



The Internal Audit Profession

1. What is internal auditing?

The internal audit profession, through The Institute of Internal Auditors (IIA), has continued to redefine itself as business risk and organizational complexity have evolved. Prior to June 1999, The IIA defined internal auditing as follows:

Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost.

Today, The IIA uses the following 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.

The new definition is part of the *Professional Practices Framework* currently projected to be revised and reissued in 2009. Adherence to *The Professional Practice of Internal Auditing* (The IIA Standards) includes following this definition. Companies may choose to develop their own definition to best meet their needs. There is no regulatory requirement on how a company must define internal auditing. However, The IIA definition is generally accepted, and the U.S. Securities and Exchange Commission (SEC), New York Stock Exchange (NYSE) and other regulatory bodies may reasonably be expected to accept and adopt The IIA's definition of internal auditing.

Note: The IIA promulgates internal audit standards and practice advisories. Effective January 2004, The IIA's Internal Auditing Standards Board (IASB) is responsible for revising and updating The IIA Standards. The IIA Standards are updated to reflect current risk management and governance requirements. Ongoing updates incorporate numerous comments on issues received through a worldwide solicitation and public exposure process, upon which the IASB approves The IIA Standards for implementation.

2. How is the internal audit profession regulated?

The internal audit profession presently is not regulated by the SEC, Public Company Accounting Oversight Board (PCAOB) or any U.S. government agency. The IIA is the self-governing professional body that includes the IASB, which is charged with evaluating and developing practice standards that are issued in draft form and subject to a public comment period, much like other professional standards and accounting pronouncements.

The IIA Standards includes a code of ethics that members must follow or face disciplinary action, including expulsion. (See Question 5 and Appendix E.)

3. Is continuing professional education (CPE) required for internal auditors?

Yes, practicing internal auditors who hold the Certified Internal Auditor® (CIA®) designation must complete and report 80 CPE hours every two years. The CIA is issued by The IIA to individuals who pass a comprehensive examination and meet educational, experience and character requirements. In addition, many internal auditors are Certified Public Accountants (CPAs) or Chartered Accountants (CAs), designations that also require a minimum of 20 related CPE units per two-year period to maintain public accountancy certification (this may vary among boards of accountancy). Because internal auditors may hold multiple certifications, such as the Certified Information Systems Auditor (CISA), Certified Fraud Examiner (CFE) and other specialized certifications, it is not uncommon for CPE credits to count toward several closely related certification programs. (Individuals holding such certifications should consult the respective certification body for exact CPE requirements.)

CIAAs are expected to maintain the high standards of the internal audit profession by selecting quality educational programs to fulfill the CPE requirements.

4. Are internal auditors required to be certified?

No. However, The IIA *Standards* require technical competence and training that can be demonstrated by various certifications, depending upon expertise and professional experience. The IIA also sponsors several additional certifications beyond the CIA, such as:

CFSA® – Certified Financial Services Auditor

CCSA® – Certification in Control Self-Assessment

CGAP® – Certified Government Auditing Professional

Additional internal audit-related certifications supported by other independent professional organizations include:

CISA – Certified Information Systems Auditor

CFE – Certified Fraud Examiner

In addition, the valuable CPA certification is recognized separately by each state. The CA designation, also valuable, is regulated by individual countries. For more information, see Question 3 and Appendix F.

Effective internal audit functions require most existing professionals and new hires to obtain and then maintain at least one certification, including but not limited to the CPA, CA, CIA, CISA and CFE. All certifications require annual CPE training. Skill sets, experience and industry familiarity are crucial in order to exhibit competence, identify and address risks appropriately, and perform in a manner that provides value to the organization.

Strong internal auditors bring together various skills, ranging from specialized industry and technical knowledge to seasoned business acumen that includes advanced degrees in business administration, finance and even law. It is not uncommon for internal auditors to possess professional designations from other disciplines beyond accounting. After all, internal audit functions examine all aspects of a business entity – a key challenge in today's complex business climate.

