbols courtesy of PowerPoint



Map Process—Flowcharts

Principles

- Graphical representation of actual or ideal path.
- Illustrate the relationship of various steps and control points.
- Identify what the process does or should do.
- Internal auditors may review existing flowcharts or prepare new ones.

Benefits/Concerns

- + Provide a clear picture of how a process works.
- + Provide a common reference point and standard language.
- **Must be accurate and kept current.**
- **Should avoid unnecessary complexity.**

Process Mapping Symbols

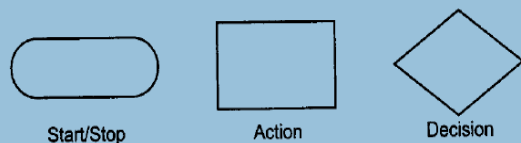
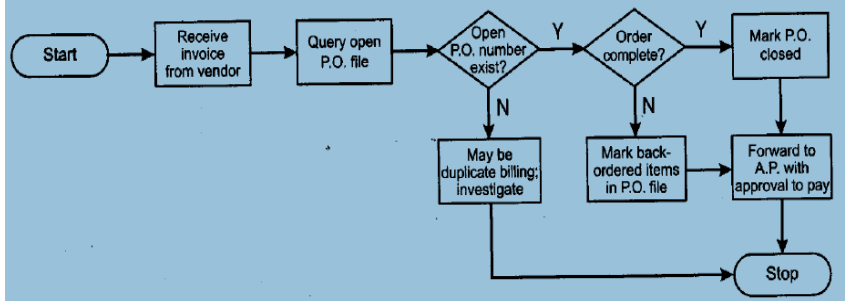


Figure 8-1

c. Below is an example of a process map prepared by the client or auditor.

Process Map for Invoice Processing in Purchasing Department



Discussion Question

Identify the flowchart formats described below as horizontal, vertical, or both.

Answers:

Both

1. Uses a rectangle to indicate a process and a diamond to indicate a choice point

Horizontal

2. Emphasizes the flow of the steps in the overall process, moving from left to right

Both

3. May use footnotes to direct the reviewer to narratives describing the process steps

Vertical

4. Emphasizes process flow and leaves considerable room outside the diagram for descriptions of the steps



Map Process—Narratives

Principles

- Provide a step-by-step picture in a single document without the use of detailed symbols or keys.
- Identify key controls and cases of under- or over-control and processing redundancy.

Benefits/Concerns

- + Can provide more detailed information than flowcharts.
- + Are flexible and facilitate open-ended questioning.
- **May not be complete enough.**
- **Lack of standardization can lead to omissions or difficult interpretation.**

Map Process—ICQs

Principles

- Pre-constructed array of questions used to elicit key information about internal control
- Start with a known or desired answer and then seek specific comments
- May be completed by the auditor or directly by the business area

Benefits/Concerns

- + Efficient and easy to use
- + Provide a checklist to help with further evaluation
- **Limited to questions with yes/no answers**
- **Do not provide for in-depth investigation**
- **Require knowing what the procedures should be**

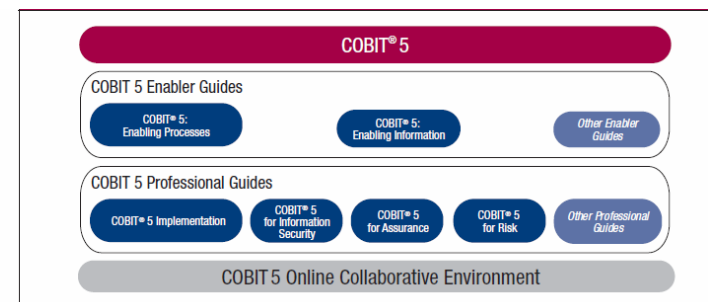
Map Process—Block Diagrams

Principles

- Pictorial representations of a process or activity
- Include a series of boxes (or other shapes) and connecting lines to indicate association and direction/order
- Useful for high-level representations

Benefits/Concerns

- + Quick and simple to construct; may be used in lieu of flowcharts
- + Can show the flow of information and organizational arrangements
- **Not appropriate for detailed analysis**



Discussion Question

What are some uses of process maps?

