



Internal Audit -

- 1. Governing framework**
- 2. Basic Principles of Internal Audit**
- 3. Standards on Internal Audit**
- 4. Internal Audit Report**

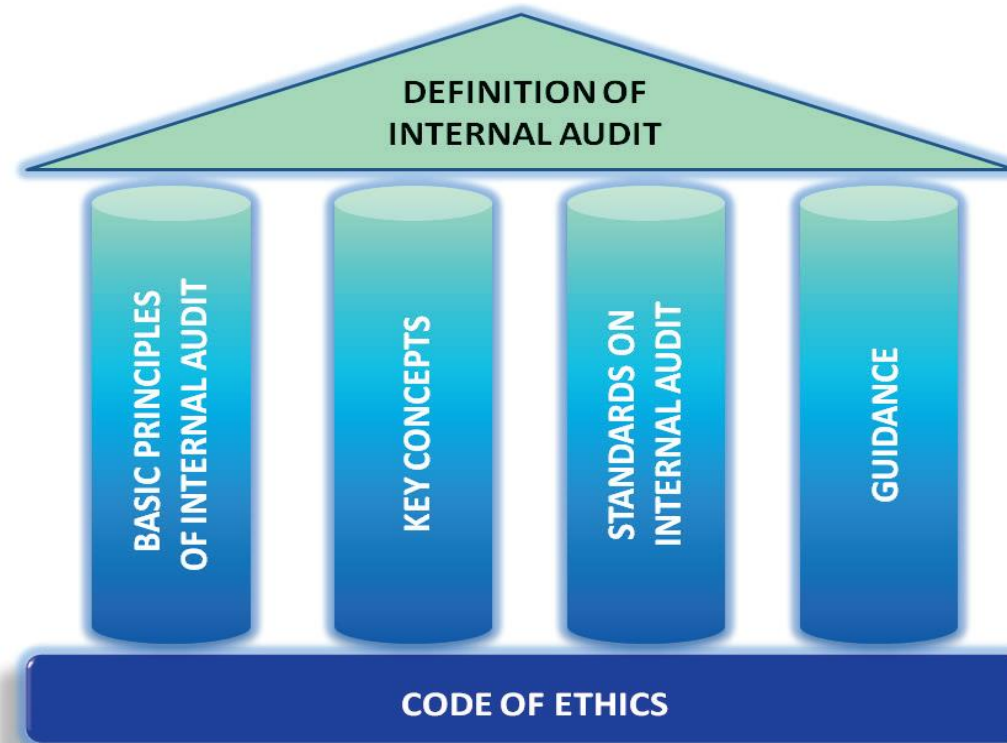
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Framework Governing Internal Audit

The Internal audit framework covers all aspects of internal audits, from the overall management of the internal audit function to the performance of specific internal audit assignments.

The Framework Governing Internal Audits comprises of "Definition of Internal Audit" (as covered in the following slide), four components and the most important underlying principle "Code of Ethics". Each component is inherent to the whole process of internal audit and implicitly forms part of the Standards on Internal Audit, even though they may not be mentioned explicitly in the Standards.



Definition of Internal Audit

“Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity’s risk management and internal control system”

Internal audit provides **independent assurance** on the **effectiveness of internal controls and risk management processes** to **enhance governance** and **achieve organisational objectives**.

Value Proposition of Internal Audit:



- Offer objective assurance
- Provides insight
- Improve effectiveness and efficiency
- Long-term sustainability

Components of Internal Audit

Independence

Internal audit shall be an independent function, achieved through the position, organization structure and reporting of the internal auditor.

Governance

A set of relationships between the Company and its various stakeholders and provides the structure through which the company's objectives are achieved. It includes compliance with internal policies.



Internal Controls and Risk Management

An internal auditor is expected to evaluate the design and operating effectiveness of internal controls and risk management processes (including reporting processes) as designed and implemented by the management.

Organisational Objective

Incorporate the interests of all stakeholders and include the short and medium-term goals that an organisation seeks to accomplish.

Applicability of Internal Audit

Applicability of Internal audits to Companies under section 138 of the Companies Act, 2013:

Particulars	Listed Companies	Unlisted public Company	Private Company
Paid up share capital	Always Applicable	≥ 50 crores	Not Applicable
Turnover	Always Applicable	≥ 200 crores	≥ 200 crores
Outstanding loans or borrowings from banks or public financial institutions at any point of time during the preceding financial year	Always Applicable	≥ 100 crores	≥ 100 crores
Outstanding deposits at any point of time during the preceding financial year	Always Applicable	≥ 25 crores	Not Applicable

Appointment of Internal Auditors

Procedures and formality under Companies Act, 2013

Section/Rule	Provision
Section 138 of Companies Act, 2013	The internal auditor shall be either a Chartered Accountant or a Cost Accountant or such other professional
Rule 13 of Companies (Account) Rules, 2014	<ul style="list-style-type: none">• Internal auditor can be:<ul style="list-style-type: none">➤ an individual or➤ a partnership firm or➤ a body corporate• Internal auditor may or may not be an employee.• It is not necessary that the Chartered Accountant or the Cost Accountant should be engaged in practice• Audit Committee/Board shall formulate the scope, functioning, periodicity and methodology for conducting the internal audit (Scope of internal audit is not defined)• The internal auditor shall be appointed only by means of resolutions passed at meetings of Board

Key Concepts

There are certain concepts which form integral part of the internal audit activity and, therefore, apply to most internal audits. In fact, some of the concepts are ingrained in the Definition of Internal Audit. The key concepts are in the nature of:

- Internal Controls
- Risk Management
- Governance Processes
- Compliance with laws and regulations
- Nature of assurance

Standards of Internal Audit

The Standards on Internal Audit (SIAs) establish uniform evaluation criteria, methods, processes and practices. The Standards are pronouncements which form the basis for conducting all internal audit activity. These pronouncements are designed to help the internal auditor to discharge his responsibilities.

Guidances

These are a set of guidelines, which include Guidance Notes and Technical Guides as issued by Institute of Chartered Accountants of India (ICAI). These guidelines are important for implementation of the SIAs and provide clarification for their applicability under particular circumstances.

Code of Ethics

A member of the Institute of Chartered Accountants of India, carrying out an internal audit activity, is, additionally, governed by:

- (a) the requirements of the Chartered Accountants Act, 1949
- (b) the Code of Ethics issued by the Institute of Chartered Accountants of India
- (c) other relevant pronouncements of the Institute of Chartered Accountants of India.

Three Dimensions of Internal Controls Framework

The Framework defines objectives of Internal controls, levels at which it should be evaluated and its components.

OBJECTIVES

Internal controls should provide reasonable assurance to achieve the following objectives

Effectiveness and efficiency of operations (including safeguarding fixed assets)

Reliability of financial reporting

Compliance with applicable laws and regulations

EVALUATION LEVELS

Internal controls must be evaluated at two levels

Entity level

Process level

COMPONENTS

Components of internal controls which can be mapped to five broad heads

Control environment

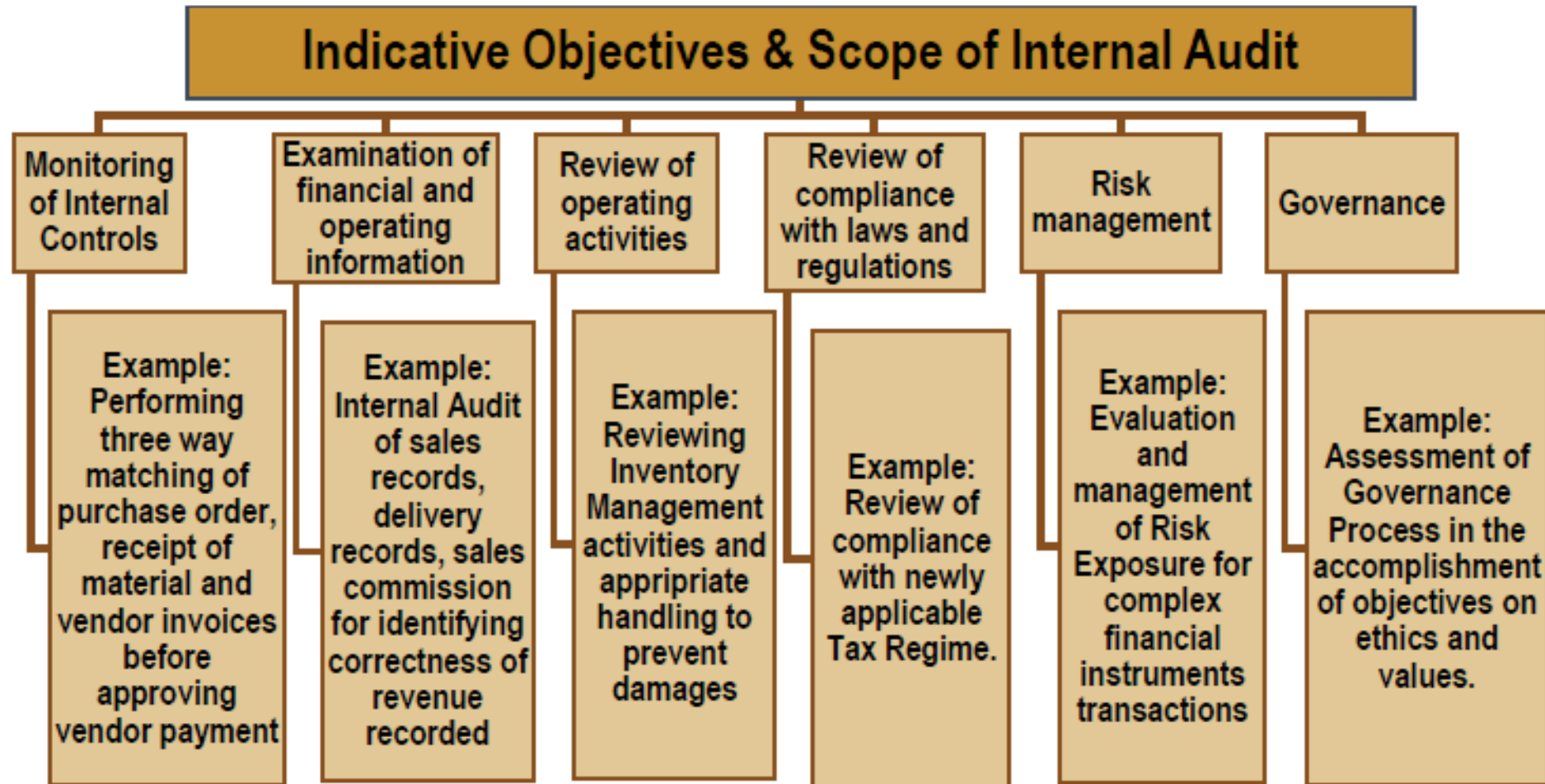
Risk assessment

Control activities

Information and Communication

Monitoring

Objective and Scope of Internal Audit



Risk Based Internal Audit Approach

- Risk-based internal audit (RBIA) is an internal methodology that focuses on the **inherent risk** involved in the activities or system. It provides assurance that risk is being managed by the management within the defined risk appetite level. RBIA is a framework that associates the internal audit to the **overall organizational risk framework**.
- In a risk-based internal audit, the audit plan is prioritized based on magnitude and frequency. The internal audit function should be kept informed of all developments such as introduction of new products, changes in reporting lines, changes in accounting practices/policies, etc.
- The internal audit function uses the results of the **audit risk assessment** to create a risk-based internal audit plan that focuses on the business areas with the most significant risk exposure while also ensuring areas of low risk receive adequate audit coverage.
- **Traditional Internal Audit:** Control assurance based on routine audit.
- **Risk Based Internal Audit:** Assurance on the effectiveness of risk management (in addition to control assurance).