Therefore, while not required or mandated specifically, it is considered best practice for internal auditors to possess and maintain professional certifications applicable to their focus and responsibilities.

5. Are there professional standards that govern the practice of internal auditing?

Yes. The IIA promulgates the *Professional Practices Framework*, which consists of the following categories of guidance: the *Standards* and *Code of Ethics*, Practice Advisories, and Position Papers and Practice Guides. The first category (considered mandatory guidance) consists of core materials:

- *Definition of Internal Audit*
- *Code of Ethics*
- *International Standards for the Professional Practice of Internal Auditing*

Mandatory guidance is considered essential for the professional practice of internal auditing. Other elements of the framework are linked to these standards.

The *Standards* and *Code of Ethics* comprise attribute, performance and implementation standards. Attribute and performance standards apply to all internal audit services. Implementation standards apply to specific types of engagements, such as assurance and consulting activities. (See Appendix D for a summary of The IIA *Standards*.) Interpretations are included as part of many standards to provide clarification as to how they should be applied in practice.

While The IIA *Standards* do not have the rule of law, the practice of internal auditing, like other professions, is based upon elements of due professional care and a ruling body that develops standards of practice through a public exposure process. The IASB and adherence to The IIA *Code of Ethics* inculcate these standards into internal audit professional practices.

For more information, visit www.theiia.org.

6. Are internal audit functions required to follow The IIA *Standards*?

For CIAs, The IIA *Code of Ethics* requires adherence to The IIA *Standards*. Practice professionals usually look to the Practice Advisories for The IIA's recommendations on matters related to situations that are not covered directly. Concepts of due professional care permeate all practice activity, and apparent violations are investigated by The IIA.

7. What are The IIA Practice Advisories?

Practice Advisories (formerly referred to as Guidelines) provide additional guidance on certain topics and issues. These advisories are not mandatory. They may have a limited life or may be elevated to a *Standards* level based upon importance, usage and acceptance. In part, Practice Advisories help auditors interpret The IIA *Standards* and apply *Standards* to specific internal auditing situations.

Although some Practice Advisories may be applicable to all internal auditors, others may be developed to meet the needs of a specific industry, a specific audit specialty or a specific geographic area, including guidance on topics such as environmental issues, control self-assessment, information technology, government auditing, and guidance issued by other standard-setting bodies and adopted by appropriate committees of The IIA.

All Practice Advisories are subjected to a formal review process by The IIA's Professional Issues Committee or other group designated by the organization's Guidance Planning Committee.

(Source: The IIA website, www.theiia.org)

8. What jurisdiction do the SEC and the PCAOB have over internal auditors?

Neither of these regulatory bodies has direct jurisdiction over internal auditors at this time. The PCAOB can influence the nature and extent of internal audit work through the rules it issues about external auditors' reliance on the work of others. For example, on May 24, 2007, the PCAOB issued Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (AS5), which described a public accountant's reliance on the work of others, including internal auditors, during audits of internal control over financial reporting (ICFR).

Currently, these regulatory bodies set requirements and monitor compliance of publicly listed U.S. companies and the public accounting profession. The internal audit profession, like the legal profession, continues to be self-regulated by a required public comment process. The IASB promulgates updated professional standards (see Question 1).

9. Can existing employees become internal auditors?

Yes. There is no prohibition against employees of a company becoming internal auditors. A number of companies host a “guest auditor” program whereby employees are assigned to the company’s internal audit function for a short duration of time or to assist on one or more specific internal audit-related matters. When transferring existing employees into the internal audit function, companies, management, internal audit function leadership and, when appropriate, audit committees should consider the following questions:

- Does the person have a positive employment record? Has the person performed at a high level in his or her current department or function? If not, why is this employee being considered for a transfer to internal audit?
- Does the employee possess:
 - Balanced assessment abilities, integrity and trustworthiness?
 - Relevant operating and functional experience to be effective?
 - Appropriate educational background to be successful?
 - Objective attitude and professional skepticism?
 - A commitment to competency, technical proficiency, continuing education and ethics as set forth in *The IIA Standards*?

