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# INTERNAL AUDIT AND BEYOND

A Quarterly E-newsletter of the Internal Audit Standards Board of the ICAI

The Institute of Chartered Accountants of India

*(Set up by an Act of Parliament)*



### Contents



### Disclaimer



## Message of the Chairman, IASB

Internal Audit can play an essential advisory role within the organization by looking beyond processes and controls. It can help the organization to attain competitive advantage by identifying enterprise-wide cost efficiencies, providing strategic insights that improve performance and also by providing key insights that focus on the risks that matter. Internal auditors also need to stay alert to changes in the risk landscape and continuously assess whether internal audit plans cover the most significant risks – and whether they possess requisite skills to address these.

The members of the Institute should be ready to meet the challenging environment as the scope of internal audit is expanding significantly, and the role of internal audit in its efforts of improving the activities and the processes within the organisations is becoming more and more focused on strategic aspects. This quarterly e-newsletter brought out by the Internal Audit Standards Board is an important means to share the latest thinking and updates in the field of internal audit, internal control and risk management. This edition of the newsletter includes some informative articles on contemporary topics like, Managing the Risks in SMEs, Analytical Procedures: One of the important tools in Internal Auditing, etc.

We are sure that this edition of the e-newsletter and the other successive editions will help the internal auditors to deliver the best, through their technical skills, professionalism and credibility. We seek your support in strengthening the image of the internal audit by being a part of this interactive medium of e-newsletter and sharing your experience, views and suggestions with us.

**CA. Rajkumar S. Adukia**
Chairman, IASB

# Message of the President, ICAI

In the present scenario, where there are sweeping changes in the business practices and complexities in economic environment, the expectations from the internal auditors are continuously elevating. 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 processes. Internal auditors have the responsibility of giving an objective and evidence based opinion on different aspects of governance, risk management and internal control.

To be effective internal audit should be proactive in its approach. World-class internal audit is about finding the right balance between protecting and enhancing shareholder's value. Apart from possessing industry knowledge and functional expertise, internal auditors should be well conversant with risk management and evaluation, continuous auditing, fraud detection skills, automation of internal control environment and improved interpersonal skills for effective communication.

The Institute has been actively helping the members to obtain requisite knowledge on internal audit through different technical publications and programs. This quarterly e-newsletter "Internal Audit and Beyond" brought out by the Internal Audit Standards Board of ICAI provides updates on latest developments, nationally and internationally, in the field of internal audit, internal control and risk management. The aim is to make internal auditors better positioned to respond to the relentless challenges, issues, opportunities and demands they face in their professional assignments. We look forward to the members to provide their feedback for making this e-newsletter more informative and useful.

**CA. Jaydeep Narendra Shah**
President, ICAI

# Message of the Vice-President, ICAI

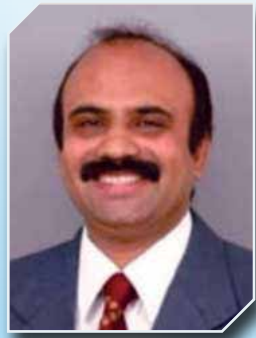
The expectations from internal audit function have changed considerably in the past decade. Internal auditors need to factor in complexity, change, pace, strategy, and other relevant information to ensure that their activities support the internal audit function, along with the organization's mission and stakeholders' interests. Internal audit is now increasingly involved in areas such as, risk management, fraud detection and monitoring and identifying opportunities for operational improvements that enhance financial performance. Most importantly, internal auditors need to demonstrate ability and versatility to meet the demands of increasing complex organisations.

This quarterly e-newsletter of Internal Audit Standards Board of ICAI aims to provide regular updates to the members on best practices and latest issues within the internal auditing profession. It would surely help the internal auditors to take a serious look at audit quality and ensure that it is practised consistently and professionally. We want to ensure that our members have the knowledge and skill sets they need to be successful in a continually evolving and expanding profession.

