



FOURTH EDITION

# INTERNAL

ASSURANCE & ADVISORY SERVICES

# AUDITING

URTON L. ANDERSON, PhD, CIA, CRMA, CGAP, CCEP

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The Institute of Internal Auditors’ (IIA’s) International Professional Practices Framework (IPPF) comprises the full range of existing and developing practice guidance for the profession. The IPPF provides guidance to internal auditors globally and paves the way to world-class internal auditing.

The IIA and the Foundation work in partnership with researchers from around the globe who conduct valuable studies on critical issues affecting today’s business world. Much of the content presented in their final reports is a result of Foundation-funded research and prepared as a service to the Foundation and the internal audit profession. Expressed opinions, interpretations, or points of view represent a consensus of the researchers and do not necessarily reflect or represent the official position or policies of The IIA or the Foundation.

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## ADDITIONAL CONTENT ON THE COMPANION WEBSITE

ACL Software

CaseWare IDEA Software

TeamMate+

The IIA's Code of Ethics

The IIA's *International Standards for the Professional Practice of Internal Auditing*

### **Case Studies**

Case Study 1, "Auditing Entity-Level Controls"

Case Study 2, "Auditing the Compliance and Ethics Program"

Case Study 3, "Performing a Blended Consulting Engagement"

Case Study 3, "Performing a Blended Consulting Engagement, abridged version"

**Students and instructors can access this material at the following address:  
[www.theiia.org/IAtextbook](http://www.theiia.org/IAtextbook)**



# PREFACE

Welcome to the fourth edition of this textbook. There are many important changes, some of which are based on updates that have been made to professional guidance such as The IIA's International Professional Practices Framework (IPPF) and the exposure draft of the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Enterprise Risk Management – Aligning Risk with Strategy and Performance*.

The authors' continuing goal, carried forward from previous editions of the textbook, is to provide students with the fundamental knowledge and a sense of the skills they will need to succeed as entry-level internal audit professionals. Accordingly, our primary target audience is undergraduate and graduate university students enrolled in introductory internal audit courses. We believe, however, that internal audit practitioners also will find the fourth edition of the textbook useful as a training and reference tool.

## SIGNIFICANT CHANGES IN THE FOURTH EDITION

As indicated above, the fourth edition of the textbook includes several important changes:

- Chapter 1, “Introduction to Internal Auditing,” introduces the concept of the internal audit function as a trusted advisor to the organization, which is carried throughout the other chapters as applicable. This chapter also introduces the changes to the IPPF that are discussed in detail in chapter 2.
- Chapter 2, “The International Professional Practices Framework: Authoritative Guidance for the Internal Audit Profession,” provides details regarding the new mission for internal auditing and other updates to the IPPF, the new internal audit global competency model, and changes in committee structure as well as the updated process for setting guidance for the profession.
- Chapter 4, “Risk Management,” has been updated to reflect the exposure draft of the new COSO framework, *Enterprise Risk Management – Aligning Risk with Strategy and Performance*, which is carried throughout the textbook.
- Chapter 6, “Internal Control,” has been updated to reflect the *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* that supersedes *Internal Control: Revised Guide for Directors on the Combined Code* (known as the Turnbull Report) in Wales and the UK. It also incorporates the relevant concepts from the exposure draft of COSO's *Enterprise Risk Management – Aligning Risk with Strategy and Performance*.
- Chapter 7, “Information Technology Risks and Controls,” includes increased coverage of emerging developments in technology, including a heightened focus on cybersecurity and the impact of associated risks to organizations.
- Chapter 8, “Risk of Fraud and Illegal Acts,” pulls in the latest information and data from the 2016 COSO Fraud Risk Management Guide as well as the 2016 Report to the Nations global survey from the Association of Certified Fraud

Examiners, and reflects the newest guidance in the exposure draft of COSO's *Enterprise Risk Management – Aligning Risk with Strategy and Performance*.