Risk Based Internal Audit Approach (Contd..)

RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively, in relation to the risk appetite.

Advantages of RBIA:

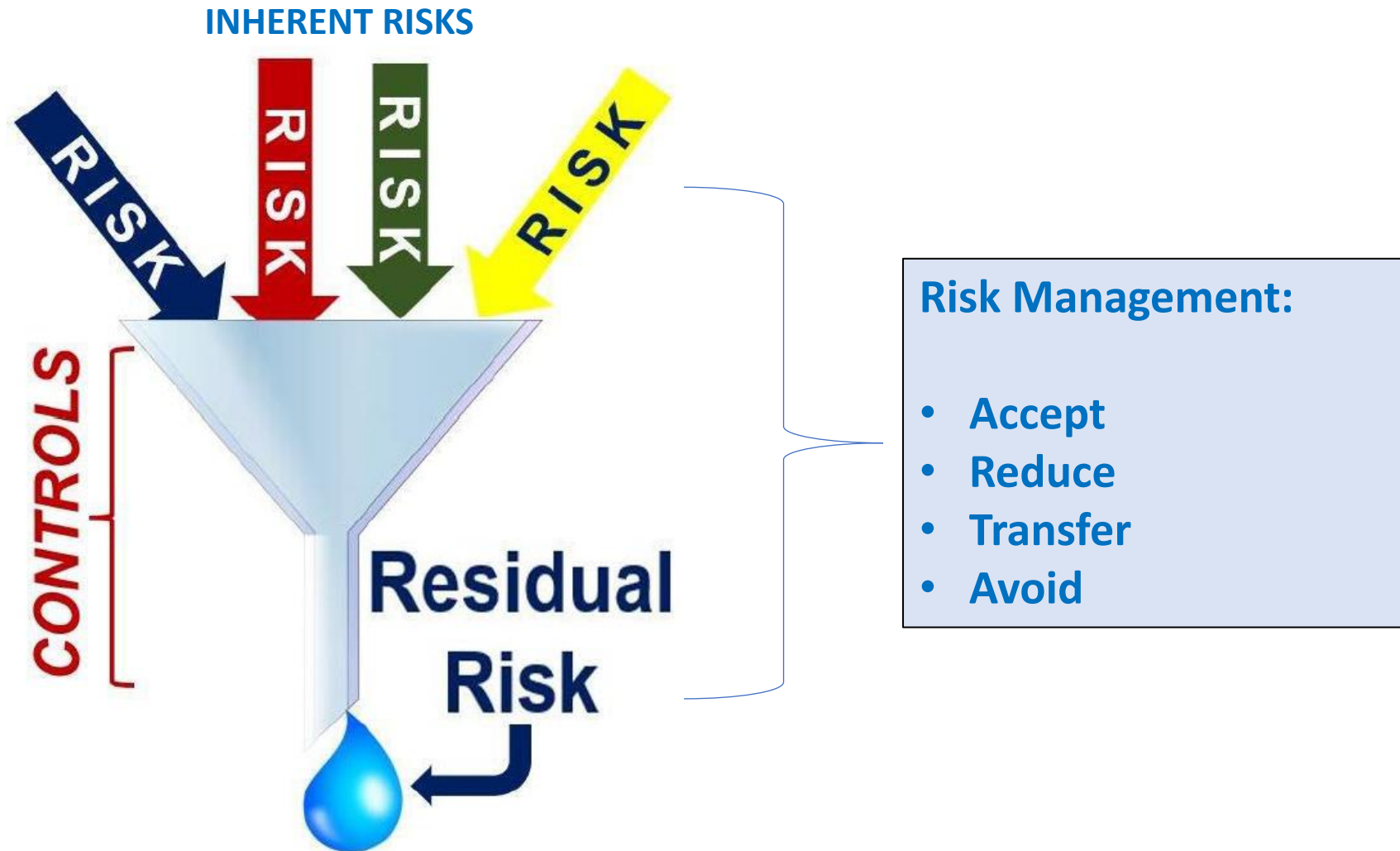
- Management has identified, assessed and responded to risks above and below the risk appetite
- The responses to risks are effective but not excessive in managing inherent risks within the risk appetite
- Where residual risks are not in line with the risk appetite, action is being taken to remedy that
- Risk management processes, including the effectiveness of responses and the completion of actions, are being monitored by management to ensure they continue to operate effectively.
- Risks, responses and actions are being properly classified and reported.

Risk Assessment Methodology

Risk assessment methodology should include the following:

- a) Previous internal audit reports and compliance
- b) Proposed changes in business lines or change in focus
- c) Significant change in management / key personnel
- d) Results of regulatory examination report
- e) Reports of external auditors
- f) Industry trends and other environmental factors
- g) Time elapsed since last audit
- h) Volume of business and complexity of activities
- i) Substantial performance variations from the Budget
- j) Business Strategy of the entity vis-à-vis the risk appetite and adequacy of controls

Relationships between Inherent and Residual Risks



Traditional Audit vs Risk Based Audit

Risk Based Audit, thus can be positioned as a risk management tool to support top and middle management in their pursuits. Traditional Audit vs Risk Based Audit can be understood with below differentiation:

Traditional Audit

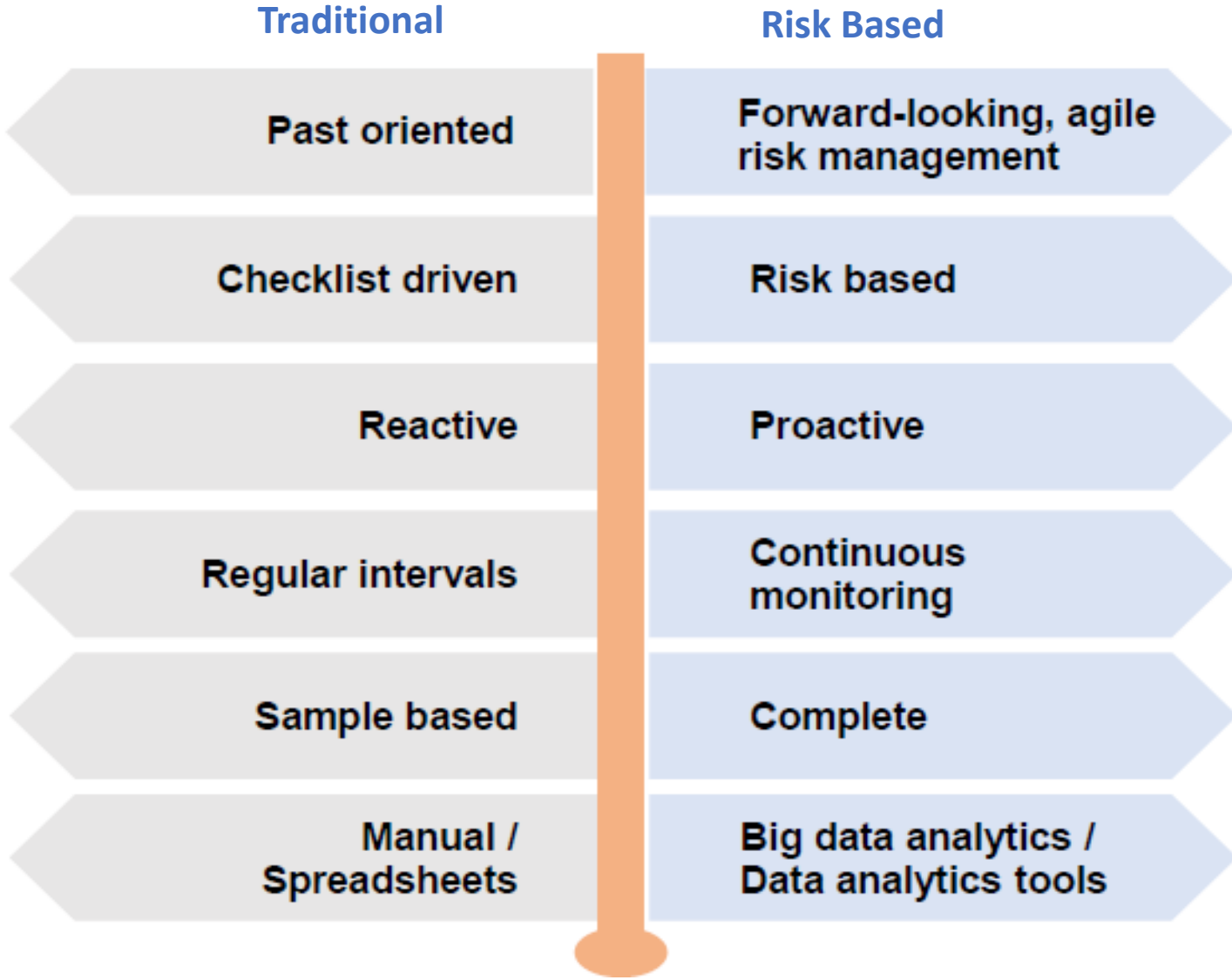
Traditional Audit is focused on:

- Correctness of recording information
- Completeness
- Accounting related controls
- Proprietary aspects relating to delegation of authority.

Risk Based Audit

- Internal Audit assumes business consulting / advisory function.
- Stretches into the realm of management audit.
- Critical Risk management tool.

Transformation of Internal Audit



Performing an Internal Audit Engagement



Reporting of Internal Audit issues

Circulate final report and presentation of his findings to the Audit committee



Perform Audit checks

Ensure adequate evidence must be collected and stored in accordance with SIA



Perform Audit Planning

Detailed Work plan must be prepared



Obtaining knowledge of the business and its environment

Obtain understanding of the business operations and the relevant industry.



Gather Required Information

Gather required information and perform checks to ensure correctness and integrity of information received.

Basic Principles of Internal Audit



Basic Principles of Internal Audit

1. INDEPENDENCE
2. INTEGRITY AND OBJECTIVITY
3. DUE PROFESSIONAL CARE
4. CONFIDENTIALITY
5. SKILLS AND COMPETENCE



6. RISK BASED AUDIT
7. SYSTEMS AND PROCESS FOCUS
8. PARTICIPATION IN DECISION MAKING
9. SENSITIVE TO MULTIPLE STAKEHOLDER'S INTEREST
10. QUALITY AND CONTINUOUS IMPROVEMENT

Independence

Internal audit provides **independent assurance** on the **effectiveness of internal controls and risk management processes** to **enhance governance** and **achieve organisational objectives**.

The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind, but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

At times, the Internal Auditor is exposed to a different type of risk to independence, whereby management seeks active business support from the Internal Auditor. Apart from providing basic assurance and advisory inputs, the Internal Auditor is assigned certain operational responsibilities (such as risk management, compliance, system automation, process re-engineering, etc.). Although some limited operational role may be acceptable with due approvals, and for a short duration, the Internal Auditor shall do so only after communicating his limitations along the following lines:

- (a) Unable to assume ownership or accountability of the process; and
- (b) Inability to take operational decisions which may be subject to an internal audit later on.