I hope the contents in this edition would prove to be useful contribution to knowledge base of the members about the current issues in the field of internal audit and also about the initiatives of Institute in the field of internal audit.

**CA. Subodh Kumar Agrawal**
*Vice-President, ICAI*

# Message of the Vice-Chairman, IASB



In these days of dynamic, complex and challenging times, the importance of internal audit in companies will become increasingly higher. Internal audit will have to extend its attention in several key areas, from which the assessing of the effectiveness of risk management will play an increasingly vital role for internal auditing. Internal audit has now the chance to upgrade its role in the process of risk management into a more strategic outcome which would not only prevent future catastrophes, but also will also enable the company to operate more efficiently. Further, internal audit will also play a significant role in the process of connecting the organization's business strategies with identified risks.

Internal auditors definitely need to enhance the stature and credibility of their internal audit activities and be well prepared to deliver the best. The Institute has been playing an important role in providing technical literature and organizing seminars, conferences, workshops, etc., in the field of internal audit. This quarterly e-newsletter is also a medium to share the latest updates in the field of internal audit with our members. This e-newsletter also gives a brief of the recent initiatives taken by the Internal Audit Standards Board for the benefit of the members which includes a range of activities like, issuing of technical literature, holding programs, conducting Certificate Course, etc.

I am sure that this edition of e-newsletter, like earlier other editions, would help our members to augment their skill sets as internal auditors and provide value added service to the organisations.

**CA. Rajendra Kumar P.**
Vice-Chairman, IASB

# Composition of the Internal Audit Standards Board (2012-13)

**CA. Rajkumar S Adukia, FCA**
Chairman, Internal Audit Standards Board

**CA. Rajendra Kumar P.**
Vice Chairman, Internal Audit Standards Board

**CA. Jaydeep Narendra Shah**
President, ICAI

**CA. Subodh Kumar Agrawal**
Vice President, ICAI

CA. Abhijit Bandyopadhyay
CA. Amarjit Chopra
CA. Anuj Goyal
CA. Atul C. Bheda
CA. Charanjot Singh Nanda
CA. G. Ramaswamy
CA. J. Venkateswarlu
CA. Nilesh S. Vikamsey
CA. Pankaj Tyagee
CA. Ravi Holani
CA. Shiwaji Bhikaji Zaware
CA. S. Santhanakrishnan
Shri Manoj Kumar
Shri Prithvi Haldea
Shri Sidharth Birla
Smt. Usha Narayanan
Shri Gautam Guha

**Co-opted Members**

CA. Porus Doctor
CA. Masani Hormuzd Bhadur
CA. Ghia Tarun Jamnadas
CA. Deepjee A Singhal
CA. Nitin Alshi
CA. Narendra Aneja
CA. Guru Prasad M

**Special Invittee**

CA. Sumit Behl

# About the Internal Audit Standards Board

The Internal Audit Standards Board (IASB) has been constituted as the Committee on Internal Audit in the year 2004, with the mission to reinforce the primacy of the Institute of Chartered Accountants of India as a promoter, source and purveyor of knowledge relating to internal audit and other aspects related to it so as to enable its members to provide more effective and efficient value added services related to this field to the industry and others and help the latter to systematize and strengthen their governance process by systematizing and strengthening their control and risk management process.

## The objectives of the Internal Audit Standards Board:

i. To review the existing internal audit practices in India.
ii. To develop Standards on Internal Audit (SIAs) to be issued under the authority of the Council of the Institute.
iii. To develop Guidance Notes on the issues relating to internal audit, including those arising from the SIAs.
iv. To formulate clarifications on issues arising from SIAs.
v. To undertake research in the field of internal audit.
vi. To organise/ provide technical assistance in, conferences, workshops etc., on the topics related to internal audit organised by the Institute

## The Internal Audit Standards Board launched it's Exclusive Website

## www.internalaudit.icai.org

The Internal Audit Standards Board of the ICAI recently launched it's exclusive website www.internalaudit.icai.org, a separate and distinct site that truly reflects the dynamic nature of internal audit profession. Since organizational needs are evolving faster than ever, internal auditors need to adapt to these changes to best sever their organizations, and maintain relevance and public trust. This site is a medium to help our members stay abreast with latest developments in the field of internal audit.