- Chapter 9, “Managing the Internal Audit Function,” now includes a section on creating a centralized professional practices group within the internal audit function and the many benefits and efficiencies that can be realized.
- Chapter 11, previously titled “Sampling,” has been renamed “Data Analytics and Audit Sampling” to reflect the chapter’s robust discussion of the beneficial use of data analytics by internal audit functions to provide assurance that is based on entire populations in a precise and efficient manner. The chapter introduces TeamMate Analytics while students and instructors retain access to the ACL and CaseWare IDEA tools that have always been available with the textbook.
- Chapter 15, “The Consulting Engagement,” discusses how successful delivery of the wide variety of advisory services can position the internal audit activity as a trusted advisor within the organization and delineates the challenges that can make it difficult to achieve.
- The end-of-chapter material has been expanded to ensure coverage of each of the major concepts addressed in each chapter, including the new material in each.
- KnowledgeLeader, a resource provided by Protiviti, has been integrated throughout the textbook in the form of a relevant case at the end of each chapter that encourages students to do further research into the applicable topic and report on what they find, allowing them to flex their critical thinking muscles.
- The latest version of TeamMate+ audit management software is integrated throughout the applicable textbook chapters, and the process for accessing the software has been much improved. TeamMate-specific case studies have been updated to reflect the latest software enhancements and are embedded in the end-of-chapter material as applicable.
- Rather than including a CD historically packaged with the textbook, access to the ancillary materials will be facilitated via a companion website hosted by The IIA. This will allow students and instructors real-time access to the most current information and materials and provide a portal to partner sites for access to TeamMate software, KnowledgeLeader case material, and use of ACL and CaseWare IDEA software.

## CONTENT AND ORGANIZATION OF THE TEXTBOOK

The textbook continues to include the following key components:

- Extensive coverage of governance, risk management, and internal control.
- A risk-based, process, and controls-focused internal audit approach.
- Integration of IT and fraud risks and controls.
- Alignment with the IPPF and Certified Internal Auditor (CIA) examination content specifications.
- Callouts of key terms in the margins of each chapter to reinforce key concepts.

Chapters 1 through 11, which are collectively referred to as Fundamental Internal Audit Concepts, cover topics that all internal auditors need to know and

understand. Chapters 12 through 15, which are collectively referred to as Conducting Internal Audit Engagements, focus on the planning, performing, and communicating phases of internal audit assurance and consulting engagements.

The end-of-chapter materials include review questions, multiple-choice questions, discussion questions, application-oriented cases, KnowledgeLeader research cases, and, in applicable chapters, exercises intended to familiarize students with TeamMate, the most popular audit management software. Other than the TeamMate exercises, which are the creation of Wolters Kluwer, unless otherwise indicated, all end-of-chapter questions and cases are the original work of the authors or have been adapted from the CIA Model Exams published by The IIA in 1998, 2004, and 2015, or from CIA exams prior to The IIA's closure of the exams in 1997.

The Glossary contains the authors' definitions of key terms used throughout the textbook. The IIA's Code of Ethics and the *International Standards for the Professional Practice of Internal Auditing* are reproduced in appendix A and appendix B, respectively.

## TEXTBOOK SUPPLEMENTS

The following supplemental materials can be accessed on the companion website of the textbook:

- **ACL and CaseWare IDEA Software.** Both ACL and CaseWare IDEA, the two predominant data analytics software programs used by internal auditors, can be accessed on the website. Instructors can decide individually the extent to which they want to give their students practical, hands-on experience with generalized audit software using ACL and/or CaseWare IDEA.
- **TeamMate Software, Demonstration Videos, and Exercises.** TeamMate, the most widely used audit management software, can be accessed on the website and integrated in the chapters to which the various software modules apply. Instructors can use the software, videos, and exercises to familiarize students with the various modules in the TeamMate suite.
- **Protiviti KnowledgeLeader.** Students and instructors have access to Protiviti's KnowledgeLeader. Case Studies at the end of each chapter direct students to the KnowledgeLeader site to research relevant guidance related to concepts in the chapters.
- **Case Studies.** The companion website contains four supplemental case studies that are intended to provide students with more in-depth, application-oriented coverage:
  - Case Study 1, "Auditing Entity-Level Controls."
  - Case Study 2, "Auditing the Compliance and Ethics Program."
  - Case Study 3, "Performing a Blended Consulting Engagement."
  - Case Study 3, "Performing a Blended Consulting Engagement, abridged version."