Integrity and Objectivity

The Internal Auditor shall be honest, truthful and be a person of high integrity. He shall operate in a highly professional manner and seen to be fair in all his dealings. He shall avoid all conflicts of interest and not seek to derive any undue personal benefit or advantage from his position.

The Internal Auditor shall conduct his work in a highly objective manner, especially in gathering and evaluation of facts and evidence. He shall not allow prejudice or bias to override his objectivity, especially in arriving at conclusions or reporting his opinion.

Due Professional Care

The Internal Auditor shall exercise due professional care and diligence while carrying out the internal audit. “Due professional care” signifies that the Internal Auditor exercises reasonable care in carrying out the work to ensure the achievement of planned objectives.

Confidentiality

The Internal Auditor shall at all times, maintain utmost confidentiality of all information acquired during the course of the audit work. He shall not disclose any such information to a party outside the internal audit function and any disclosure shall be on a “need to know basis”.

The Internal Auditor shall keep confidential information secure from others. Under no circumstance any confidential information shall be shared with third parties outside the company, without the specific approval of the Management or Client or unless there is a legal or a professional responsibility to do so (e.g., to share information with Statutory Auditors). Internal audit reports shall be addressed to specified internal auditees and distributed to only those who appointed or engaged the Internal Auditor and as per their directions.

Skills and Competence

The Internal Auditor shall have sound knowledge, strong inter-personal skills, practical experience and professional expertise in certain areas and other competence required to conduct a quality audit.

Where the Internal Auditor lacks certain expertise, he shall procure the required skills either through in-house experts or through the services of an outside expert, provided independence is not compromised. The objective is to ensure that the audit team as a whole has all the expertise and knowledge required for the area under review.

Risk Based Audit

The Internal Auditor shall identify the important audit areas through a risk assessment exercise and tailor the audit activities such that the detailed audit procedures are prioritised and conducted over high-risk areas and issues, while less time is devoted to low-risk areas through curtailed audit procedures. Additionally, this approach shall ensure that risks under consideration are more aligned to the overall strategic and company objectives rather than narrowly focused on process objectives.

A risk-based audit shall ensure the following **three-fold objectives**:

- Audit procedures need not cover the whole process and can be limited only to the important controls in the process.

- Establish linkage to the aspects relevant and connected with company and functional objectives; and

- Findings and issues highlighted are significant and important and time is not devoted to areas with low probability of significant observations.

Systems and Process Focus

An Internal Auditor shall adopt a system and process focused methodology in conducting audit procedures. This methodology is more sustainable than the one adopted to test transactions and balances as it goes beyond “error detection” to include “error prevention”. It requires a root cause analysis to be conducted on deviations to identify opportunities for system improvement or automation, to strengthen the process and prevent a repetition of such errors.

Participation in Decision Making

- As part of his advisory role, the Internal Auditor shall avoid participation in operational decision making which may be subject of a subsequent audit.
- The focus of the Internal Auditor shall remain with the quality and operating effectiveness of the decision making process and how best to strengthen it, such that the chance of flawed or erroneous decisions is minimised. However, the Internal Auditor is at full liberty to present the lessons which can be learnt from such past decisions.

Sensitive to Multiple Stakeholder's Interest

The Internal Auditor shall evaluate the implications of his observations and recommendations on multiple stakeholders, especially where diverse interests may be conflicting in nature. In such situations, the Internal Auditor shall remain objective and present a balanced view. This would permit senior management to make a decision using all the information and balance the strategy and objectives of the company with the expectations and interests of its multiple stakeholders.

Quality and Continuous Improvement

The quality of the internal audit work shall be paramount for the Internal Auditor since the credibility of the audit reports depends on the reliability of reported findings. The Internal Auditor shall have in place a process of quality control to:

- (a) ensure factual accuracy of the observations;
- (b) to validate the accuracy of all findings; and
- (c) continuously improve the quality of the internal audit process and the internal audit reports.

The Internal Auditor shall ensure that a self-assessment mechanism is in place to monitor his own performance and also that of his subordinates and external experts on whom he is relying to complete some part of the audit work.

A photograph of a modern office desk. On the desk, there is a silver laptop, a spiral notebook with a pen and eraser, and several architectural plans or blueprints. The desk is dark-colored, and the background shows a bright window with white curtains and a vase of white flowers.

Standards on Internal Audit (SIA)

Index on SIAs

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SIA	Heading
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SIA 110 – Nature of Assurance

Objective: The main objective of this Standard is to provide clarity on:

- Whether the internal auditor can provide any assurance at all;
- Essential requirements which must be satisfied to be able to provide the assurance;
- Nature of assurance that can be provided (Reasonable or Limited)

Components of an Assurance Assignment:

- A three-party relationship, involving an Internal Auditor, An Auditee and Assurance User;
- Presence of three key elements, involving a Subject Matter, a Pre-defined criteria, and a Conclusive Outcome;

SIA 120 – Internal Controls

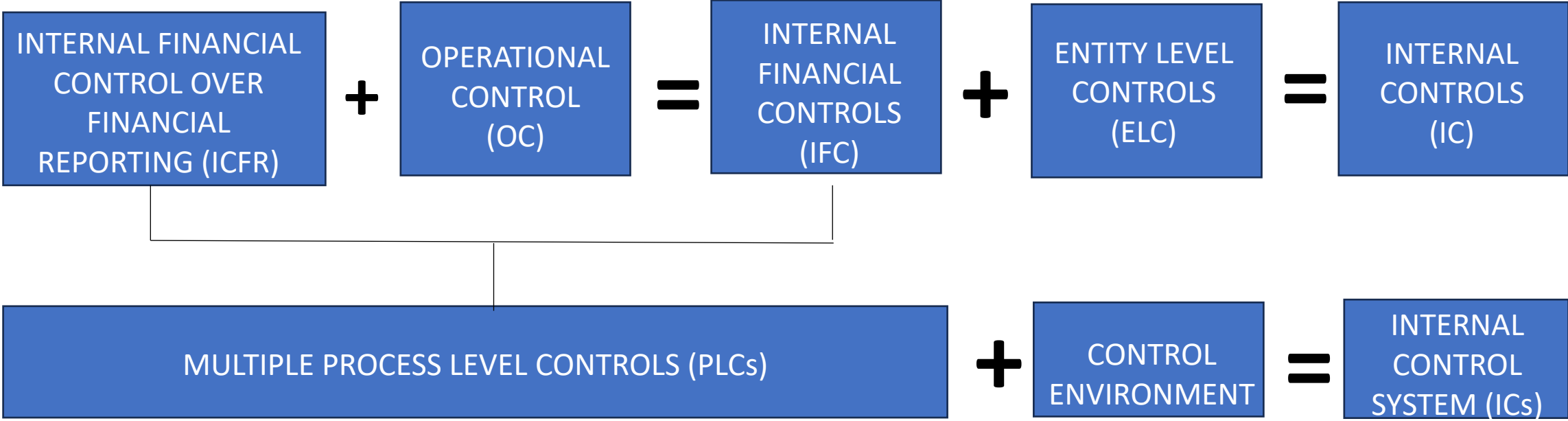
Objective: The objectives of this Standard on Managing the Internal Audit Function are to:

- To define Internal Controls
- Explaining responsibilities of Management and Internal Auditor

Nature, Purpose and Types of Internal Controls

- “Internal Control System” means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable
- Internal controls may be either preventive or detective
- Internal controls are generally concerned with achieving the following objectives:
 - Transactions are executed
 - Transactions are promptly recorded
 - Assets and records are safeguarded
 - Recorded assets are compared with the existing assets
 - Systems and procedures are effective in design and operation
 - Risks are mitigated to a reasonable extent

SIA 120 – Internal Controls (Contd..)



SIA 130 – Risk Management

Objective: The objectives of this Standard on Managing the Internal Audit Function are to:

- Explain the responsibilities of the Board of Directors, risk management department and management with regard to risk management, as mandated by law and regulations
- State the responsibilities of the internal auditor, especially when providing an assurance on the risk management framework.

Enterprise Risk Management

- Risk can be defined as the probability of a threat exploiting vulnerability of business assets or processes or controls by occurrence of an event causing significant impact to the business operations. Area impacted by Risk may be broadly classified into Strategic, Operational, Financial etc.
- Enterprise Risk Management is a term used to refer to various risk management frameworks uniformly applied on an entity-wide basis towards a comprehensive approach to manage organisational risks.
- Enterprise Risk Management is a structured, consistent and continuous process of measuring or assessing risk and developing strategies to manage risk within the risk appetite
- The Enterprise Risk Management process consists of Risk identification, Prioritization, Reporting, Risk mitigation, Risk monitoring and assurance

The scope of the internal auditor's work in assessing the effectiveness of the enterprise risk management would, normally, include:

- Assessing the risk maturity level both at the entity level as well as the auditable unit level.
- Assessing the adequacy of and compliance with the risk management policy and framework.

SIA 140 – Governance

Objectives:

The purpose of this Standard is to:

- Provide a common terminology on governance to prevent ambiguity or confusion on the subject matter;
- Explain the responsibilities of the Board of Directors and Management, Audit Committee with regard to governance, as mandated by law and regulations; and
- Specify responsibilities of the Internal Auditor, especially, when providing independent assurance on the governance framework.

The overall objective of this Standard is to clarify the responsibilities of Management, Audit Committee, Board of Directors and Internal Auditors towards various stakeholders (both internal and external), and the requirements which need to be met to assess, evaluate, report and provide independent assurance over the governance framework.

Responsibility of Internal Auditor:

- The Internal Auditor shall plan and perform internal audit procedures to evaluate the design, implementation and operating effectiveness of such framework so as to provide independent assurance to management and to those charged with governance
- The Internal Auditor shall not assume any responsibility to manage or operate the Governance framework or to take governance related decisions. It is not responsibility of the Internal Auditor to execute or resolve governance related risks.

SIA 150 – Compliance with Laws and Regulations

Effect of Laws and Regulations

Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on not only the reporting framework of the financial statements but also on its functioning

Responsibility of Management - Compliance with Laws & Regulations

It is the primary responsibility of Management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations.