### 1. ISACA issues Control Framework for Information Security

The Information Systems Audit and Control Association (ISACA) has released COBIT 5 for information security, which builds on its recently released COBIT 5 framework to provide practical guidance for those interested in security at all levels of an organisation. ISACA's COBIT 5 framework is the only business framework for the governance and management of enterprise IT.
Please refer link: *http://www.isaca.org/COBIT/Pages/Product-Family.aspx*

### 2. Managing Risks of Cloud Computing the Focus of COSO's Latest Thought Leadership

In response to the growing number of organizations utilizing cloud computing as a viable alternative for meeting their technology needs, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) has published a new thought paper titled Enterprise Risk Management for Cloud Computing. The thought paper provides guidance on following the principles of the COSO Enterprise Risk Management (ERM) – Integrated Framework to assess and mitigate the risks arising from cloud computing.
Please refer link: http://www.coso.org/documents/COSO%20Thought%20Paper%20Cloud%20Computing%20Release%20June%202012%20Final.pdf

### 3. IFAC Issues New Guidance to Help Organizations Improve Internal Control

The Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) has issued new International Good Practice Guidance, *Evaluating and Improving Internal Control in Organizations*, highlighting areas where the practical application of existing internal control standards and frameworks often fails in many organizations.

The new guidance will assist professional accountants in business as they work with their organizations to continuously evaluate and improve internal control, and ensure that it is an integrated part of the organization's systems of governance and risk management. Better integrated internal controls can save the organization time and money while helping to create and preserve value.
Please refer link: *http://www.ifac.org/sites/default/files/publications/files/Evaluating%20and%20Improving%20Internal%20Control%20in%20Organizations%20-%20updated%207.23.12.pdf*

### 4. New Publication from ISACA and IFAC Helps Organizations Maximize the Value of XBRL

ISACA and the International Federation of Accountants (IFAC)'s Professional Accountants in Business (PAIB) Committee have jointly developed a paper, *Leveraging XBRL for Value in Organizations*, to provide guidance on how to leverage the value of eXtensible Business Reporting Language (XBRL) through effective implementation.
Please refer link: *http://xbrlindia.com/wp-content/uploads/Leveraging-XBRL-for-Value-in-Organisations.pdf*

### 5. APB Consults on Revisions to Auditing Standards on the Use of Internal Audit

The Auditing Practices Board (APB) of the Financial Reporting Council (FRC) have issued a consultation on proposed revisions to International Standards on Auditing (ISAs) (UK and Ireland) addressing the use of internal audit to adopt changes to the corresponding ISAs issued by the International Auditing and Assurance Standards Board (IAASB).
Please refer link: *http://www.frc.org.uk/getattachment/09b1534b-8b37-4a35-8b81-9216fdfbe029/Consultation-Paper-Revision-of-ISAs-%28UK-and-Ireland%29-315-and-610-re-internal-audit.aspx*

### 6. The IAASB has Unanimously Approved and Released a Milestone Consultation Document in its Work to Enhance, on a Global Basis

The communicative value of the auditor's report on financial statements. The IAASB's *Invitation to Comment (ITC): Improving the Auditor's Report* sets out the indicative direction of the board's future standard-setting proposals to improve how and what auditors report in accordance with International Standards on Auditing (ISAs). Please refer link:

## 7. Survey Finds Improvement in Internal Control Over Financial Reporting Since Passage of Sarbanes-Oxley, According to New Protiviti Research Automation of internal controls cited as key focus area

Protiviti's 2012 Sarbanes-Oxley Compliance Survey– which includes feedback from nearly 600 executives and other professionals who are involved with or have a stake in the SOX compliance process – explores the many issues companies address related to SOX, from cost and resource constraints to achieving a stronger internal control environment and improved operational efficiency and effectiveness.

