

STANDARD ON INTERNAL AUDIT (SIA) 1

PLANNING AN INTERNAL AUDIT*

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The following is the text of the Standard on Internal Audit (SIA) 1, *Planning an Internal Audit*, issued by the Council of the Institute of Chartered Accountants of India. These Standards should be read in conjunction with the *Preface to the Standards on Internal Audit*, issued by the Institute.

In terms of the decision of the Council of the Institute of Chartered Accountants of India taken at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standards shall become mandatory from such date as notified by the Council.

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Objectives of Planning

1. The purpose of this Standard on Internal Audit is to establish standards and provide guidance in respect of planning an internal audit. An internal audit plan is a document defining the scope, coverage and resources, including time, required for an internal audit over a defined period. The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner. Adequate planning ensures that appropriate attention is devoted to significant areas of audit, potential problems are identified, and that the skills and time of the staff are appropriately utilised. Planning also ensures that the work is carried out in accordance with the applicable pronouncements of the Institute of Chartered Accountants of India.
2. The overall objectives of an internal audit, as defined in the Preface to the Standard
 - to suggest improvements to the functioning of the entity; and
 - to strengthen the overall governance mechanism of the entity, including its strategic risk management as well as internal control system.
3. Internal audit, therefore, helps inter alia in:
 - (i) Understanding and assessing the risks and evaluate the adequacies of the prevalent internal controls.
 - (ii) Identifying areas for systems improvement and strengthening controls.
 - (iii) Ensuring optimum utilisation of the resources of the entity, for example, human resources, physical resources etc.
 - (iv) Ensuring proper and timely identification of liabilities, including contingent liabilities of the entity.

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- (v) Ensuring compliance with internal and external guidelines and policies of the entity as well as the applicable statutory and regulatory requirements.
 - (vi) Safeguarding the assets of the entity.
 - (vii) Reviewing and ensuring adequacy of information systems security and control.
 - (viii) Reviewing and ensuring adequacy, relevance, reliability and timeliness of management information system.
4. The internal audit plan should be comprehensive enough to ensure that it helps in achieving of the above overall objectives of an internal audit. The internal audit plan should, generally, also be consistent with the goals and objectives of the internal audit function as listed out in the internal audit charter as well as the goals and objectives of the organisation. An internal audit charter is an important document defining the position of the internal audit vis a vis the organisation. The internal audit charter also outlines the scope of internal audit as well as the duties, responsibilities and powers of the internal auditor(s). In case the entire internal audit or the particular internal audit engagement has been outsourced, the internal auditor should also ensure that the plan is consistent with the terms of the engagement.
5. Planning involves developing an overall plan for the expected scope and conduct of audit and developing an audit programme showing the nature, timing and extent of audit procedures. Planning is a continuous exercise. A plan once prepared should be continuously reviewed by the internal auditor to identify any modifications required to bring the same in line with the changes, if any, in the audit environment. However, any major modification to the internal audit plan should be done in consultation with those charged with governance. Further, the internal auditor should also document the changes to the internal audit plan.
6. The internal auditor may also discuss the significant elements of his overall plan, including important procedures, with those charged with

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governance. This would help the internal auditor as well as the client to assess whether the internal audit is directed to achieve the objectives as set out in the terms of engagement. The discussion would also help the internal auditor to gauge whether the client's perception of the role and responsibilities of the internal auditor is appropriate. The internal auditor should also assess the client expectations as to the assurance level on different aspect of entity's operations and controls. For instance, the client may feel assured if inventories are verified once in a quarter, while for cash verification, monthly interval may be specified. This will enable the auditor to plan the frequency and extent of audit procedures to be adopted.

Factors Affecting the Planning Process

7. The internal audit plan should be based on the knowledge of the entity's business. While developing the internal audit plan, the internal auditor should have regard to the objectives of the internal audit engagement as well as the time and resources required for conducting the engagement. In addition, the internal audit plan should also reflect the risk management strategy of the entity. Planning an internal audit involves establishing the overall strategy for the engagement so as to keep the risks associated with the assignment at the acceptable level. Therefore, the planning process is also influenced by the internal auditor's understanding and assessment of:
 - The objectives of the activity being subjected to internal audit.
 - The significant risks associated with the above activity.
 - The risk management and internal control system instituted in the organisation to reduce the above risks to an acceptable level.
 - The possible areas in which the internal audit can suggest improvement to the risk management and/ or internal control system associated with the concerned activity.