Internal Auditor's Consideration of Compliance with Laws and Regulations

- Obtaining an Understanding of the Legal and Regulatory Framework
- Laws and Regulations Generally Recognized to have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements
- Procedures to Identify Instances of Non-Compliance – Other Laws and Regulations
- Non-Compliance brought to the Internal Auditor's Attention through Other Audit Procedures
- Internal Audit Procedures when Non-Compliance is not identified or suspected
- Evaluating the Implications of Non-Compliance

SIA 210 – Managing the Internal Audit Function

Objective: The objectives of this Standard on Managing the Internal Audit Function are to ensure the following:

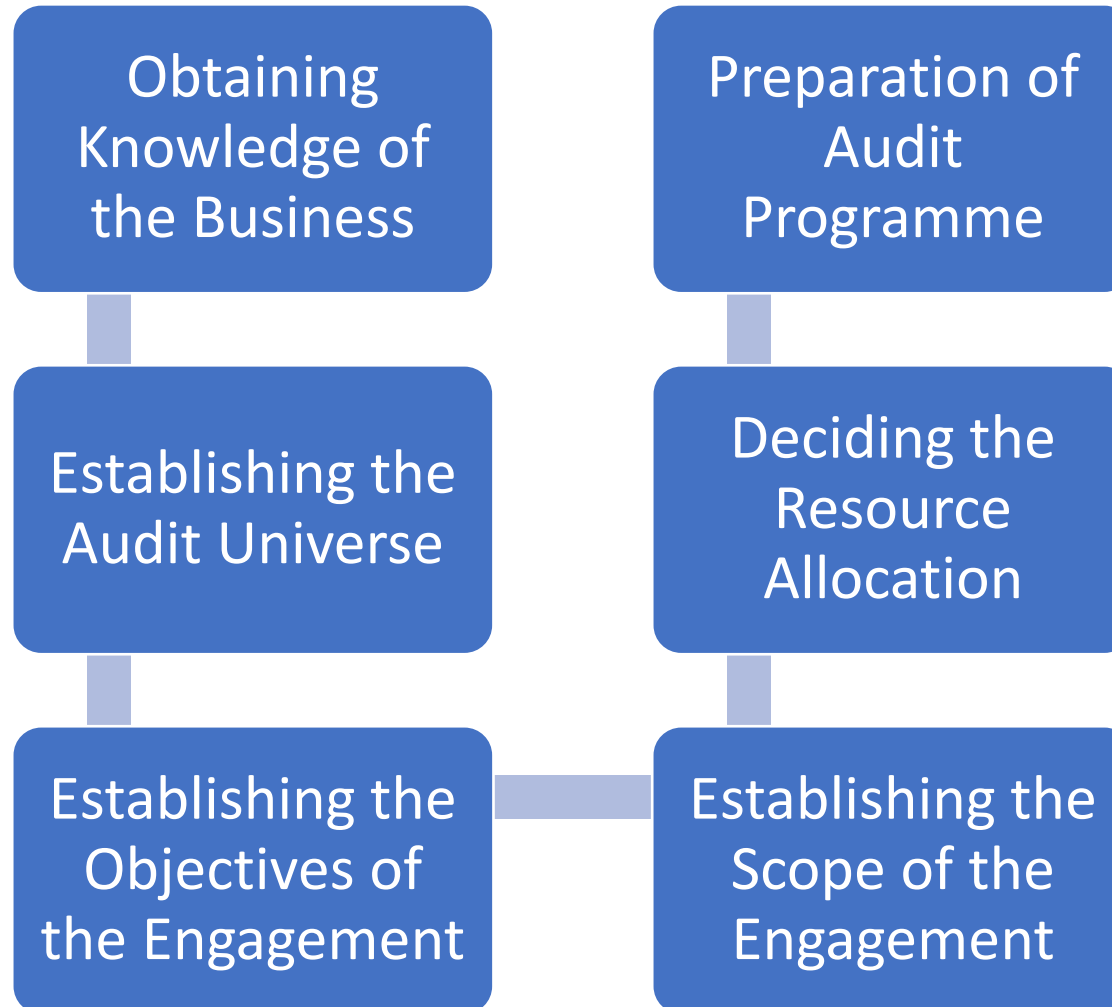
- Achievement of overall objectives of internal audit;
- Adequate skilled resources and expertise are in place and deployed well;
- Assignments are undertaken in a systematic, disciplined and professional manner;
- Quality of the work performed forms a sound basis for reporting;
- Work is conducted in conformance with the Standards on Internal Audit.

Requirement by Internal Auditor:

- Resourcing plan shall be prepared to ensure that the internal audit function has the required professional skills either internally/externally;
- Internal audit assignments shall be executed as per the documented internal audit process and audit process shall be adequately reviewed, monitored and supervised to achieve the planned objectives;
- Internal audit function shall have in place a formal quality evaluation and improvement program designed to ensure that all the internal audit activities undertaken by the function are conducted in conformance with the pronouncements and Standards on Internal Audit

SIA 220 – Conducting Overall Internal Audit Planning

Planning Process Chart:



SIA 220 – Conducting Overall Internal Audit Planning (Contd..)

Detailed Planning Process:

Obtaining Knowledge of the Business

- Previous experience
- Legislation and regulations
- Policy and procedures manual
- Minutes of the meetings
- Management reports
- Previous internal audit reports
- Newspaper/ industry journals
- Discussion with Those Charged with Governance
- Visits to entity's plant facilities

Establishing the Audit Universe

- Audit universe comprises the activities, operations, units etc., to be subjected to audit during the planning period.
- The audit universe and the related audit plan should also reflect the overall business objectives, changes in the management's course of action, corporate objectives, etc.
- The internal auditor should periodically, say half yearly, review the audit universe to identify any changes

Establishing the Objectives of the Engagement

Establishment of objectives should be based on:

- The auditor's knowledge of the client's business
- Review of the risks and controls associated with the activities forming subject matter of the internal audit engagement.

SIA 220 – Conducting Overall Internal Audit Planning (Contd..)

Detailed Planning Process:

Establishing the Scope of the Engagement

- The scope of the engagement should be sufficient in coverage
- Consider information gathered during the preliminary review
- If circumstances exist would restrict from carrying out the procedures, discuss the matter with the client to continue the engagement or not.
- The scope should be documented comprehensively
- System based audit tools should be clearly understood

Deciding the Resource Allocation

Internal auditor should prepare audit work schedule such as:

- Activities/ procedures to be performed
- Engagement team responsible for performing activities
- Time allocated to each of these activities

For preparing work schedule, internal auditor should have regard to:

- Any significant changes to the entity's missions and objectives or governance structure of the entity
- Composition of the engagement team in terms of skills & experience

Preparation of Audit Programme

Audit Programme should be to:

- Identifying and evaluating the risks associated with the audit.
- Identifying and selecting the audit procedures to be performed.
- Selection of audit tools / techniques for performing various audit procedures.
- Evaluating the adequacy and appropriateness of the evidence gathered.

SIA 230 – Objectives of Internal Audit

Functions:

- The objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.
- The activities of the internal audit function may include one or more of the following such as
 - Monitoring of internal control,
 - Examination of financial and operating information,
 - Review of operating activities,
 - Review of compliance with laws and regulations,
 - Risk management and governance etc.

SIA 240 – Using Work of an Expert

Independence and Objectivity of the Expert

The Internal Auditor should conduct procedures to assess the ability of the Expert to function in an independent and objective manner, such as the following:

- The Appointing and Supervisory Authority;
- Employee of the Company or External Service provider;
- Relationship of Expert;
- Personal Interests;

Qualifications and Credentials of the Expert:

The Internal Auditor shall independently validate the qualification and credentials of the Expert, with procedures, such as the following:

- Confirmation of educational and professional qualifications and membership of professional bodies;
- Background and reference checks of the experience and/or reputation of the Expert;
- Details of instances and nature of similar past assignments undertaken; and
- Self Certification by the Expert regarding his qualifications, expertise, any conflict of interest or any pending disciplinary actions.

SIA 250 – Communication with TCWG

Objectives:

The purpose of this standard is to:

- Provide a framework for continuous communication with those charged with governance (TCWG);
- Indicate the need to conduct such communication in a process driven manner; and
- Establish certain essential matters which should be communicated to those charged with governance.

The overall objective of this Standard on Internal Audit is to emphasise the need for a continuous dialogue and discussion on essential internal audit matters between the Internal Auditor and TCWG in a process driven manner and to ensure that this communication is independent, definite, effective and timely.

Requirements:

- Communication with TCWG shall be independent, objective, effective and timely through an established relationship. The Internal Auditor shall ensure that an effective communication is established and maintained with TCWG.
- The nature of communication is left to the professional judgements of the Internal Auditor and TCWG. However, a formal communication process, pre-agreed with TCWG, shall be put in place to facilitate effective and timely communication.
- Certain information considered important for communication is mandated by other SIA and laws and regulations, which shall be included in the list of essential matters for communication.

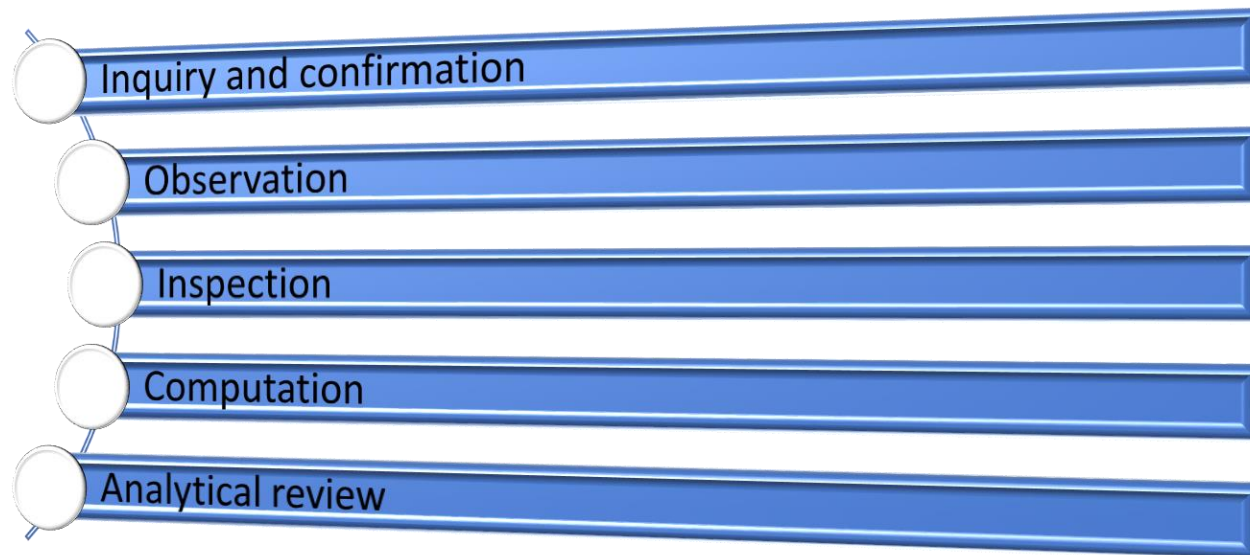
SIA 320 – Internal Audit Evidence

Requirement:

- Auditor shall obtain sufficient and appropriate audit evidence which can form the basis of audit findings and allow reliable conclusions to be drawn from those findings;
- Evidence shall be obtained from reliable sources with consistency between various evidences collected;
- Audit evidence collected shall be recorded and the internal audit function shall maintain a written process explaining the way in which audit evidence is to be gathered, reviewed, documented and stored

Obtaining Internal Audit Evidence

The internal auditor obtains evidence by performing one or more of the following procedures:



SIA 330 – Internal Audit Documentation

Requirement:

- Internal auditor shall record the nature, timing and extent of completion of all internal audit activities and testing procedures
- Documentation shall be complete and sufficient to support the analysis conducted on the audit evidence, the identification of findings, the formulation of audit observations and shall clearly state the purpose of the procedure, the source of evidence, the outcome of the audit work.
- The internal audit work paper files shall be completed prior to the issuance of the final internal audit report.
- The ownership and custody of the internal audit work papers shall remain with the Internal Auditor

SIA 330 – Internal Audit Documentation (Contd..)