The following supplemental materials are available separately for instructors on the companion website:

- **Solutions Manual.** The Solutions Manual contains answers prepared by the textbook authors for the end-of-chapter questions and cases.



- **Textbook Exhibits.** Each of the textbook exhibits has been reproduced individually for instructors who want to use them separately as visual aids and/or handouts.
- **Slide Templates.** Slide templates have been prepared for each chapter. Instructors can use these templates as a starting point for preparing their personal sets of slides.
- **Illustrative Exams.** The illustrative exams prepared by the authors are intended to give instructors a head start on constructing exams best suited for their classes.
- **Internal Audit Project.** Two of the textbook authors, Urton Anderson and Mark Salamasick, describe how they have successfully integrated real-world internal audit projects into their Internal Auditing Education Partnership (IAEP) Program curricula.

## ACKNOWLEDGMENTS

First and foremost, the authors thank Kurt Reding, who saw the need for a comprehensive internal auditing textbook and recruited the rest of us to execute on his vision. Under his leadership, the first three editions of this textbook benefitted from his passion for improving the profession through education. Kurt's very high standards and appreciation for the diversity of thought around the execution of internal auditing resulted in a textbook that we've all been proud to have contributed to and that we believe has positively impacted the educational landscape around internal auditing. Due to competing priorities, Kurt was not available to lead us through this fourth edition and his talents and enthusiasm were sorely missed. While he was not with us physically, the spirit of his vision was ever present and we worked hard to build on the previous editions to create this new edition that reflects the latest guidance on emerging topics while retaining Kurt's drive for excellence.

The authors would like to thank the organizations and individuals, including college instructors and students, who used the first, second, and/or third editions of the textbook.

We especially want to thank Deborah Kretchmar, CIA, Senior Vice President, Internal Audit, LPL Financial. In her role as a member of the Internal Audit Foundation's Board of Trustees and Trustee Champion of the textbook, Deborah thoroughly reviewed each updated chapter of the fourth edition and provided insightful comments that helped us produce a high-quality textbook that we believe will serve students well.

Additionally, we appreciate the efforts of Margaret Christ, PhD, CIA, Associate Professor of Accounting, University of Georgia, and Steve Goodson, CIA, CISA, CGAP, CCSA, CLEA, CRMA, Internal Audit Lecturer, McCombs School of Business, The University of Texas at Austin, for reviewing and providing valuable feedback on select chapters of this fourth edition.

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In addition, the authors would like to thank the following organizations and individuals for their contributions to the fourth edition of the textbook:

- The Internal Audit Foundation for sponsoring the writing of the textbook.
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- The IIA for permission to incorporate the International Professional Practices Framework (IPPF) and other materials, including questions from the Certified Internal Auditor Model Exams and from past CIA examinations.
- ACL Services Ltd. for contributing the education edition of ACL audit software that is provided on the companion textbook website.

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- Michael Gowell, General Manager and Senior Vice President, TeamMate, and Michael Charney, Senior Director of Professional Services, TeamMate, of Wolters Kluwer for partnering with us to provide students who use this textbook with hands-on experience with TeamMate software.
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- Debi Roth, Managing Director – Global Standards & Guidance, The IIA, for providing timely information on updates to IPPF guidance throughout the writing of this textbook.
- Faceout Studio for designing the textbook's interior and cover.

## ABOUT THE AUTHORS

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Urton is EY Professor and Director of Von Allmen School of Accountancy at the University of Kentucky. Prior to joining the Von Allmen School, he was a member of the accounting faculty at the McCombs School of Business at the University of Texas at Austin. His research has addressed various issues in internal and external auditing and organizational governance—particularly compliance, enterprise risk management, and internal control. In addition to numerous articles, he has written four books, several of which have been translated into French, Spanish, Chinese, and Japanese.