Sample answer: Process maps can be any drawing or computer rendering of the steps in any process. They can be used for every process from planning each step in an audit to taking notes on an observed work procedure.



Practice Advisory 2210.A1-1 Risk Assessment in Engagement Planning

4. Internal auditors summarize the results from the reviews of management's assessment of risk, the background information, and any survey work. The summary includes:
- Significant engagement issues and reasons for pursuing them in more depth.
 - Engagement objectives and procedures.
 - Methodologies to be used, such as technology-based audit and sampling techniques.
 - Potential critical control points, control deficiencies, and/or excess controls.
 - When applicable, reasons for not continuing the engagement or for significantly modifying engagement objectives.

Discussion Question

Which of the following information is appropriate to include when summarizing preliminary survey results? (Select all that apply.)





- I. Significant engagement issues
- II. Engagement objectives and procedures
- III. Evidence of regulatory compliance
- IV. Potential excess controls

Answer: I, II, and IV. While important information, evidence of regulatory compliance would be more pertinent during the engagement.



Performance Standard 2201, "Planning Considerations"

"In planning the engagement, internal auditors must consider:

-  The objectives of the activity being reviewed and the means by which the activity controls its performance;
-  The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level;
-  The adequacy and effectiveness of the activity's risk management and control processes compared to a relevant control framework or model; and
-  The opportunities for making significant improvements to the activity's risk management and control processes."

Engagement Objectives, Defined

“Broad statements developed by internal auditors that define intended engagement accomplishments”

- Engagement procedures are the means to attain engagement objectives.
- Engagement objectives and procedures, taken together, define the scope and should address the associated risks.

Discussion Question

Which of the following describe appropriate coordination activities?
(Select all that apply.)

- Evaluating corrective actions taken to reduce hazardous waste
- Comparing annual internal and external audit plans
- Reviewing related regulatory reports
- Exchanging audit schedules and reports with the quality control function

Answer: All of these are valid coordination efforts to maximize audit coverage and minimize redundancies.



Discussion Question

Which of the following is an example of an assurance engagement objective?

- Validate the accuracy of reporting.
- Hire a chief compliance officer.
- Increase international market share.
- Reduce processing time for customer orders.

Answer: A. Engagement objectives are the internal auditor's means for determining how well operating objectives are being met.



Broad Categories of Engagement Objectives

Effectiveness and efficiency of operations

- Profitability
- Delivery of excellent products and services
- Reduced processing time
- Safeguarding of assets
- Support of organizational mission and vision and appropriate work environment

Reliability of reporting

- Maintenance of accurate financial records
- Collection of useful, reliable, and timely information for decision-making

Compliance

- Compliance with applicable laws and regulations
- Compliance with internal policies and procedures

Engagement Objectives

Practice Advisory 2210-1, "Engagement Objectives"

- ▶ Address the risks associated with the activity under review.
- ▶ For planned engagements, the objectives proceed and align to those initially identified during the risk assessment process.
- ▶ For unplanned engagements, the objectives are established prior to the start and are designed to address the specific issue that prompted the engagement.

Consideration of Management's Risk Assessment

The internal auditor will want to take into account:

- ▶ The reliability of management's assessment of risk.
- ▶ Management's process for monitoring, reporting, and resolving risk and control issues.
- ▶ Management's reporting of events that exceeded the limits of the organization's risk appetite and management's response to those reports.
- ▶ Risks in related activities relevant to the activity under review.

Practice Advisory 2210.A1-1, "Risk Assessment in Engagement Planning"

Use of a Risk Control Matrix

Steps

- 1 Identify business objectives.
- 2 Identify risks to business objectives.
- 3 Rate each risk in terms of likelihood and significance (L/S).
- 4 Identify the controls.
- 5 Evaluate the adequacy of controls.
- 6 Test the effectiveness of controls.
- 7 Arrive at the final opinion on adequacy and effectiveness of controls.