Form and Content

- Documentation may be recorded on paper or on electronic or other media
- Internal audit documentation, however, is not a substitute for the entity's accounting records.
- Internal audit documentation should record:
 - Internal audit charter
 - A copy of the internal audit engagement letter (If Internal Audit is outsourced)
 - Internal audit plan
 - Nature, timing and extent of audit procedures performed
 - Conclusions drawn from the evidence
- Documentation should be sufficient to provide complete and detailed to provide overall understanding of the audit.
- Documentation should enable an experienced internal auditor (or a reviewer) to understand:
 - Nature, timing and extent of the audit procedures
 - Results of the audit procedures and audit evidence obtained
 - Significant matters arising during the audit and the Conclusions
 - Terms and conditions of an internal audit engagement

SIA 350 – Review and Supervision of Audit Assignments

Objectives:

- The objectives of review and supervision of audit assignments are to:
 - Confirm and update the audit assignment plan, including the planned audit procedures and the adequacy of the resources allocated;
 - Evaluate the audit procedures undertaken, evidence collected, proper documentation and conclusions drawn by the audit staff;
 - Help formulate the audit observations and draft the internal audit report; and
 - Establish that work performed is in conformance with the applicable pronouncements of the Institute of Chartered Accountants of India (ICAI).
- The overall objective of review and supervision of an audit assignment is to ensure the effective and efficient performance of the audit procedures in line with quality standards and to accomplish the objectives of the audit.

Requirements:

- The Chief Internal Auditor (or the Engagement Partner) has the overall responsibility of review and supervision of the nature, timing and extent of all internal audit activities and testing procedures, and to ensure that evidence collected is sufficient and reliable.
- The periodicity and extent of the review shall be planned and documented at the audit planning stage taking into account the overall audit objectives, proficiency of staff, time and budget constraints, as per the professional judgement of the Chief Internal Auditor or Engagement Partner.

SIA 350 – Review and Supervision of Audit Assignments (Contd..)

- A review of the audit workpapers shall be carried out to ensure that these are sufficient and appropriate to allow the reviewer to arrive at the same conclusions and formulate similar observations, as done by the audit staff. The documentation shall record the evidence of the supervision and review conducted, including the performance of any audit procedures subsequent to the review.
- The Internal Audit function (or out-sourced Firm) shall maintain a written process explaining the manner in which review and supervision shall be performed to ensure conformance to the quality as per Standards on Internal Audit.

SIA 360 – Communication with Management

Requirement: All communication shall be clear, appropriate and in line with the agreed process and timelines.

- Internal Auditor shall establish a written communication process and protocol with management;
- The process documentation shall outline - Modes and channels of communication, Periodicity and timelines for communication, Certain essential information required to be communicated and Where essential matters are concerned, any verbal communication should subsequently be confirmed in writing and maintained as audit documentation.

Establishing the Communication Process –

- Clear communication of the internal auditor's responsibilities
- The planned scope and timing of the internal audit
- The expected general content of communications helps establishing the basis for effective two-way communication

Forms of Communication –

- Structured presentations and written reports
- Less structured communications, including discussions

Timing of Communications - The appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by the management.

SIA 370 – Reporting Results

Objective: The objectives of issuing Internal Audit Reports on significant internal audit assignments is to:

- Share with the auditee, details of all significant findings;
- Allow management to understand the issues and take corrective actions;
- Provide a sound basis for any assurance being provided by the Internal Auditor.
- The overall objective of Reporting Results is to highlight the effectiveness of internal controls and risk management processes to enhance governance in line with the Internal Audit Charter.

Requirements: Internal Auditor shall issue a clear, well documented Internal Audit Report which includes the following:

- Objectives, scope and approach;
- Fact that an internal audit has been conducted in accordance the SIA;
- Executive summary of key observations;
- Summary of the corrective actions required;
- Nature of assurance.
- No internal audit report shall be issued in final form unless a written draft of the report has previously been shared with the auditee.
- The internal audit report shall be issued within a reasonable time frame from the completion of the internal audit work.

SIA 390 – Monitoring and Reporting of Prior Audit Issues

Objectives:

- The specific objectives of this Standard are to ensure:
 - Proper monitoring and closure of open issues from prior audits;
 - Independent validation of corrective actions taken by the auditee;
 - Escalation of any concerns in case of delays in closure of issues; and
 - Timely reporting of status to those charged with governance.
- The overall objective of this Standard is to ensure that the auditee mitigates the risks highlighted in the audit observations through timely corrective actions or that a conscious decision is taken to accept the risks.

Requirements:

- The Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues. This shall be done with a formal monitoring process. The responsibility to take action remains with the management.
- Sufficient and appropriate audit evidences shall be obtained, and documentation shall be maintained (or updated) to confirm either effective closure of the issue, or reasons for its delay or deferral.
- In case of delays or ineffective implementation of the corrective actions, the Internal Auditor shall escalate such delays and concerns to the management and the follow-up timelines may be reset, or the issue may be deferred to the next audit and a plan to carry-forward such audit recommendation(s) may be agreed upon with management.
- The internal auditor shall periodically report to the management, and the Audit Committee, the status of prior issues (generally in the form of an “Action Taken Report”).

SIA 520 – Internal Audit in IT Environment

Objectives:

- Audits are undertaken after due study and understanding of the Organisation's ITE, which covers the IT strategy, policies, operating procedures, the risks and governance mechanism in place to manage the ITE.
- An independent risk assessment, along with an evaluation of the controls required to mitigate those risks, forms the basis of the audit procedures
- The audit procedures, as designed and executed, are sufficient to allow an independent assurance, especially in the areas of (indicative list):
 - Security and reliability of information.
 - Efficiency and effectiveness of information processing.
 - Compliance of the IT related laws and regulations.

IT Environment – Matters to Consider

The internal auditor should consider the effect of an IT environment on the internal audit engagement:

- Extent to which the IT environment is used to record, compile, process and analyse information
- The system of internal control in existence in the entity with regard to:
 - The flow of authorised, correct and complete data to the processing centre
 - The processing, analysis and reporting tasks undertaken in the installation
 - The impact of computer-based accounting system on the audit trail that could otherwise be expected to exist in an entirely manual system

SIA 520 – Internal Audit in IT Environment (Contd..)

The nature of the risks and the internal control characteristics in IT environments include the following:

Lack of transaction trails

Uniform processing of transactions

Lack of segregation of functions

Potential for errors and irregularities

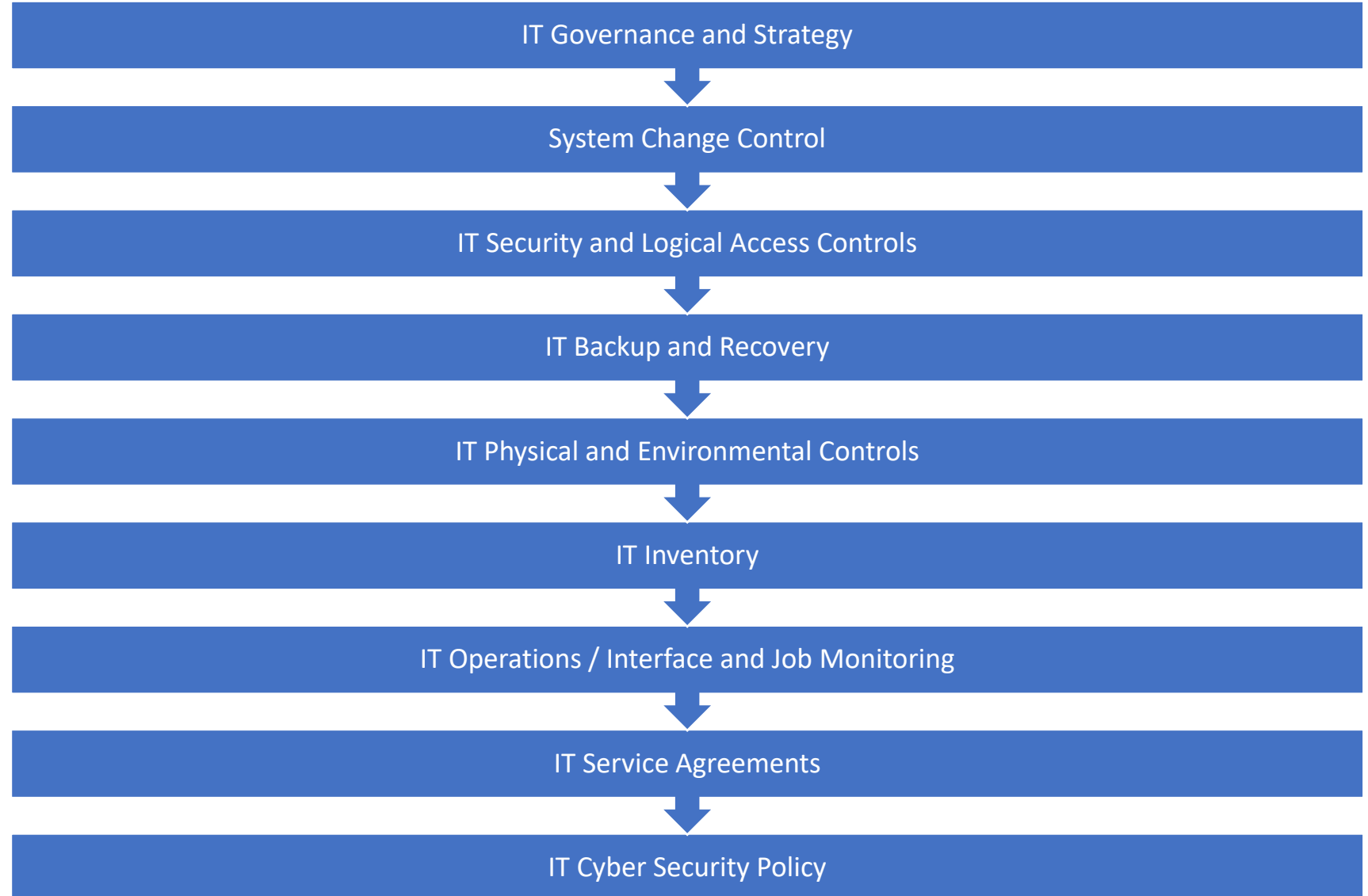
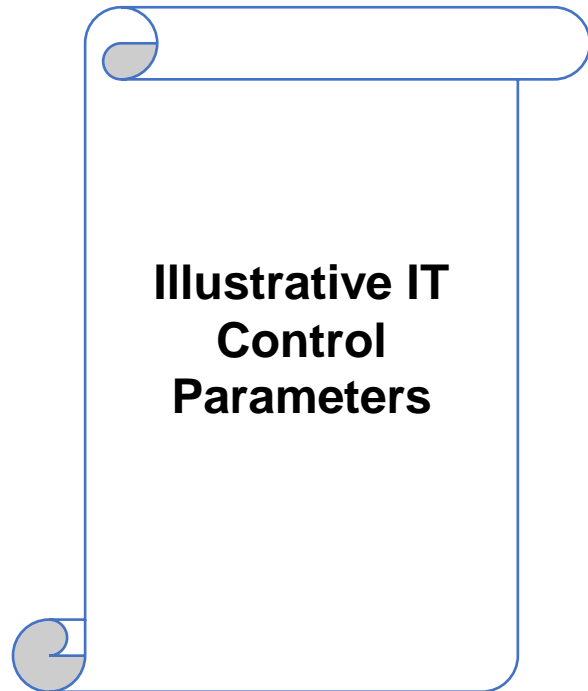
Initiation or execution of transactions