Professor Anderson has been involved in the AAA Audit Section throughout his career, and also served as President of the Section (2009–2010). Urton also is active in The IIA. He has been Chair of The IIA's Board of Regents (2003–2007) and Chair of the Internal Auditing Standards Board (2002–2003 and 2007–2010). In 1997, he received The IIA's Leon R. Radde Educator of the Year Award. In 2006, The IIA recognized his outstanding contributions to the field of internal auditing by giving him the Bradford Cadmus Memorial Award. He served as Chair of the Internal Audit Foundation's Committee of Research and Education Advisors from 2011–2015 and is currently a member of the Foundation's Board of Trustees.

In March 2016, Urton was one of four internal audit leaders from business, government, and academia to make up the 2016 class of the American Hall of Distinguished Audit Practitioners. Established in 2011, the honor annually recognizes individuals who contributed significantly to the profession throughout their careers. Urton also serves on the Board of Directors for the Society of Corporate Compliance and Ethics/Health Care Compliance Association and served as its President from 2016–2017. From 2011–2012, Urton was an Academic Fellow in the Office of the Chief Accountant of the U.S. Securities and Exchange Commission.

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Mike retired from TD Ameritrade in May 2013, where he served as the Chief Audit Executive. As Managing Director of Corporate Audit at TD Ameritrade, Mike was responsible for the coordination and delivery of risk-based and process-driven review, assurance, and advisory services specific to internal controls and risk management throughout TD Ameritrade. During his more than 36-year career, he served in various capacities, including Director of Internal Audit, Audit Manager, and Controller, for several companies and financial institutions. His experience includes developing and implementing comprehensive, risk-based internal audit functions, and serving as a strategic, financial, operational, and compliance control consultant to the financial services industry.

In addition to earning numerous professional designations—Certified Internal Auditor, Certified Public Accountant, Certified Management Accountant, Chartered Bank Auditor, and Certified Information Systems Auditor—Mike is a FINRA Registered General Securities Representative (Series 7), General Securities Principal (Series 24), and a Financial and Operations Principal (Series 27). He is an active member of The IIA. He also serves as an appointed member of the Public Company Accounting Oversight Board (PCAOB) Investor Advisory Group (IAG). In the past, Mike served as Vice Chair – Finance of the Executive Committee of The IIA’s International Board and served on and chaired the Audit Committee of The IIA’s International Board. Mike has also served as Chairman of the North American Advocacy Committee, a Trustee on the Internal Audit Foundation Board, a North American Board member, and a Midwestern Region District Advisor. Mike co-authored *Internal Auditing: Assurance & Consulting Services*, a textbook published by the Foundation in July 2007 with the second and third editions released in 2009 and 2013. He also co-wrote “Blended Engagements,” published in *Internal Auditor* magazine, which earned the authors the 2010 Outstanding Contributor Award. In 2014, Mike was awarded the CAHILL Award for Excellence by Creighton University’s Heider College of Business. In the Fall of 2015, Mike helped form the Creighton Student Center for the Public Trust and served as the faculty moderator until June 2016. Mike, who earned a BSBA degree at the University of Missouri – Columbia, is also a member of the American Institute of Certified Public Accountants, the Nebraska Society of CPAs, Missouri Society of CPAs, Information Systems Audit & Control Association, and Institute of Management Accountants.

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Sri has been an Associate Professor in the School of Accountancy and a Director of the Corporate Governance Center in the Michael J. Coles College of Business at Kennesaw State University for almost seven years. He will be joining the Department of Accounting faculty at the University of Dayton, Ohio, in Fall 2017. His broad research and teaching interests include corporate governance, risk management, ethics, financial and managerial accounting, external and internal auditing, international accounting, forensic accounting, and business valuation.