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- The selection of engagement team (including, where necessary, the engagement team quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members.
- Business developments affecting the entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.
- Industry developments such as changes in industry regulations and new reporting requirements.
- Changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

Scope of Planning

8. Internal audit plan should cover areas such as:
 - Obtaining the knowledge of the legal and regulatory framework within which the entity operates.
 - Obtaining the knowledge of the entity's accounting and internal control systems and policies.
 - Determining the effectiveness of the internal control procedures adopted by the entity.
 - Determining the nature, timing and extent of procedures to be performed.
 - Identifying the activities warranting special focus based on the materiality and criticality of such activities, and their overall effect on operations of the entity.
 - Identifying and allocating staff to the different activities to be undertaken.

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- Setting the time budget for each of the activities.
- Identifying the reporting responsibilities.

The internal audit plan should also identify the benchmarks against which the actual results of the activities, the actual time spent, the cost incurred would be measured.

9. The scope of an internal audit is normally affected by factors such as:

- Terms of the engagement.
- Nature of accounting system – manual or IT-based - and the degree of reliance placed by the auditor on the same.
- Accounting policies adopted by the entity.
- Nature of information technology system used by the client in the various business processes and the exception reports generated by the system.
- Authorization and delegation of authority in the systems environment and data entry checks and data security measures including generation of day end logs of security and authorisation violations.
- The nature of management information system in vogue and the extent to which the management information system reports are used by the client in establishing and reviewing internal controls.
- Expected audit coverage, including identification of areas of audit requiring special attention, number and locations to be included, nature of business segments to be audited and the need, if any, for specialized knowledge.
- Materiality thresholds established in respect of various areas of audit especially, those areas requiring special attention.
- Nature and extent of audit evidence to be obtained.

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- Experience and skills of the staff and the need for supervising, directing, coordinating and reviewing their work.
- Requirements of the applicable pronouncements of the Institute of Chartered Accountants of India.
- Statutory or regulatory framework in which the entity operates.

Planning Process

Obtaining Knowledge of the Business

10. The internal auditor should obtain a level of knowledge of the entity sufficient to enable him to identify events, transactions, policies and practices that may have a significant effect on the financial information. Following are some of the sources wherefrom the internal auditor can obtain such knowledge:
 - Previous experience, if any, with the entity and the industry.
 - Legislation and regulations that significantly affect the entity.
 - Entity's policy and procedures manual.
 - Minutes of the meetings of the shareholders, board of directors, and important committees of the board such as the audit committee, remuneration committee, shareholders' grievances committee.
 - Management reports/ internal audit reports of prior periods.
 - Newspaper/ industry journals.
 - Discussion with client's management and staff.
 - Visits to entity's plant facilities etc., to obtain first hand information regarding the production processes of the entity.
 - Visits to the entity's department where the accounting and other documents are generated, maintained, and the administrative procedures followed.

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- Other documents produced by the entity, for example, material sent to the shareholders and the regulatory authorities, management policy manuals, manuals relating to accounting and internal controls, organizational charts, job description charts, etc.

Knowledge of the entity's business, among other things, helps the internal auditor to identify areas requiring special focus, evaluate the appropriateness of the accounting policies and disclosures, accounting estimates and management representations. Knowledge of the business would also help the auditor to identify the priorities of the business, critical factors or constraints in the smooth running of the business as also understand the trends in respect of various financial and operating ratios, etc.

Establishing the Audit Universe

11. The next step in audit planning is establishment of the audit universe or the audit territory. Audit universe comprises the activities, operations, units etc., to be subjected to audit during the planning period. The audit universe is designed to reflect the overall business objectives and therefore includes components from the strategic plan of the entity. Thus, the audit universe is affected by the risk management process of the client. The audit universe and the related audit plan should also reflect changes in the management's course of action, corporate objectives, etc.
12. As discussed in paragraph 4, planning is a continuous exercise. The internal auditor should periodically, say half yearly, review the audit universe to identify any changes therein and make necessary amendments, to make the audit plan responsive to those changes.

Establishing the Objectives of the Engagement

13. The next stage in planning is establishing the specific objectives of the internal audit engagement. The establishment of such objectives should be based on the auditor's knowledge of the client's business, especially a preliminary understanding and review of

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the risks and controls associated with the activities forming subject matter of the internal audit engagement. The preliminary understanding and review involves gathering necessary information by means of a combination of the following procedures:

- Observation of the activity being performed.
- Inquiry of the staff associated with performing the activity.
- Discussion with the client.
- Reading through the internal audit reports, management reports etc., of previous periods.
- Performing analytical procedures.
- Performing actual walk-through tests.