Dependence of other controls over computer processing

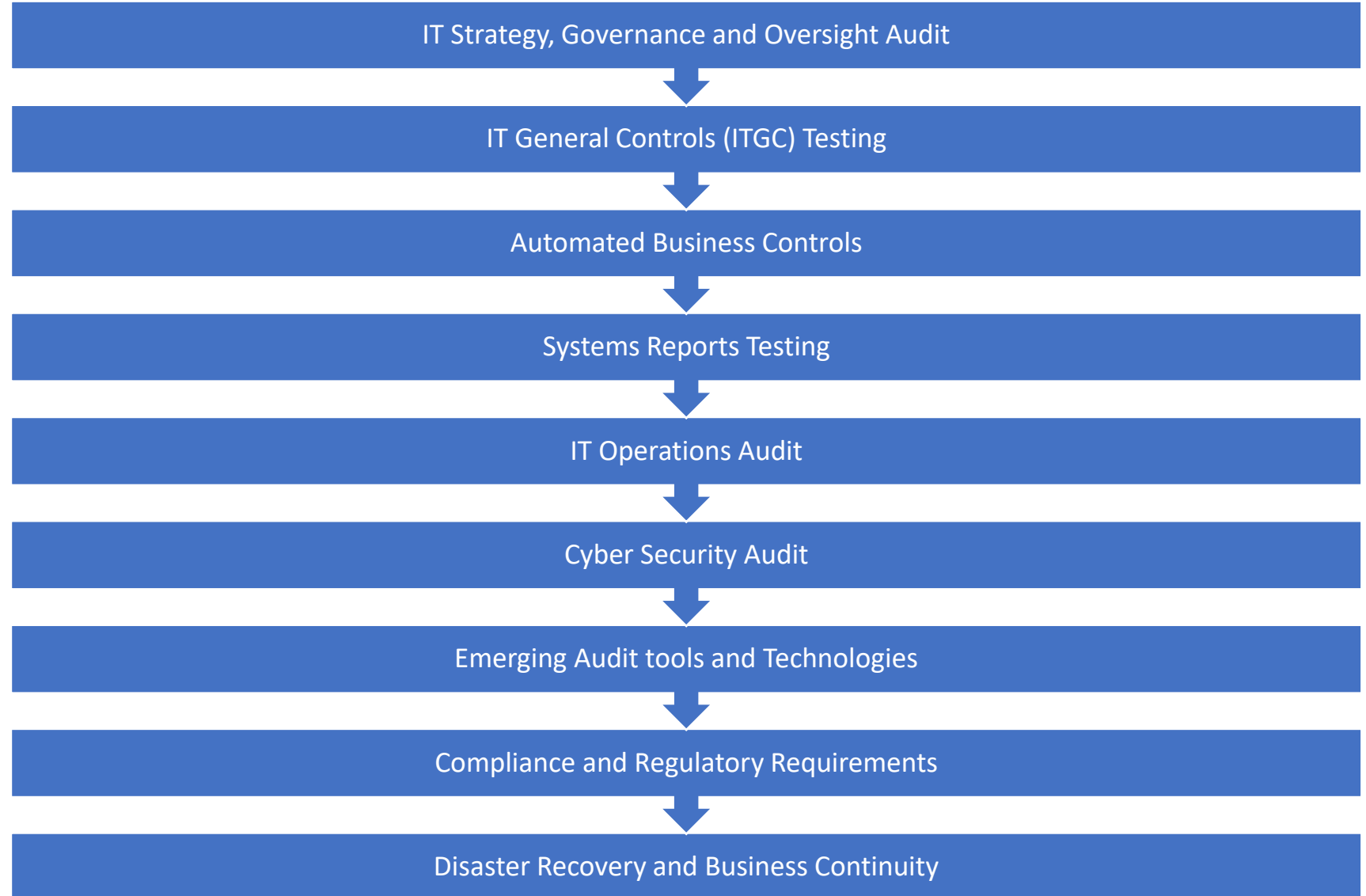
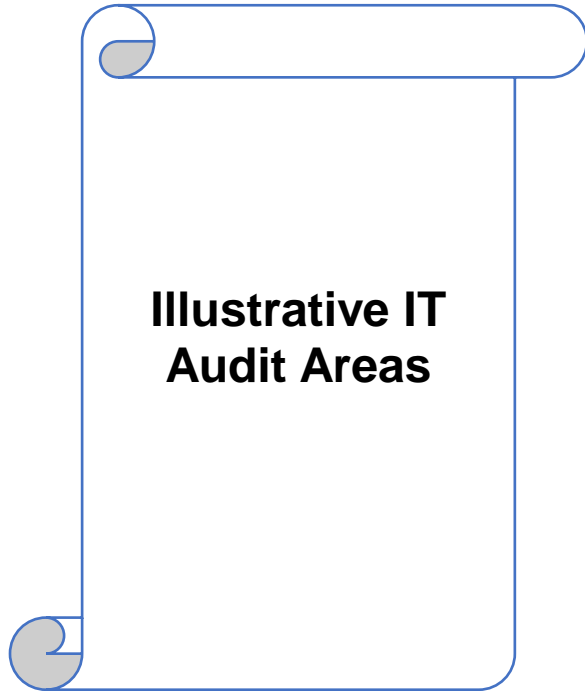
Potential for increased management supervision

Potential for the use of Computer-Assisted Audit Techniques (CAAT)

SIA 520 – Internal Audit in IT Environment (Contd..)



SIA 520 – Internal Audit in IT Environment (Contd..)



SIA 530 – Third Party Service Provider

Objectives:

- The primary objective of this Standard is to prescribe the key requirements for providing an independent assurance over business operations at third party service providers (TPSP). These requirements are in the nature of:
 - Assessment of risks associated with outsourcing, especially, in securing and protecting its information;
 - Evaluation of adequacy of controls to address risks of errors and irregularities with respect to financial, operational processing and reporting;
 - Cost and operational efficiencies in the collection, storage, processing and continuous availability of User Entities' information; and
 - Ensuring compliance with IT policies and standards, as well as contractual, statutory and regulatory requirements.
- To ensure quality independent audit reports on TPSP's Controls. These audit reports help the User Entity to develop a trust on the controls at the TPSP.
- To prescribe requirements for the Internal Auditor in evaluating the Third-Party Audit and Assurance (TPAA) Report provided by an Independent Auditor covering effectiveness of outsourced processes of TPSP.

SIA 530 – Third Party Service Provider (Contd..)

Requirements:

- The Internal Auditor shall study and evaluate the scope of TPSP's services, governance and oversight process in place to outsource and manage risks of deploying TPSPs, especially, risks arising from direct access and control over critical information of the User Entity.
- The Internal Auditor shall review both, the Pre-engagement and Post-engagement due diligence undertaken by the User Entity, including an assessment of the control environment at the TPSP.
- A periodic independent risk assessment of each third-party arrangement shall be conducted by the management and reviewed by the Internal Auditor to ensure adequate mitigation steps and control activities are designed, implemented, and operated effectively.
- The Internal Auditor shall conduct an independent audit of the TPSP (where permissible), which shall include TPSPs' entity's level controls, IT controls and process controls.

SIA 5 – Sampling

When designing an audit sample, the internal auditor should consider:

- Specific audit objectives
- Population of the sample
- Stratification (a process of dividing a population into sub-populations, each of which is a group of sampling units having similar characteristics)

Sample Size

- When determining the sample size, the internal auditor should consider
 - **Sampling risk**
 - **Tolerable error**
 - **Expected error**

Selection of the Sample:

- Sample should be selected in such a manner that it can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.

“The lower the risk that the internal auditor is willing to accept, the greater the sample size needs to be”

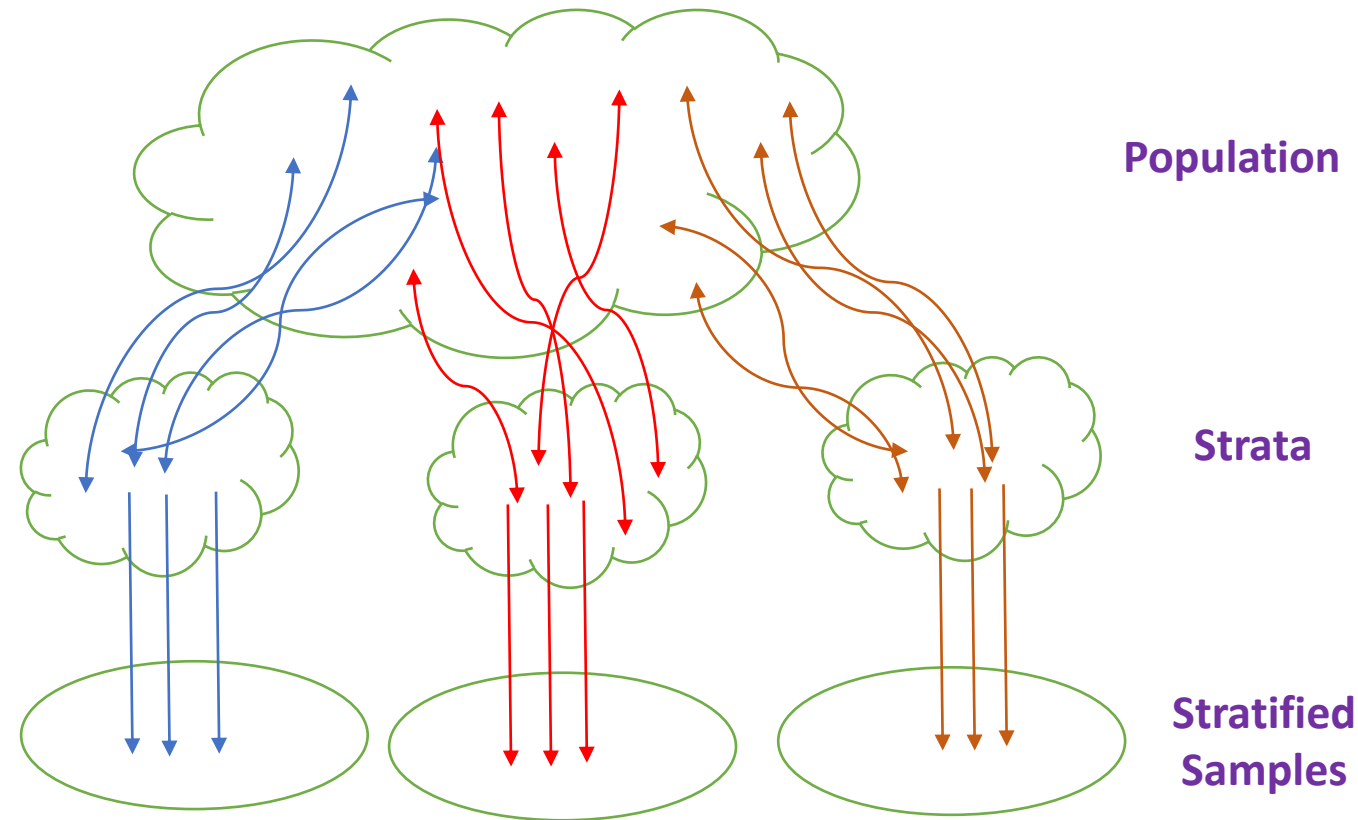
SIA 5 – Sampling (Contd..)