Sri earned a Bachelor of Commerce (BCom) degree from Bombay University, India, became professionally qualified as a Chartered Accountant in India, and worked for two years with EY in the Middle East before earning the MAcc and PhD degrees from The Ohio State University. After completing his PhD, Sri served on the accountancy faculty of the University of Illinois at Urbana-Champaign. A prolific contributor to governance, risk, and compliance (GRC) literature, he has published more than 35 research and professional articles. His co-authored book, *A.B.C.'s of Behavioral Forensics: Applying Psychology to Financial Fraud Prevention and Detection* (Ramamoorti et al., 2013, Wiley), won the 2015 Coles College Publication prize and has been presented to the FBI Academy. Among his IIA-funded, co-authored research monographs are *Research Opportunities in Internal Auditing*, *Using Neural Networks for Risk Assessment in Internal Auditing*, *Behavioral Dimensions of Internal Auditing*, *Promoting and Supporting Effective Organizational Governance: Internal Audit's Role*, and *CAE Strategic Relationships: Building Rapport with the Executive Suite*, which won the Internal Audit Foundation's Larry Sawyer Project of the Year Award in 2014. He has published several *Internal Auditor* articles.

Prior to returning to academia, Sri was a principal with Arthur Andersen & Co. at the Chicago World Headquarters, National EY Sarbanes-Oxley Advisor, and a corporate governance partner with Grant Thornton LLP in the firm's National Office. Subsequently, he was a principal for Infogix Advisory Services, leading the GRC professional services division of Infogix, Inc., based in Naperville, IL. He was a core member of the Grant Thornton authoring/development team for the 2009 COSO Guidance on *Monitoring Internal Control Systems*, and later for ISACA's 2010 guidance, *Monitoring Internal Control Systems and IT*.

In December 2016, Sri completed a three-year term on the prestigious Standing Advisory Group of the Public Company Accounting Oversight Board (PCAOB). He currently serves as a Trustee of the Financial Executives Research Foundation (FERF) and as a member of the Litigation Forensics Board of the National Association of Certified Valuators and Analysts (NACVA). Sri has been an active volunteer as the Chairman of the Academy for Government Accountability, a member of the Internal Audit Foundation's Board of Trustees, co-chair of the Foundation's Global Common Body of Knowledge (CBOK) 2010 study, and a member of The IIA's Global Ethics Committee. Over the last two decades, he has made professional presentations in 15 countries.

## **CRIS RIDDLE, MA, CIA, CRMA**

### **Solutions & Strategy Senior Audit Manager**

#### ***TD Ameritrade***

Cris is the Solutions & Strategy Senior Audit Manager for TD Ameritrade. She is responsible for managing the processes, systems, and databases for the administration of the internal audit department. Additionally, she develops and delivers internal training and reviews and edits audit materials, including audit reports, meeting presentations, audit committee and risk meeting materials, and the Audit Manual. Cris also teaches English Composition, Critical Reasoning and Rhetoric, Professional Communication, Engaging the Short Story, and World Literature at Creighton University and Nebraska Methodist College.

In addition to co-authoring all four editions of *Internal Auditing: Assurance & Advisory Services*, Cris has served as the General Editor and project manager. She was also the General Editor of the sixth edition of *Sawyer's Internal Auditing*. Cris received the Outstanding Contributor Award for the article "Blended Engagements" that she co-authored with fellow authors Kurt Reding and Michael Head.

She is a member of The IIA as well as a FINRA Registered General Securities Representative (Series 7). She received both her BA and MA degrees in English/Creative Writing from Creighton University in Omaha, NE, where she held a Presidential Fellowship as a graduate student. Cris writes and presents on numerous topics.

## **MARK SALAMASICK, CIA, CISA, CRMA, CSP**

### **Executive Director of Audit**

#### *University of Texas System*

Mark is currently Executive Director of Audit at the University of Texas System. In this role, he assists in the oversight of the Academic Institution audit groups of the UT System. He also works in advancing progressive strategies and initiatives outlined for the internal audit enterprise across the UT System. Previous to this, he was the Director of the Center for Internal Auditing Excellence at the University of Texas at Dallas (UTD). Mark created the internal audit program and many of the courses in the program over the 12 years he led that program. He started the program in the Fall of 2003 with an extensive curriculum in internal auditing, technology, audit software, information security, corporate governance, and forensic accounting. He taught Internal Audit, Information Technology Audit and Risk Management, and Advanced Auditing.