14. The internal auditor would use the information so gathered to determine the objective(s) of the engagement as also to decide the nature, timing and extent of his procedures. The internal auditor should also document the results of his preliminary review so conducted. The documented results would, normally, cover aspects such as:

- Preliminary assessment and understanding the risks and controls associated with the activity, viz., sufficiency and appropriateness of the controls, procedures for identification and management of risks associated with the activity.
- Significant issues thrown up by such a review, for example, significant errors, non-compliance with any significant law.
- Procedures proposed to be adopted by the internal auditor to resolve the above issues.
- Preliminary time budget for completing the engagement.

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Establishing the Scope of the Engagement

15. The next stage in planning an internal audit is establishing the scope of the engagement. The scope of the engagement should be sufficient in coverage so as to meet the objectives of the engagement. The internal auditor should consider the information gathered during the preliminary review stage to determine the scope of his audit procedures. The nature and extent of the internal auditor's procedures would also be affected by the terms of the engagement. In case the internal auditor is of the view that circumstances exist which would restrict the auditor from carrying out the procedures, including any alternative procedures, considered necessary by him, he should discuss the matter with the client to reach a conclusion whether or not to continue the engagement. The scope of his engagement should be documented comprehensively to avoid misunderstanding on the areas covered for audit. The internal auditors are often confronted with a situation where client denies access to certain information or has a negative list of areas where internal audit is not desired. There are also situations where while the client requires internal audit procedures to be carried but findings are not to form part of the report but to be reported separately.
16. Further, in case of information technology based environment, the scope of engagement would include the extent to which internal auditor are permitted to access the system and reports which can be viewed and those which can be exported. Further, system based audit tools that an internal auditor can use to draw and analyze the data should be clearly understood in the scope of his engagement.

Deciding the Resource Allocation

17. Once the scope of the internal audit procedures is established, the next phase is that of deciding upon the resource allocation. Efficient resource allocation is essential to achieve the desired objective, within the constraints of time and cost as well as optimum utilization of resources. For this purpose, the internal auditor should prepare an audit work schedule, detailing aspects such as:

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- activities/ procedures to be performed;
- engagement team responsible for performing these activities/ procedures; and
- time allocated to each of these activities/ procedures.

18. While preparing the work schedule, the internal auditor should have regard to aspects such as:

- any significant changes to the entity's missions and objectives, business processes, and management's strategies to counter these changes, for example, changes in the entity's controls structure or changes in the risk assessment and management structures
- any changes or proposed changes to the governance structure of the entity
- composition of the engagement team in terms of skills and experience and any changes thereto

The engagement work schedule should, however, be flexible enough to accommodate any unanticipated changes as well as professional judgment of the engagement team in the components of the audit universe as discussed above. The work schedule should also reflect the internal auditor's assessment of risks associated with various areas covered by the particular internal audit engagement and the priority attached thereto.

Preparation of Audit Programme

19. The internal auditor should also prepare a formal internal audit programme listing the procedures essential for meeting the objective of the internal audit plan. Though the form and content of the audit programme and the extent of its details would vary with the circumstances of each case, yet the internal audit programme should be so designed as to achieve the objectives of the engagement and also provide assurance that the internal audit is carried out in accordance with the Standards on Internal

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Audit. As a corollary, the audit plan developed by the internal auditor would need to be a risk-based plans, appropriately reflecting and addressing the priorities of the internal audit activity, consistent with the organisation's goals. The internal audit programme should also be finalised in consultation with the appropriate authority before the commencement of the work. The internal audit programme identifies, in appropriate details, the objectives of the internal audit in respect of each area, the procedures to be performed to achieve those objectives, the staff responsible for carrying out the particular activity, the time allocated to each activity as also the sufficiently detailed, instructions to the staff as to how to carry out those procedures. The internal audit programme may also have provision for information such as the procedures actually performed, reasons for not performing the originally identified procedures, actual time consumed in carrying out the relevant procedure, reasons for deviations from budgeted time etc. A well prepared, comprehensive audit programme helps proper execution of the work as well as of the proper supervision, direction and control of the performance of the engagement team.

Effective Date

20. This Standard on Internal Audit is applicable to all internal audits commencing on or after Earlier application of the SIA is encouraged.