Please refer link: *www.protiviti.com/soxsurvey*

## 8. New Edition of "Internal Auditing Around the World" from Protiviti Finds Internal Audit Becoming Training Ground for Future Business Leaders

High value placed on internal auditors' experience with risk and internal controls

Internal audit leaders from some of the world's top organizations share how they have reshaped the internal audit function to meet new risk and compliance needs in the latest edition of Internal Auditing Around the World from Protiviti a global consulting firm. Volume eight of the series, How Internal Audit Functions Develop Great People explores the strategies that internal audit executives use to keep their people and departments ahead of the curve as internal audit evolves, expands and becomes an even more integral part of daily business operations.

Please refer link: *http://www.protiviti.com/en-US/Documents/Resource-Guides/IA-Around-the-World-V8-Protiviti.pdf*

## 9. IRC Releases Draft Outline of Integrated Reporting Framework

The International Integrated Reporting Council (IIRC) released the Draft Outline of the Integrated Reporting Framework. The Outline establishes for the first time the basic structure of the Framework and is intended to keep stakeholders informed as the Framework is developed.

The IIRC also announces that a prototype Framework will be released by the end of 2012, with the Draft Framework being produced for public consultation in early-mid 2013 and a "version 1.0" of the Framework in late 2013.

Please refer link: *http://www.theiirc.org/wp-content/uploads/2012/07/Draft-Framework-Outline.pdf*

## 10. <IR> in the news: addressing the global financial crisis

A newly published report entitled "Lenses and Clocks: Financial Stability and Systemic Risks,"describes lessons learned from the global financial crisis and highlights the importance of <IR> in averting future crises. The report outlines four major recommendations, one of which focuses on Integrated Reporting <IR>: "Build on the work of the IIRC and others to promote transparency in the operations of organisations." The joint report by the United Nations Environment Programme Finance Initiative (UNEP-FI), the International Institute for Sustainable Development (IISD), and The Blended Capital Group advises the creation of a new protocol requiring the world's major stock exchanges to evaluate listed entities in terms of integrated reporting standards.
Please refer link: *http://www.theiirc.org/wp-content/uploads/2012/08/UNEP-FI-Lenses-Clocks-June-2012.pdf*

# Sustainability Reporting – Framework and Guidelines

The following list provides links to some of the standards and frameworks (some of which require a purchase) that explain the principles, concepts, benefits and processes related to Sustainability Reporting:

| | | |
|---|---|---|
| IFAC Sustainability Framework 2.0 (2011) | The updated Sustainability Framework issued by the IFAC consolidates the important aspects of embedding sustainability into the DNA of an organization and can be applied to entities of all sizes and complexities. This edition focuses on the integration of sustainability factors from three perspectives--business strategy, operational, and reporting--and highlights the important roles that professional accountants play in facilitating the sustainable development of their organizations. | http://www.ifac.org/publications-resources/ifac-sustainability-framework-20 |
| American Institute of CPAs (AICPA) , Canadian Institute of Chartered Accountants (CICA), and Chartered Institute of Management Accountants (CIMA), Evolution of Corporate Sustainability Practices: Perspectives from the UK, US and Canada (London: CIMA, 2010), 15, | To gain a sense of the state of sustainability in the UK and North America, CIMA, the AICPA and CICA recently surveyed over 2000 organisational leaders from their respective memberships, and interviewed sustainability executives from leading organisations to examine key characteristics of business sustainability, and the level of finance function involvement in corporate sustainability initiatives. | http://www.cimaglobal.com/Documents/Thought_leadership_docs/CIMA_AICPA_CICA%20sustainability_report.pdf |
| Global Reporting Initiative, Sustainability Reporting Guidelines (2011) | GRI's core sustainability reporting guidance for all organizations. | https://www.globalreporting.org/resourcelibrary/G3.1-Guidelines-Incl-Technical-Protocol.pdf |
| Integrated Reporting Committee, Framework for Integrated Reporting and the Integrated Report, Discussion Paper (Johannesburg, 2011), | This discussion paper outlines a principles-based approach to integrated reporting and the integrated report. It further seeks to offer practical direction on the integrated report. | http://www.sustainabilitysa.org/Portals/0/Integrated%20report%20discussion%20paper.pdf |
| Professional Accountants in Business Committee, Why Sustainability Counts for Professional Accountants in Business (New York: International Federation of Accountants, 2006), | This information paper provides an overview of enterprise sustainability and sets out the business/financial case for addressing sustainable development at the enterprise level in terms of the risks that sustainable development poses and the opportunities which it brings. The paper also seeks to identify the main sustainability related roles which the PAIB might occupy, today, tomorrow or at some more distant future time. | http://www.ifac.org/sites/default/files/publications/files/why-sustainability-counts-f.pdf |
| "How companies manage sustainability: McKinsey Global Survey results," McKinsey Quarterly (March 2010), | This survey explored how companies define sustainability, how they manage it, why they engage in activities related to sustainability, and how they assess as well as communicate this engagement. | www.mckinseyquarterly.com/How_companies_manage_sustainability_McKinsey_Global_Survey_results__2558. |
| The Institute of Internal Auditors, Practical Guide: Evaluating Corporate Social Responsibility/Sustainable Development (Altamonte Springs, US, 2010), | This guide will assist internal auditors in understanding the risks (operational, reputational, etc.) associated with CSR activities and how to use such knowledge in audit planning, the approaches to evaluating CSR activities, including auditing, facilitating, and consulting. | https://na.theiia.org/standards-guidance/recommended-guidance/practice-guides/Pages/Evaluating-Corporate-Social-Responsibility-and-Sustainable-Development-Practice-Guide.aspx |
| KPMG, International Survey on Corporate Responsibility Reporting, 2011 | It provides valuable benchmarks and key insights into the evolving field of CR reporting that companies can use to assess themselves against and others may apply to draw further conclusions for their specific purpose. | http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/corporate-responsibility/Documents/2011-survey.pdf |
| Institute of Chartered Accountants in England and Wales, Information for Better Makers Sustainability: The Role of Accountants, (London, 2004), | A report, Sustainability: the role of accountants, published by The Institute of Chartered Accountants in England & Wales (ICAEW) in October 2004, analyses the potential role of accountants in supporting mechanisms to enhance sustainability. The concept of sustainable development involves operating in a way that takes full account of an organisation's impacts on the planet, its people and the future. | http://www.icaew.com/~/media/Files/Technical/Financial-reporting/Information%20for%20better%20markets/IFBM/sustainability%20abstract.pdf |
| United Nations Conference on Trade and Development, Guidance on Corporate Responsibility Indicators in Annual Reports (Geneva/New York, 2008), | The purpose of this guidance is to assist preparers of enterprise reporting in producing concise and comparable corporate responsibility indicators within their annual financial reports. In so doing, this publication seeks to address the demand among investors and other stakeholders for more information on the broader non-financial contributions of corporations to society. | www.unctad.org/en/docs/iteteb20076_en.pdf. |

# Managing the Risk in SMEs

## Philosophy

Traditional risk management practices assert risk is "bad." In reality that may not be so. Taking calculated risks is essential for an organization to grow and capitalize on its capabilities.

## What is Risk?

According to Oxford English Dictionary 'Risk' simply means a situation that could be dangerous or have a bad outcome, or the possibility that something unpleasant will happen. Based on this the definition can be a bit elaborated as the probability and severity of accident or loss from exposure to various hazards, including injury to people and loss of resources.

From the business point of view it can be said that risk is an event which can prevent, hinder, and fail to further or otherwise obstruct the enterprise in achieving its objectives. Risk can cause financial disadvantage for example additional costs or loss of funds or assets. It can result in damage, loss of value and/or loss of an opportunity to enhance the enterprise operations or activities. Risk is the product of probability of occurrence of an event and the financial impact of such occurrence to an enterprise.