He authored *Auditing Outsourced Functions: Risk Management in an Outsourced World* published by the Internal Audit Foundation in October 2012. He was the principal researcher on a project with the Foundation and Intel on PC Management Best Practices along with another publication, *Auditing Vendor Relationships*, both published in 2003. He was previously with Bank of America for more than 20 years. He worked within the Internal Audit Group for 18 years, serving as Senior Vice President and Director of Information Technology Audit with responsibility for various technology, financial, and operational audits. He was responsible for partnering on and auditing technology, information security, and business continuity. Before joining Bank of America, Mark was a senior consultant with Accenture (Andersen Consulting).

Mark currently serves on the Academic Relations Committee of IIA International. He previously served multiple terms on the Foundation's Board of Trustees and Committee of Research and Education Advisors. He received the 1994 IIA International Audit and Technology Award. In 2005, he was named Leon R. Radde Educator of the Year by The IIA. The University of Texas at Dallas created the endowed IT Audit Fellowship in his name in 2016.

He is a frequent conference speaker on emerging technology issues, internal audit practices, and the future direction of internal audit. He was on The IIA's Dallas Chapter's Board of Governors for 20 years. Mark holds a BS in Business Administration and an MBA from Central Michigan University, where he taught accounting and information systems as a graduate student and as a full-time faculty member.

## PAUL J. SOBEL, CIA, QIAL, CRMA

### Vice President/Chief Audit Executive

#### *Georgia-Pacific LLC*

Paul is Vice President/Chief Audit Executive for Georgia-Pacific, LLC, a privately owned forest and consumer products company based in Atlanta, GA. He previously served as the Chief Audit Executive for three public companies: Mirant Corporation, an energy company based in Atlanta, GA; Aquila, Inc., an energy company based in Kansas City, MO; and Harcourt General's publishing operations based in Orlando, FL. His responsibilities included leading the global internal audit efforts at these companies, as well as consulting on each company's enterprise risk management (ERM), compliance, and internal controls programs. He has also served as International Audit Manager for PepsiCo, Senior Manager in Arthur Andersen's Business Risk Consulting practice, and Experienced Manager in Arthur Andersen's Financial Statement Assurance practice.

Paul is a frequent speaker on governance, risk management, and internal audit topics. In addition to co-authoring the previous editions of this textbook, he has published a book titled *Auditor's Risk Management Guide: Integrating Auditing and ERM*, currently in its eighth edition, and co-authored *Enterprise Risk Management: Achieving and Sustaining Success*, a book published by the Internal Audit Foundation. Paul is a past Chairman of the Board for The IIA and has served in other IIA officer and board roles. In 2012, Paul was recognized in *Treasury & Risk* magazine's list of 100 Most Influential People in Finance. He has also served on the COSO ERM Advisory Council for its recent update to the COSO ERM framework, the Standing Advisory Group of the Public Company Accounting Oversight Board (PCAOB), and as The IIA's representative on the Pathways Commission, which developed recommendations to enhance the future of accounting education in the United States.





# Introduction to Internal Auditing

## LEARNING OBJECTIVES

- Understand the value proposition that stakeholders expect from the internal audit function.
- Obtain a basic understanding of internal auditing and the internal audit process.
- Understand the relationship between auditing and accounting.
- Distinguish between financial reporting assurance services provided by internal auditors and those provided by independent outside auditors.
- Become familiar with the internal audit profession and The IIA.
- Understand the competencies needed to excel as an internal auditor.
- Be aware of the various internal audit career opportunities it is possible to pursue.

Think about the term “internal auditing” for a moment. What pops into your mind? What does the term mean to you? For many people, the term has no particular significance, and for some, it may invoke negative thoughts. For example, many people have long held the view that auditing in general is merely a boring branch of accounting. To others, internal auditing conveys an even more negative connotation—after all, the only thing auditors do is check other peoples’ work and report the mistakes they make, sort of like a police function. As the authors of this textbook, we hope to dispel these misperceptions about internal auditing.