Benefits

- + Focuses the audit on the areas of greatest risk.
- + Documents the complete thought process from risk identification to audit program development.
- + "Teaches" the risk assessment thought process.
- + Facilitates participatory auditing.

Risk Control Matrix

Entity Level Control: Control Environment									
Entity Level Control: Control Environment									
Business Risks	Reference (if applicable)	Controls to mitigate business risks	Control Frequency	Type	Analysis of IA Testing	Reliance	Re-Test Strategy	Re-Test Sample	Sample Size
1 Key executives may not exhibit integrity and ethical behavior.	1.01	Onyx is heavily involved in the business and expects executive team to exhibit integrity and ethical behavior. This expectation is communicated on an almost daily basis to the team.	Frequently, less than daily	Manual Prevent	Based on review of the test plan, we will not rely on the IA workpapers and will instead perform our own testing.	No	N/A	N/A	2
2 Key executives may not exhibit integrity and ethical behavior.	1.02	All employees are required to read and acknowledge the Code of Ethics and sign-off as such on an annual basis. Also, HR tracks the employees who have not acknowledged the Code of Ethics.	Annually	Manual Prevent	Based on review of the test plan, we will not rely on the IA workpapers and will instead perform our own testing.	No	N/A	N/A	25 or 10%
3 Management may not exhibit proper control consciousness or operating style.	1.06	Management maintains an appropriate organizational structure with proper segregation of duties.	Annually	Manual Prevent	Based on review of the test plan, we will not rely on the IA workpapers and will instead perform our own testing.	No	N/A	N/A	1
4 The assignment of authority and responsibility may not be adequate.	1.13	Onyx CEO is heavily involved in the business. All non-immaterial transactions must go through Morty for approval. In addition, all policies and procedures must go through Morty for approval as well.	Annually	Manual Prevent	Based on review of the test plan, we will not rely on the IA workpapers and will instead perform our own testing.	No	N/A	N/A	1
5 The organizational structure and assignment of authority and responsibility may not be adequate.	1.13	Management maintains an appropriate organizational structure with proper segregation of duties.	Quarterly	Manual Detect	Based on review of the test plan, we will not rely on the IA workpapers and will instead perform our own testing.	No	N/A	N/A	2
6 Human resource policies and procedures may not be adequate.	1.2	Onyx CEO is heavily involved in the business. All non-immaterial transactions must go through Morty for approval. In addition, all policies and procedures must go through Morty for approval as well.	Annually	Manual Detect	Based on review of the test plan, we will not rely on the IA workpapers and will instead perform our own testing.	No	N/A	N/A	N/A

2220 – Engagement Scope

The established scope must be sufficient to satisfy the objectives of the engagement.

2220.A1 – The scope of the engagement must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.

2220.A2 – If significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities, and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards.

2220.C1 – In performing consulting engagements, internal auditors must ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations must be discussed with the client to determine whether to continue with the engagement.

2220.C2 – During consulting engagements, internal auditors must address controls consistent with the engagement's objectives and be alert to significant control issues.

Engagement Scope

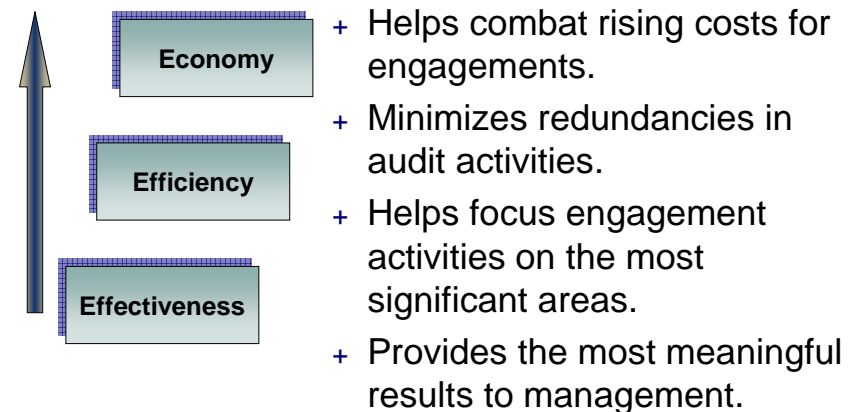
- ✓ Establishes the boundaries of the internal audit
- ✓ Identifies what the internal auditor will do
- ✓ May include a description of the nature and extent of the audit work
- ✓ May include supportive information such as the time period