All employees will not necessarily become, nor should they be expected to become, effective internal auditors.

10. What personal qualities, knowledge and skills should internal auditors possess?

Internal auditors should possess and demonstrate through their work, actions and communication a number of traits, including, but not limited to:

- A commitment to and demonstration of competence in the field of internal auditing
- Strong financial and operational background in accounting, IT, regulatory compliance or the industry in which a company operates
- Honesty and integrity
- Strong work ethic and attention to detail

In general, internal auditors should develop and maintain a healthy level of professional skepticism and objectivity to assist in evaluating information and making judgments. Additionally, internal audit professionals should possess exceptional verbal and written communication skills, and be proficient in negotiating and reasoning with a variety of departments and groups over which internal audit may have no formal authority. Finally, personal integrity, professional due diligence and curiosity are important traits for individuals tasked with conducting internal audit work.

Internal auditors also need to acquire and then master new areas of expertise and knowledge of emerging or re-emerging issues. This can be accomplished by attending internal and external training programs. Realizing the internal audit profession is continuously evolving, Protiviti has conducted a series of internal audit capabilities and needs surveys in recent years to provide benchmarks by which internal auditors can measure their knowledge and skills and identify gaps to be addressed. See Appendix J for a list of skills and knowledge used in this internal audit benchmarking study.

11. Do internal auditors have to comply with any professional ethics requirements?

Yes. Like most professions, members must adhere to a code of ethics as part of following *The IIA Standards*. In addition, other professional certifications that practitioners may hold typically require adherence to a standard of ethics. (See Question 5 and Appendix E.)

Along with the CIA designation, many internal auditors also hold CPAs, CISAs (IT auditors) or other certifications that require strict adherence to a formal code of ethics, with serious repercussions by an ethics board for violations.

In addition to professional ethics requirements, the organization in which internal auditors are employed may have its own specific code of conduct, rules of behavior and other ethical requirements that internal auditors need to be aware of, must comply with and may at times be responsible for validating compliance with.

12. How much should a company spend on internal audit?

The costs, focus and size of an internal audit function should be tailored to each company’s individual needs. In addition, a company’s written internal audit charter, approved by the audit committee, will impact the amount of annual internal audit investment. The amount invested should depend on the level and complexity of risks a company faces, its industry profile and the responsibilities given to the internal audit function.

This is supported by a 2007 study sponsored by Corporate Executive Board’s Audit Director Roundtable®. Data from this study (shown below) indicates that internal audit budgets are correlated positively both to company size (as measured by revenue) and complexity. However, it is not a linear relationship.

Revenue Range (Billions of USD)	Budget as a Percentage of Company Revenue		
	First Quartile	Median	Third Quartile
<\$1B	.08%	.13%	.19%
\$1B - \$2B	.07%	.11%	.19%
\$2B - \$3B	.05%	.07%	.10%
\$3B - \$5B	.04%	.07%	.09%
\$5B - \$10B	.03%	.04%	.06%
\$10B - \$20B	.02%	.03%	.06%
>\$20B	.02%	.03%	.05%

Corporate Executive Board goes on to state in this study that, “... even within similar revenue brands, there is significant variation [in internal audit budgets] across industries.” Internal audit departments that operate in heavily regulated industries “must incorporate regulatory compliance into their processes, and at times, must audit at least two separate sets of books (statutory and accounting).”

The third edition of *Moving Internal Audit Back into Balance*,² which reviews the results of Protiviti’s Internal Audit Rebalancing study, also supports the philosophy of matching these budgets to company risk profiles and internal audit responsibilities. In this study, more than half of the respondents said they expect no change in their internal audit budgets in the near future, as many of them are experiencing at least a moderate decrease in the amount of internal audit hours spent on Sarbanes-Oxley compliance. This is allowing internal audit to focus more of its time and budget on other areas of the COSO model rather than just Sarbanes-Oxley-related activities.