The fact is that internal auditing is widely viewed as a prestigious, high-profile profession, the stature of which has never been higher than it is now. The demand for talented individuals at all levels of internal auditing far exceeds the supply. Chief audit executives (CAEs) of public companies commonly report directly to the audit committee of the board of directors and are viewed as peers among senior management executives. Worldwide membership in The IIA as of 2016 exceeded 185,000.



However, to survive and thrive, internal audit, like any other function within an organization, must justify its existence to its key stakeholders. In other words, the stakeholders must value the services the internal audit function has to offer. In recognition of this fact, The IIA formed a task force in 2008 “to explore and develop a clear and concise description of internal audit’s value proposition...” In 2010, the IIA Global Board of Directors, The IIA’s governing body, endorsed the outcomes of the task force’s work. A visual depiction of internal audit’s value proposition, as set forth by The IIA, is presented in exhibit 1-1. The three components of the value proposition are defined below:

- **Assurance = Governance, Risk, and Control.** Internal audit provides assurance on the organization’s governance, risk management, and control processes to help the organization achieve its strategic, operational, financial, and compliance objectives.
- **Insight = Catalyst, Analyses, and Assessments.** Internal audit is a catalyst for improving an organization’s effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business process.
- **Objectivity = Integrity, Accountability, and Independence.** With commitment to integrity and accountability, internal audit provides value to governing bodies and senior management as an objective source of independent advice.<sup>1</sup>

## Internal Auditing

An independent, objective assurance and consulting activity designed to add value and improve an organization’s operations.

### EXHIBIT 1-1 THE VALUE PROPOSITION



### Internal Auditing = Assurance, Insight, and Objectivity

Governing bodies and senior management rely on internal auditing for objective assurance and insight on the effectiveness and efficiency of governance, risk management, and internal control processes.

Source: Miller, Patty, and Tara Smith, *Insight: Delivering Value to Stakeholders* (Lake Mary, FL: The Institute of Internal Auditors, 2011), 14.

## Add Value

Value is provided by improving opportunities to achieve organizational objectives, identifying operational improvement, and/or reducing risk exposure through both assurance and consulting services.

This value proposition clearly articulates why internal auditing is important. In the next section of this introductory chapter, we walk through the definition of internal auditing and introduce readers to the internal audit process. We next clarify the relationship between auditing and accounting and distinguish the financial reporting assurance services provided by internal auditors from those provided by independent outside auditors. We then provide an overview of the internal audit profession and The IIA. We conclude the chapter by discussing the competencies

needed to excel as an internal auditor and the various internal audit opportunities that interested, competent individuals can pursue.

## DEFINITION OF INTERNAL AUDITING

The IIA's Board of Directors adopted the current definition of internal auditing in 1999:

*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.<sup>2</sup>*

The Definition of Internal Auditing states the fundamental purposes, nature, and scope of internal auditing. The key components of this definition are listed here and discussed in turn below:

- Helping the organization accomplish its objectives.
- Evaluating and improving the effectiveness of risk management, control, and governance processes.
- Assurance and consulting activity designed to add value and improve operations.
- Independence and objectivity.
- A systematic and disciplined approach (specifically, the engagement process).

### Helping the Organization Accomplish Its Objectives

An organization's objectives define what the organization wants to achieve, and its ongoing success depends on the accomplishment of its objectives. At the highest level, these objectives are reflected in the organization's mission and vision statements. The mission statement expresses, in broad terms, what the organization wants to achieve today. The vision statement conveys what the organization aspires to achieve in the future.

There is no single right way to categorize business objectives. This textbook uses the following categorization:

- **Strategic objectives** are those goals that management sets specifically related to stakeholder interests. Throughout this textbook, the term *objectives* will be used when discussing what an organization wants to achieve and the term *strategy* when discussing the way management intends to achieve those objectives.
- **Operations objectives** pertain to the effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding resources against loss.<sup>3</sup>
- **Reporting objectives** pertain to internal and external financial and nonfinancial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, standard setters, or the entity's policies.<sup>4</sup>
- **Compliance objectives** pertain to adherence to laws and regulations to which the entity is subject.<sup>5</sup>