The CAE's Role in Coordination with External Auditors

Practice Advisory 2050-1, "Coordination"

- ▶ Achieve effective coordination of work.
- ▶ Minimize duplication with internal auditing coverage.
- ▶ Assist external auditors—possibly agreeing to perform some work.
- ▶ Regularly evaluate the coordination between internal and external auditors.

Coordination and Cooperation with External Auditors and Regulatory Agencies



Fraud Risk

- The probability that fraud will occur and the potential severity or consequences when it occurs
- Often based on:
 - ☐ Ease of action
 - ☐ Motivational factors leading to fraud
 - ☐ The company's fraud history

Fraud Triangle



Fraud Red Flags

- Signs indicating the:
 - ☐ Inadequacy of controls in place
 - ☐ Possibility that some perpetrator has committed fraud
- Only warning signs; not proof

Discussion Question

Which of the following exemplify fraud red flags? (Select all that apply.)

- I. Ignoring corporate policies for bid requirements
- II. High volume of manually prepared disbursement checks
- III. Accomplishment of established goals and objectives for a special program
- IV. Missing or easy access to blank checks

Answer: I, II, and IV. The specific nature of the engagement and the judgment skills of the internal auditor help to identify the relevant types of fraud and red flags for inquiry.



Effective Fraud Risk Assessment

- Is performed on a systematic and recurring basis
- Considers possible fraud schemes and scenarios
- Assesses risk across multiple levels
- Evaluates likelihood, significance, and pervasiveness
- Assesses exposure arising from each category of fraud risk
- Is performed with the involvement of appropriate personnel
- Considers management override of controls
- Is updated when special circumstances arise

Resource Considerations

Practice Advisory 2230-1, "Engagement Resource Allocation"

- The number and experience level of the internal audit staff
- Knowledge, skills, and other competencies of the internal audit staff
- Availability of external resources where additional knowledge and competencies are required
- Training needs of internal auditors

Engagement Work Program, Defined

"A document that lists the procedures to be followed during an engagement, designed to achieve the engagement plan"

- Also called audit program during assurance engagements
- Becomes guidance for Performance Standard 2300, "Performing the Engagement"

Benefits of an Engagement Work Program

- Provides documentation that can be used to secure management approval
- Provides an outline of work to be performed and facilitates an understanding of the audited unit
- Furnishes evidence that the work is adequately planned
- Provides a record for management review
- Provides assurances that all risks have received adequate consideration
- Assists in controlling work and assignment responsibilities

2340 – Engagement Supervision

Engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.

Interpretation:

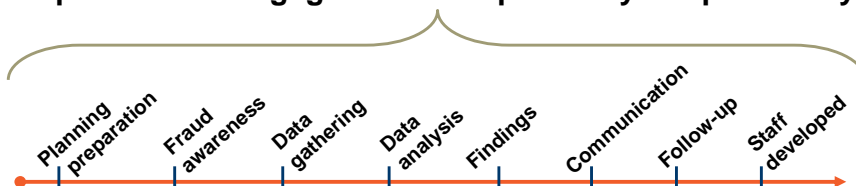
The extent of supervision required will depend on the proficiency and experience of internal auditors and the complexity of the engagement. The chief audit executive has overall responsibility for supervising the engagement, whether performed by or for the internal audit activity, but may designate appropriately experienced members of the internal audit activity to perform the review. Appropriate evidence of supervision is documented and retained.