Three methods of Sample selection:

- Random selection and use of CAATs
- Systematic selection
- Haphazard selection

Evaluation of Sample Results, the auditor should:

- Analyse the nature and cause of any errors detected in the sample;
- Project the errors found in the sample to the population;
- Reassess the sampling risk; and
- Consider their possible effect on the specific internal audit objective and on other areas of the internal audit engagement.



Documentation includes design of the sample, expected rate of error, sampling risk and the tolerable error, nature and cause of errors, Rationale for using a particular sampling technique, Effect of the sample results, Projection of sample results.

SIA 6 – Analytical Procedures

Nature and Purpose of Analytical Procedures

- Analytical procedures include the consideration of comparisons of the entity's financial and non-financial information
- Analytical procedures also include consideration of relationships - Among elements of financial information, Between financial information and relevant non-financial information
- Analytical procedures may be applied to consolidated financial statements, financial statements of components and individual elements of financial information and relevant non-financial information
- In determining the extent to which the analytical procedures should be used, the internal auditor should consider the factors including:
 - The significance of the area
 - The adequacy of the system
 - The availability and reliability of financial and non-financial information
 - The precision of prediction of results of analytical procedures
 - The availability and comparability of organizational information
 - The extent to which other auditing procedures provide support for audit results

Analytical Procedures as Risk Assessment Procedures & in Planning the Internal Audit

- The internal auditor should apply analytical procedures as risk assessment procedures to obtain an understanding of the business, the entity and its environment and in identifying areas of potential risk.

SIA 7 – Quality Assurance in Internal Audit

- This Standard on Internal Audit shall apply whenever an internal audit is carried out, whether carried out by an in-house internal audit department or by an external firm of professional accountants.
- The objective of this standard is that:
 - The internal audit should provide reasonable assurance
 - The internal auditors comply with professional Standards, regulatory and legal requirements, so that the reports issued by them are appropriate in the circumstances.
- In the case of the in – house internal audit or a firm carrying out Internal audit, it should ensure that the system of quality assurance include policies and procedures addressing each of the following elements:
 - Leadership responsibilities for quality in internal audit
 - Ethical requirements
 - Acceptance and continuance of client relationship and specific engagement, as may be applicable
 - Human resources
 - Engagement performance
 - Monitoring

SIA 11 – Consideration of Fraud in Internal Audit

- A fraud normally occurs in situations where there is an incentive or a pressure to commit fraud, an opportunity to commit fraud or a rationalization for committing fraud
- An internal auditor is not expected to possess skills and knowledge of a person expert in detecting and investigating frauds, he should, however, have reasonable knowledge of factors that might increase the risk of opportunities for frauds in an entity and exercise reasonable care and professional skepticism while carrying out internal audit.

It is essential for the internal auditor to gain an understanding of the components of the system of internal control.

Responsibility of Internal Auditor: the primary responsibility for prevention and detection of frauds is that of the management of the entity. The internal auditor should, however, help the management fulfill its responsibilities relating to fraud prevention and detection.

Communication of Fraud: Auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action.

Documentation: The internal auditor should document fraud risk factors identified as being present during the internal auditor's assessment process and document the internal auditor's response to any other factors.

Identification of fraud

W I L L

LET ALL MEN KNOW THAT I, Shri. Laxmichand Rupamlal Shah, aged about 70 years make this my last Will which shall supersede all my previous Wills. Upon my death, I would like to bequeath and distribute all my assets and properties (except jewelry and some bank deposits) to my Son, Shri. Vishwapratap Laxmichand Shah. All my jewelry of 2.350 Kgs certified by BIS gold-hallmark and bank deposit with ICICI Bank of ₹ 35,000/- (apprx.) shall be bequeathed by my daughter Smt. Palguni L. Shah (residing at 2-34, Bazar Gate Street, Opp. C. Shivaji Terminus). Advocate Mr. Navroz Pagdiwala (23, Bazargate street, Fort, Mumbai 400001, Phone: 2373586) shall be sole executor of my Will.

Sign : L. R. Shah
Name : Laxmichand R. Shah
Place : Delhi, Date : 28th February, 1958.
PAN : ABVPS7264J;
Address : 23, Club Building, Ber Sarai Market, Next to UTI Bank, Opp. JNU Campus, New Delhi 110001.

Witness : Khanna Name : Shri. V. S. Khanna.
Address : 34/C, South Block, Raisina Hill, New Delhi - 110001.

SIA 18 – Related Parties

Related Party Transactions

- A related party transaction is a transfer of resources, services or obligations between an entity and a related party, regardless of whether price is charged or not.
- Transactions may include borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates, buying/ selling transactions at a price that differs significantly from its appraised value, exchanging property for similar property, making loans with no scheduled terms of repayment, granting of a guarantee without adequate compensation.
- Transactions with related party may have been motivated solely for lack of sufficient working capital or credit to continue the business, an urgent desire for a continued favorable earnings, an overly optimistic earnings forecast, excess capacity, significant litigation, a declining industry characterized by a large number of business failures, significant technology obsolescence.

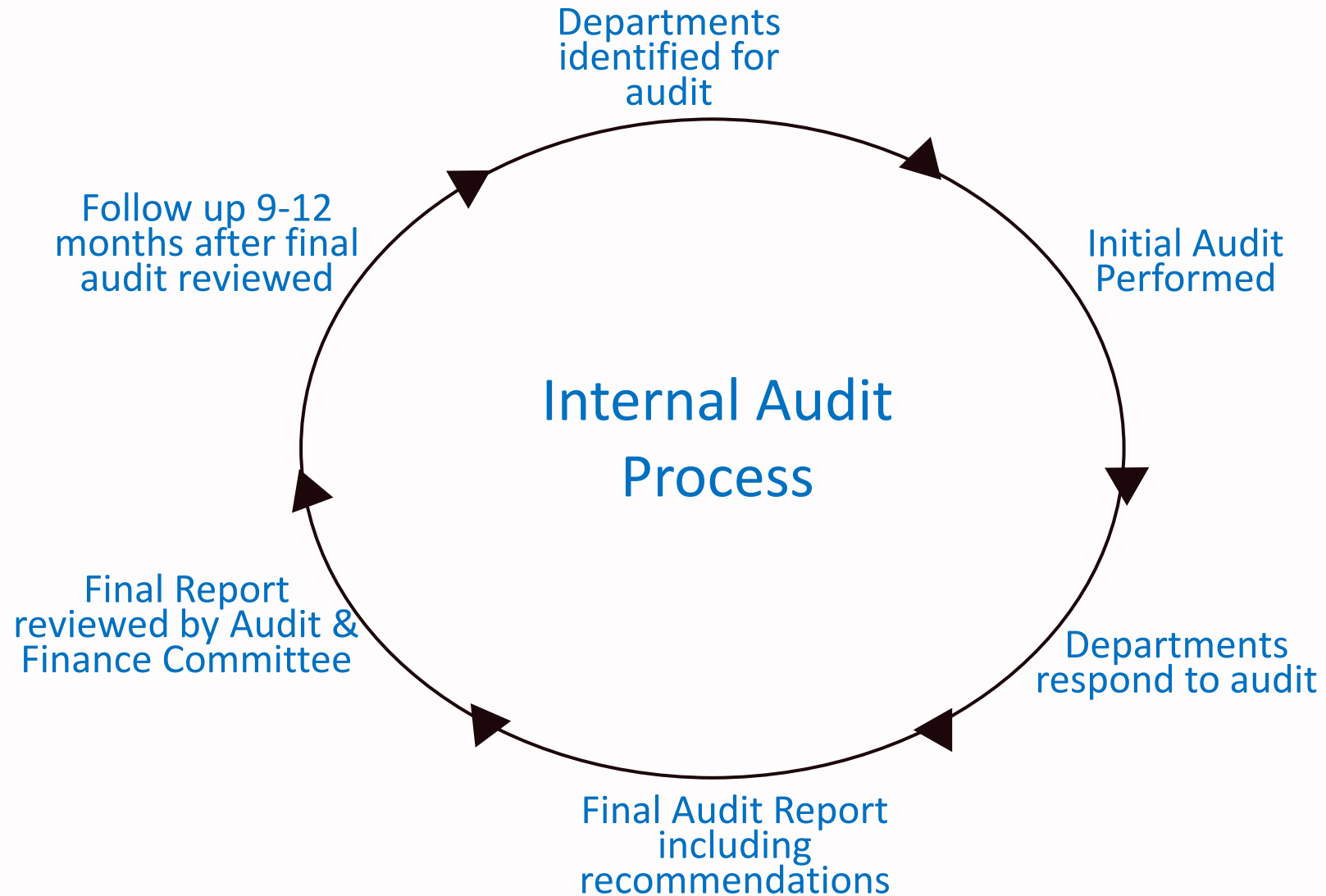
Internal Audit Procedures for Related Party Transactions:

- The internal auditor shall gather the following information pertaining to related party relationships and transactions:
 - The identity of the entity's related parties including changes from the prior period
 - The nature of the relationships between the entity and these related parties
 - Whether the entity has entered into any transaction with these related parties during the period and, if so, the nature and extent, and the purpose of the transaction

SIA 18 – Related Parties (Contd..)

- With regard to significant related party transactions outside normal course of business, the internal auditor should inspect underlying contracts or agreements, if any, and evaluate whether:
 - Rationale suggests possible fraudulent financial reporting or concealment of misappropriated assets
 - Terms are consistent with management's explanations
 - Transactions are accounted for and disclosed in accordance with the generally accepted accounting principles
 - Ensure transactions have been appropriately authorized and approved
- The internal auditor should obtain sufficient appropriate audit evidence about management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an **arm's length transaction**.
- The internal auditor should consider the following matters:
 - Document the names of the identified related parties and the nature of the related party relationships
 - Communicate with those charged with governance, or relevant committee thereof, such as, audit committee, any significant matters arising during the internal audit in connection with related parties
- The internal auditor should consider the impact on the internal audit report if it is not possible to obtain sufficient appropriate audit evidence concerning related parties and transactions and should suitably disclose it in the internal audit report, based on its materiality.

Internal Audit Process



Effective Management of Internal Audit Function

Following are some of the events which should be planned for Effective Management of Audit Function:


- Audit Kick Off Meeting;
- Walkthrough Commencement;
- Data Requirement Roll Out;
- Data Availability From Client;
- Data Analytics & Sampling;
- Audit Execution;
- Regular Status Updates to client;
- Interim Review - Feedback Meeting;
- Queries Discussion;
- Draft & Final Report Preparation, Review & Submission;
- Draft & Final Report Discussion;
- Audit Closing Meeting;
- Audit Committee Reporting




Internal Audit Report

Flow of Internal Audit Reports


(a) An overview of the objectives, scope and approach of the audit assignments;



(b) The fact that an internal audit has been conducted in accordance with Standards on Internal Audit;



(c) An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;



(d) A summary of the corrective actions required (or agreed by the Management) for each observation; and

Typical Elements in Internal Audit Reports

01

- ▶ Title Page
- ▶ Addressee
- ▶ Report Distribution List
- ▶ Period of Audit Covered

02

- ▶ Table Of Contents

03

Executive Summary:

- ▶ Report Rating
- ▶ Audit Issues
- ▶ Status of Management Remediation Plan

04

Audit Issues Highlighting:

- Synopsis of the Findings
- Detailed Observations
- Root Cause of Issue
- Business Impact/Risk
- Issue Severity – Risk
- Rating Recommendations
- Management Comments
- Issue Owner
- Target Date of Action

05

Annexures of the Findings

Opening / Introductory Paragraphs and Scope Paragraph



Opening / introductory paragraph should comprise of the following:

- Background of the Company / entity
- Identification of process and items of controls / business cycles being
- Statement of responsibility of the entity's management and responsibility of the internal auditor.