The IIA also has identified, through its annual Global Audit Information Network (GAIN) reports, a general range of internal audit expenditures from companies in many different industries and of varying sizes. These well-established practices and benchmarks tracked by The IIA provide average internal audit costs based upon revenue, although these often vary by industry. As mentioned above, these costs should be driven by the risk and complexity of the overall business environment, including potential exposures to business failure.

The GAIN estimations provide a general guideline for internal audit expenditures. Keep in mind that these estimates represent average internal audit costs of in-house resources. Depending on the strategy, risks and scope of the internal audit work, it is not uncommon for costs to fluctuate based upon significant events or changes that expose an organization to additional risks. For more information on the GAIN benchmarks as they relate to internal audit spend, please visit www.theiia.org/research/benchmarking/.

²For more information, see Protiviti’s *Moving Internal Audit Back into Balance: A Post-Sarbanes-Oxley Survey*, available at www.protiviti.com.

13. Are there industry groups for internal auditors?

Yes, there are a number of internal audit groups that have been formed based upon industry affiliation. Their size and degree of formality vary widely. Industries that have formal internal audit organizations include, but are not limited to:

- Banking
- Media
- Gaming
- Pharmaceuticals
- Healthcare
- Colleges and universities
- High technology
- Consumer products
- Energy
- Utilities
- Governmental entities
- Insurance
- Construction
- Hospitality
- Hospitals
- Manufacturing
- Commercial airlines

We recommend that internal auditors seek out these organizations within their industries and become active participants in them. (See Appendix F for a list of other organizations.)

14. Isn't internal auditing a duplication of what external auditors do?

No, not at all. External auditors are hired by and report to a company's audit committee. Their historical objective has been to express an opinion on the fair presentation of the company's financial statements in conformity with generally accepted accounting principles (GAAP). Their audit is completed in accordance with generally accepted auditing standards (GAAS) that were originally established by The American Institute of Certified Public Accountants (AICPA) and are now the responsibility of, and are being updated by, the PCAOB. For public companies and certain other qualifying organizations, external auditors must provide an opinion on a company's ICFR, following AS5, which is now required by Section 404 of the Sarbanes-Oxley Act of 2002.

An easy-to-remember distinction might be that the external auditor is responsible for attesting to accounting reports issued to outside parties and investors, including reporting on ICFR, while an internal auditor is responsible for reviewing inside business practices and internal accounting and process controls.

As noted in Question 1, internal audit is defined by The IIA as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Internal auditors may be hired by and report to both management and the audit committee. Internal auditors assist management and the audit committee in identifying and evaluating key business risks, completing focused audits in high-risk areas, completing special investigations for the board and management and, at times, assisting external auditors with parts of their work on the company's financial statements. The scope of internal audit work is determined by the audit committee, management and the internal audit function itself. The standards internal auditors should follow in planning, executing and communicating the results of their work are The IIA *Standards*.

However, both internal and external auditors should collaborate to minimize duplication of effort. Internal and external auditors work in tandem to help management and the audit committee ensure that a company's financial reports and other information are accurate and that its system of internal control is effective (see Question 40).

External auditors may consider and use the work of internal auditors in connection with their integrated audit of the financial statements of a company. Currently, the authoritative literature on this relationship is the AICPA Statement of Auditing Standard 65 (SAS 65). In addition, the external auditor may also use the work of internal auditors in many circumstances in connection with an audit of ICFR, as noted by the PCAOB in Paragraphs 15–19 of AS5. (See Questions 47 and 53.)

15. How is “independence” defined differently for internal auditors and external auditors?

The term “independent” and the concept of independence are often referred to in connection with both internal and external auditors. However, there is a considerably different meaning, degree and context regarding independence for each.