Planning and Supervision Considerations

- ✓ Achievement of engagement objectives
- ✓ Staff competency
- ✓ Travel arrangements
- ✓ Assignments
- ✓ Team communication and supervision
- ✓ Team development

Engagement Supervision

Span of CAE Engagement Supervisory Responsibility



CAE
dd/mm/yyyy

Assures that engagement has been carried out according to high quality standards, objectives achieved, staff evaluated for professional development.

Elements of Proper Engagement Supervision

- Trained auditor—knowledge, skills, and competencies to perform.
- Proper instructions during the planning and approval of engagement program.
- Program is completed and modified using accepted practices.
- Working papers support observations, conclusions, and recommendations.
- Communications are accurate, objective, clear, concise, constructive, and timely.
- Engagement objectives are met.
- Opportunities for developing auditors' knowledge, skills, and competence.

Questions?



- Study Unit Nine
 - Internal Audit Ethics

Internal Auditing: IIA Definition

“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.”

Independence and Objectivity, Defined

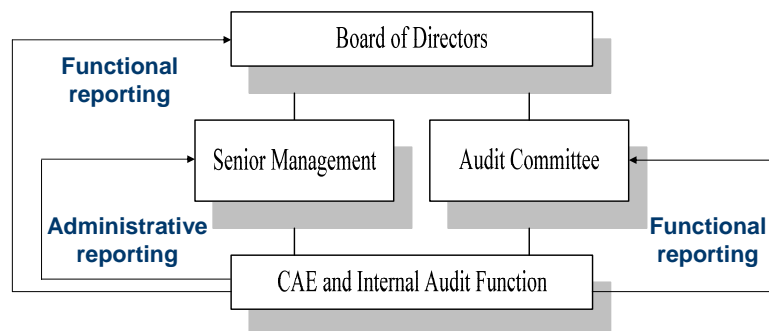
Independence

“The freedom from conditions that threaten objectivity or the appearance of objectivity”

Objectivity

“An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made”

Independence and Organizational Reporting



Functional Reporting

Provides independence and authority

Examples:

- Approve:
 - Internal audit activity's charter.
 - Internal audit risk assessment and related audit plan.
 - All decisions regarding performance evaluation, appointment/removal of CAE.
 - Annual compensation and salary adjustment of CAE.
- Receive communications from CAE.
- Make appropriate inquiries of management and CAE.

Administrative Reporting

Facilitates day-to-day operations

Examples:

- Budgeting and management accounting
- Human resource administration
- Internal communications and information flows
- Administration of the internal audit activity's internal policies and procedures

The IIA's Code of Ethics, Defined

"Principles relevant to the profession and practice of internal auditing and Rules of Conduct that describe behavior expected of internal auditors. The Code of Ethics applies to both parties and entities that provide internal audit services. The purpose of the Code of Ethics is to promote an ethical culture in the global profession of internal auditing."

Principles:

- ▢ Integrity
- ▢ Objectivity
- ▢ Confidentiality
- ▢ Competency

Discussion Question

Which of the four principles underlying The IIA Code of Ethics is missing from the following list?

- ▢ Integrity
- ▢ Objectivity
- ▢ Confidentiality
- ▢ Competency



IIA Code of Ethics

Integrity	Objectivity	Confidentiality	Competency
<p>1.1. Perform work with honesty, diligence, and responsibility.</p> <p>1.2. Observe the law and make disclosures expected by the law and the profession.</p> <p>1.3. Avoid illegal activity or acts that are discreditable to the IA profession or to the organization.</p> <p>1.4. Respect and contribute to legitimate and ethical objectives of the organization.</p>	<p>2.1. Avoid acts or relationships that impair unbiased assessment, including those that conflict with the organization's interests.</p> <p>2.2. Accept nothing that might impair professional judgment.</p> <p>2.3. Disclose all material facts known that, if undisclosed, may distort reporting.</p>	<p>3.1. Be prudent in use and protection of information acquired in the course of duties.</p> <p>3.2. Do not use information for personal gain, contrary to the law, or to the detriment of legitimate and ethical objectives of the organization.</p>	<p>4.1. Engage only in services for which you have the knowledge, skills, and experience.</p> <p>4.2. Perform internal auditing services in accordance with the <i>Standards</i>.</p> <p>4.3. Continually improve proficiency and effectiveness and quality of services.</p>

Discussion Question

What should you do when confronted by an ethical dilemma that can't be resolved by reference to any of the specific Rules of Conduct?