Scope Paragraph should comprise of the following:

- Reference to the generally accepted audit procedures in India / overseas as applicable
- Description of the audit engagement background and the methodology of the internal audit
- Description of the population and the sampling technique used
- Limitation in scope / exclusions, if any.



Detailed Report – features of the observations

Criteria

What is the standard that was not met?

The standard may be a company policy or other regulatory guideline. expectations used in making an evaluation

Condition

The factual evidence as to what was found

Cause

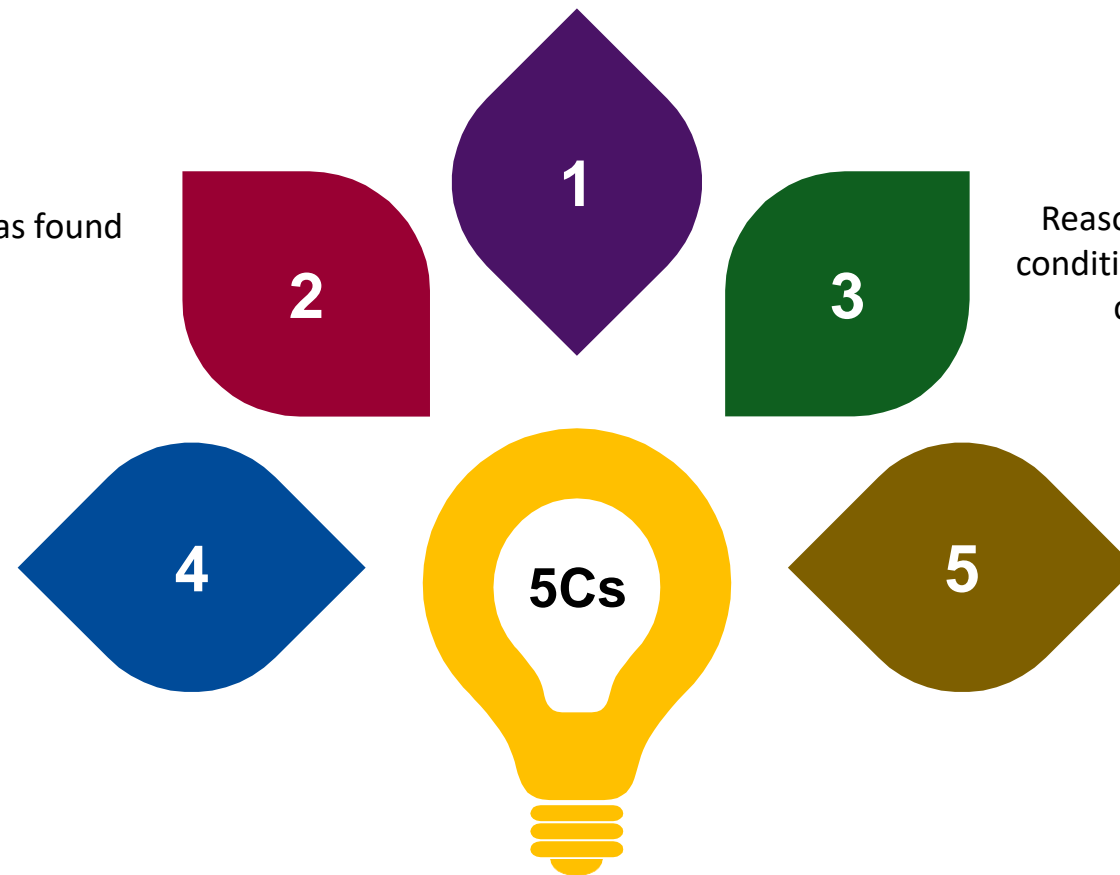
Reason for difference between criteria & condition [lack of controls, circumvention of controls or external influences]

Consequences

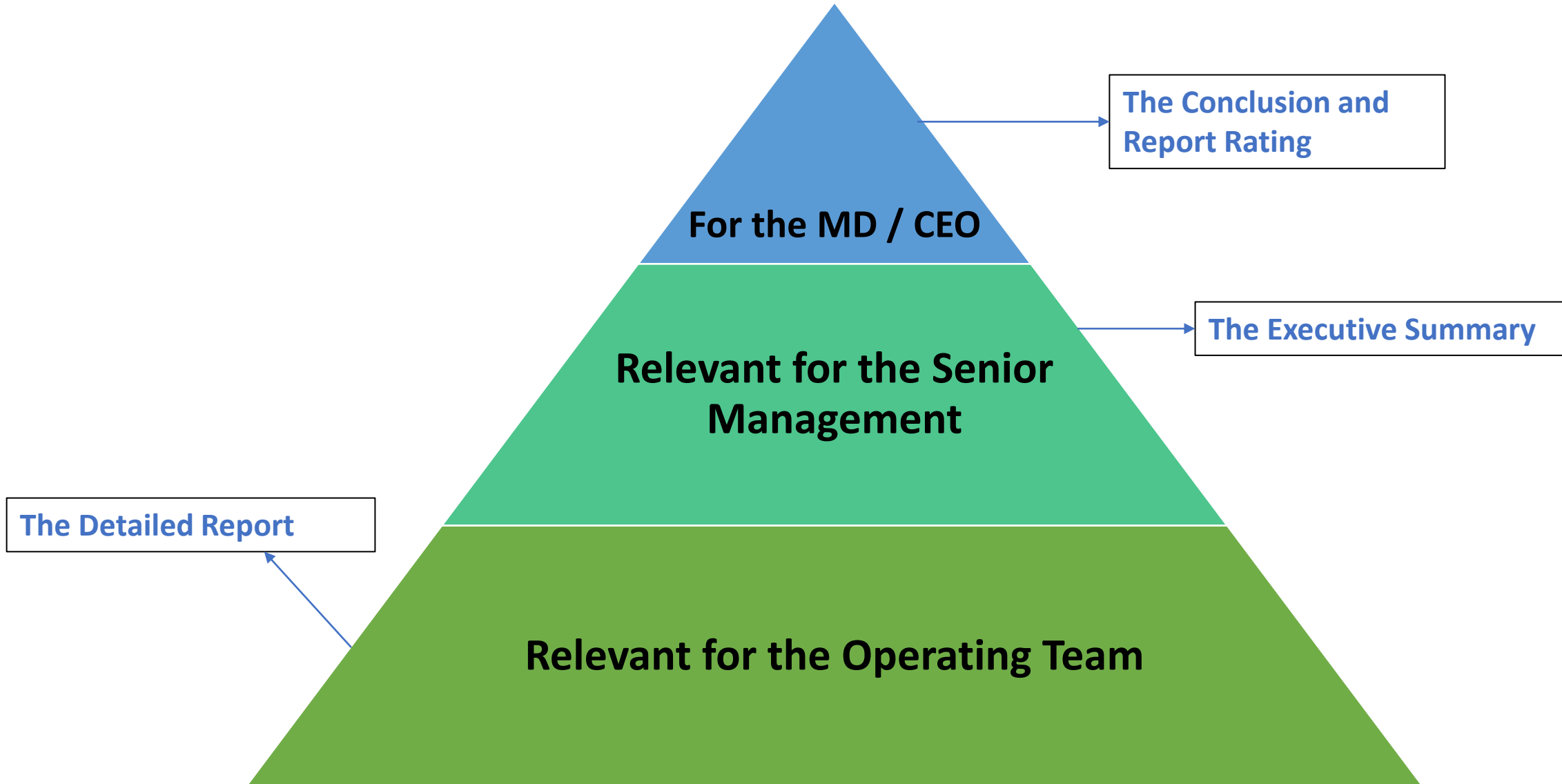
Difference between condition and criteria [impact on the individual, business unit and company as a whole, quantify the impact]

Corrective Action

Action that must be taken to correct to rectify the finding / observation



One Report – Many Purposes



5 C's in Report Writing – Case Study

Observation To Contain 5Cs	Observation to answer the following	Example
Criteria	What is the standard?	Variation in stock on physical verification with the balance as reflected in the stock register should be NIL.
Condition	What is wrong?	The stock physically verified was short by 5045 units as against the balance shown in the stock register.
Cause	Why is it wrong?	Issues made during the night shift were not recorded.
Consequences	What is the risk / impact?	The stock position in the books is overstated and the possibility of stock pilferage is high due to lack of control.
Corrective Action	What should be done? /How to correct?	<p>The corrective actions should be suggested in two phases which is generally the one-time corrective action and long-term preventive actions to mitigate the risk at a control level.</p> <p>Night shift stock keeper needs to be appointed.</p> <p>Alternatively, the requirement of stock for the night shift should be issued at day end as per the requisition of the production in charge for the night shift.</p> <p>The consumption during night shift is verified by counting in the morning the balance stock left out of the lot issued to the floor during the previous days close.</p>

Internal Audit Reports

Risk Rating

High (H)	Represents critical control weaknesses requiring prompt action to mitigate information systems or business process vulnerabilities. Adequate compensating controls do not exist to mitigate risk exposure or may not be sufficient given the impact of a risk occurrence should it occur. Regulatory non-compliances involving penalties/prosecutions are also included in this category.
Medium (M)	Represents moderate control weaknesses requiring near-term management focus to strengthen existing controls. Some compensating controls are present, but additional controls are necessary to further mitigate risk exposure.
Low (L)	Represents minor control weaknesses requiring management focus to enhance existing controls. Compensating controls are present to mitigate exposure (or if not, the impact of a risk occurrence is minor), but opportunities exist to enhance controls or improve operating efficiency.

Risk Category

Operational (O)	Effectiveness and efficiency of operations.
Financial (F)	Reliability of financial reporting / financial impact.
Compliance (C)	Compliance with applicable laws and regulations.
Process Improvement (PI)	Scope of improvement in the business process.

Essentials of a Good Internal Audit Report

Accurate	Objective	Clear	Concise	Constructive	Complete	Timely
Free from errors and distortions and faithful to the underlying facts	Fair, impartial, and unbiased and is a result of a fair-minded and balanced assessment of all relevant facts and circumstances	Easily understood and logical, avoiding unnecessary technical language and providing all significant and relevant information	To the point, avoid unnecessary elaboration, superfluous detail, redundancy, repetitiveness and wordiness	Helpful to the auditee /client and the organization and leads to improvements where needed	Lacking nothing that is essential to the target audience and includes all significant and relevant information and observations to support Recommendations and conclusion	Opportune and expedient, depending on the significance of the issue, allowing management to take appropriate corrective action

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Thank you