For internal auditors, independence refers to an attitude that is free from bias or undue influence. It also embodies the reporting structure of an internal audit function, which includes reporting to the audit committee and the CEO, in order to allow for an appropriate level of organizational freedom and a lack of restriction in their work and access to records. There are no SEC regulations covering or requiring the independence of internal auditors. Additionally, internal auditors can be employees of the company they serve, whereas external auditors, of course, cannot be.

While The IIA *Standards* use the word “independence” to describe internal auditors in certain places, “objectivity” might be a better word to describe one of the primary characteristics that internal auditors need to exhibit. In fact, that is the word the PCAOB uses when describing the external auditor’s evaluation of factors supporting the extent of reliance.

SAS 65 further supports this view and point of differentiation when it explains that, although internal auditors are not independent from the entity, The IIA *Standards* define internal audit as “an independent, objective and consultative activity designed to add value and improve an organization’s operations.” SAS 65 further states that this concept of “independence” is different from the independence the external auditor must maintain under the AICPA Code of Professional Conduct and SEC regulations. The standard describes how internal auditors maintain “objectivity” with respect to the activity being audited. To further underscore this distinction, the AICPA clarified in SAS 65 that the internal audit function is part of the entity’s control environment. The PCAOB has reinforced this point of view.

For external auditors, however, independence is a much more structured and defined term, as well as a regulatory requirement for performance. External auditors are required to be independent under various SEC and AICPA professional standards. Requirements concerning external auditor independence include:

- Strict adherence to reporting directly and solely to the audit committee, including having the audit committee responsible for approving the external audit fees and, in some cases, pre-approving certain types of services to further ensure independence of the external auditor
- Prohibitions on the nature and extent of services that can be provided to an audit client, such as internal audit outsourcing, valuation services, bookkeeping, design of financial systems and other specifically listed services that the SEC has determined would undermine the independence of the external auditor
- Adhering to independence requirements in both appearance and fact
- Not being an advocate for an audit client or having a mutuality of or conflicting interest
- Scope and extent of audit work must be determined by the auditor alone
- Not taking on any responsibilities that could be construed to be those of a management function, and not being in a position of auditing the external auditor’s own work
- No direct equity ownership in an audit client
- Required rotation of certain personnel on audit engagements
- Prohibitions on audit firm personnel at certain levels being hired by the companies they audit for a period of time after they cease to provide services to those companies

Also, under GAAS, external auditors are required to confirm their independence in writing to the audit committee of the companies they audit. Penalties can be levied against external auditors by the SEC and AICPA for violations of independence rules. The SEC also can require the financial statements to be re-audited for any period for which it determines that an audit firm was not independent while performing an audit of those statements.

16. What role and responsibility do internal auditors have for fraud?

The IIA Standard 1210.A2 regarding assurance engagements in internal auditor's work with respect to fraud states:

Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

The related Practice Advisory 1210.A2-1 goes on to state:

Internal auditors are responsible for assisting companies [to] prevent fraud by examining and evaluating the adequacy and effectiveness of their internal controls' system, commensurate with the extent of a potential exposure within the organization. When meeting their responsibilities, internal auditors should consider the following elements:

- 1. Control environment.** Assess aspects of the control environment, conduct proactive fraud audits and investigations, communicate results of fraud audits and provide support for remediation efforts. In some cases, internal auditors also may own the whistleblower hotline.
- 2. Fraud risk assessment.** Evaluate management's fraud risk assessment, in particular, their processes for identifying, assessing, and testing potential fraud and misconduct schemes and scenarios, including those that could involve suppliers, contractors, and other parties.
- 3. Control activities.** Assess the design and operating effectiveness of fraud-related controls; ensure that audit plans and programs address residual risk and incorporate fraud audits; evaluate the design of facilities from a fraud or theft perspective; and review proposed changes to laws, regulations, or systems, and their impacts on controls.
- 4. Information and communication.** Assess the operating effectiveness of information and communication systems and practices, as well as provide support to fraud-related training initiatives.
- 5. Monitoring.** Assess monitoring activities and related computer software; conduct investigations; support the audit committee's oversight related to control and fraud matters; support the development of fraud indicators; and hire and train employees so they can have the appropriate fraud audit or investigative experience.