Answer: Apply the four principles to determine an ethical course of action.



Discussion Question

A code of conduct related to conflicts of interest should include

- A. a description of expected behavior for employees, other corporate agents, and suppliers.
- B. a discussion of industry best practices.
- C. provisions for reporting alleged misconduct.
- D. mention of what constitutes plausible exceptions to the policy.

Answer: A. Codes of conduct are intended to provide a proactive statement on the organization's position on acceptable employee behavior.



The code of ethics

- 1000- Purpose, Authority and Responsibility
- 1010 – Recognition of the definition of internal auditing , The code of ethics and the standard in the internal audit charter

The code of ethics

- 1300- Quality assurance and improvement program
- 1311- internal assessments
- 1320- Reporting on the quality assurance and improvement program
- 1321- Use of “Conforms with the international standards for the professional practice of internal auditing”
- 1322- Disclosure of nonconformance

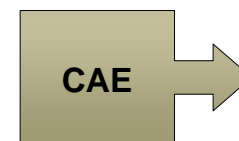
The code of ethics

- 2110-Governance
- 2110.A1 –Evaluate the org’s ethics-related activities

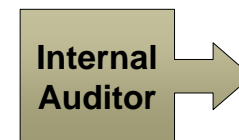
The code of ethics

- 2431- Engagement Disclosure of Nonconformance

Additional Best Practices to Maintain Objectivity



- Periodic query of internal auditing staff
- Periodic staff assignment rotation



- Refusal of material fees, gifts, or entertainment—consideration of what is “reasonable”

Discussion Question

Identify which of the following items exemplify potential impairments. Respond “yes,” “no,” or “probable.”

Answers:

No

1. Accepting a breakfast invitation

Yes

2. An executive demanding the rescheduling of an audit

Probable

3. A designer passport travel ID case

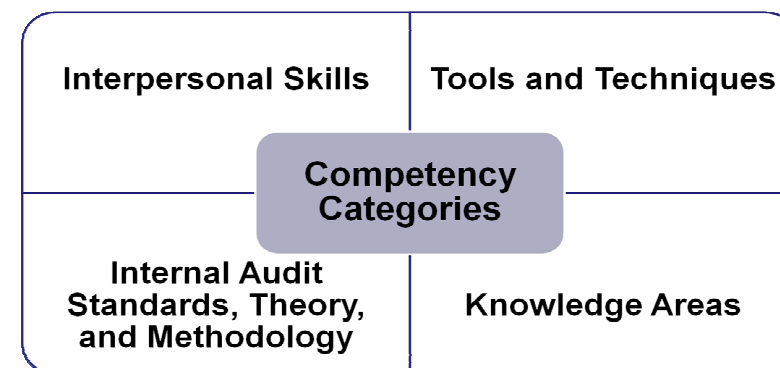
Yes

4. Denial of facility access

Potential impairments should be reported to the CAE.



Internal Audit Designated Competencies



Discussion Question

Who is ultimately responsible for ensuring that the internal audit activity is staffed appropriately?

- A. Audit committee
- B. Chief audit executive (CAE)
- C. Board
- D. Human resources

Answer: B. The CAE is responsible for determining levels of education and experience for the organization's IA positions.



How to Evaluate Staff Proficiency

- 4 Conduct a staffing analysis.
- 3 Obtain and review information pertaining to specialized skills required by the IA activity.
- 2 Review staff and management job descriptions.
- 1 Review the education and background of the IA activity's staff.



Questions?