It also seems clear from The IIA's definition of internal auditing (see Question 1) that internal audit should play a role in assisting management and the audit committee with fraud-related issues, including the prevention, detection and investigation of fraud as part of "bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit* (SAS 99), updated by the AICPA in July 2007 and effective for audits of financial statements for periods beginning on or after December 15, 2002, is the current standard for external auditors concerning fraud. As part of this standard, "the auditor should evaluate whether entity programs and controls that address identified risks of material misstatement due to fraud have been suitably designed and placed in operation."

Though this standard provides guidance for external auditors in connection with their audits of company financial statements, it also suggests that a company and its management should be involved in or complete the following activities related to fraud:

- Determine key fraud risks at the company.
- Identify programs and controls to prevent and detect fraud, including an appropriate "tone at the top."
- Determine the effectiveness of such programs and controls to detect and prevent fraud.
- Investigate and resolve any reported instances of fraud.

Internal auditors, given their objectivity and role within the organization, can be of substantial assistance to management and the audit committee in meeting their responsibilities under SAS 99 and in matters related to fraud in general.

Additionally, Section 302 of Sarbanes-Oxley requires management to report to the external auditor and the audit committee, at least quarterly, “any fraud, whether material or not, that involves management or other employees who have a significant role in internal control.” Again, internal audit logically can play a role in assisting management with investigating such reported instances, some of which may be detected and reported by internal audit. More importantly, internal audit can assist management and the audit committee in implementing processes and controls to prevent fraud in the form of education and orientation programs, enhanced internal controls and more robust fraud monitoring systems.

Companies and their internal auditors may want to access *Management Antifraud Programs and Controls*, a publication jointly developed and issued by The IIA, the Association of Certified Fraud Examiners, Financial Executives International, the AICPA and others.

AS5, in Paragraphs 11, 14 and 15, clearly identifies fraud considerations as an integral part of a company’s ICFR. The PCAOB makes it clear that part of management’s responsibility when designing a company’s ICFR is to design and implement programs and controls to prevent, deter and detect fraud. In this regard, internal audit can be a qualified and logical source to assist management and the audit committee.

17. Are there university programs in internal auditing?

Yes. In fact, the number of formal collegiate internal audit programs is increasing. The IIA’s Academic Relations Committee encourages and supports the implementation of internal audit curricula at the collegiate and graduate level worldwide. The IIA endorses programs that meet high-quality standards including faculty, student and program expectations.

A few of the pioneer and well-known programs include:

- Louisiana State University – www.bus.lsu.edu/centers/cia/
- Northern Illinois University – www.cob.niu.edu/
- University of Texas - Dallas – <http://som.utdallas.edu/iaep/index.htm>
- University of Texas - Austin – www.mcombs.utexas.edu/mpa/
- Universiteit van Amsterdam – www.abs.uva.nl/emia/home.cfm

More than 35 colleges and universities offer programs, concentrations and certificates as part of business degrees, including a doctorate dissertation scholarship program for internal audit studies. See Appendix G for a complete listing.

18. What is the Common Body of Knowledge?

The Common Body of Knowledge (CBOK) 2006 study is the largest project ever undertaken by The IIA Research Foundation. Chief audit executives (CAEs), internal audit practitioners of all levels of experience, and IIA Chapter and Institute leaders were surveyed for CBOK, which targeted the following topics:

- Compliance to and adequacy of The IIA *Standards*
- Current status of the internal audit activity within organizations
- Activities and types of audits being performed
- Tools and techniques used by internal auditors
- Skills and knowledge possessed by internal auditors

The IIA plans to repeat the CBOK study every three years, with the next study scheduled for 2009. The result will be a continuously expanding library of information about the internal audit profession worldwide. By examining how internal auditors are executing their work, CBOK will help The IIA to shape the future of the profession. For further information on CBOK, please visit www.theiia.org.