## Terminology in Risk Management

<u>Risk</u>: The chance of personal injury or property damage or loss, determined by combining the results of individual evaluations of specific elements that contribute to the majority of risk concerns. Risk generally is a function of severity and probability. The models in this Instruction, however, single out exposure as a third risk factor.

<u>Severity</u>: An event's potential consequences in terms of degree of damage, injury, or impact on a mission.

<u>Probability</u>: The likelihood an individual event will occur.

<u>Exposure</u>: The amount of time, number of cycles, number of people involved, and/or amount of equipment involved in a given event, expressed in time, proximity, volume, or repetition.

Mishap: An unplanned single or series of events causing death, injury, occupational illness, or damage to or loss of equipment or property.

<u>Hazard</u>: Any real or potential condition that can endanger a mission; cause personal injury, illness, or death; or damage equipment or property.

<u>Risk Assessment</u>: The systematic process of evaluating various risk levels for specific hazards identified with a particular task or operation. Various models are available to complete this step in the ORM process.

<u>Risk Rating Scale</u>: A scale of specific risk degrees, determined during the ORM process's risk assessment step. Various Coast Guard communities and activities should use the safety industry's standard terms low, medium, and high when discussing risk across program lines. However, each community will define low, medium, and high risk in terms meaningful to its own personnel.

## Basic Principles of Managing the Risk

*Accept No Unnecessary Risk*: All Coast Guard operations and daily routines entail risk. Unnecessary risk conveys no commensurate benefit to safety of a mission. The most logical courses of action for accomplishing a mission are those meeting all mission requirements while exposing personnel and resources to the lowest possible risk. ORM provides tools to determine which risk or what degree of risk is unnecessary.

*Accept Necessary Risk When Benefits Outweigh Costs*: Compare all identified benefits to all identified costs. The process of weighing risks against opportunities and benefits helps to maximize unit capability. Even high-risk endeavors may be undertaken when decision-makers clearly acknowledge the sum of the benefits exceeds the sum of the costs. Balancing costs and benefits may be a subjective process open to interpretation. Ultimately, the appropriate decision authority may have to determine the balance.

*Make Risk Decisions at the Appropriate Level*: Depending on the situation, anyone can make a risk decision. However, the appropriate level to make those decisions is that which most effectively allocates the resources to reduce the risk, eliminate the hazard, and implement controls. Commanders at all levels must ensure subordinates are aware of their own limitations and when subordinates must refer a decision to a higher level.

*Operational Risk Management (ORM) is Just as Critical in Executing as in Planning All Activities*: While ORM is critically important in an operation's planning stages, risk can change dramatically during an actual mission. Therefore, supervisors and senior leadership should remain flexible and integrate ORM in executing tasks as much as in planning for them.

*Integrating Risk Management into Mission, Planning, Preparation, And Execution*; Risk management must be a fully integrated part of planning and executing any operation, routinely applied by management, not a way of reacting when some unforeseen problem occurs.

## Type of Risks in an Organisation

Depending upon size and nature of business, an organisation may have various types of risks which may be broadly categorized in;

- Financial Risks
- Operational Risks
- Strategic Risks
- HR related Risks
- IT Risks

Once these have been categorized, they may be further split into the risks emerging out of the functionality of each category. For e.g.

- **Financial Risks** can be then further classified into:

    - **Investment Risks** – pertaining to the Safety, Security, Recovery and Income Realization of the investments of the company,
    - **Debt Recovery Risk**
    - **Statutory Compliance Risks** – relating to the various laws applicable to the company and its timely compliance.
    - **Foreign Currency Fluctuations Risk** – relating to the global ups and downs of the financial currencies in relation to the export/import
    - **Risk of Competition** or loss of revenue to various factors, including technology obsolescence, employee turnover etc
    - **Risk of Fraud**

- **Operational Risks** would include:

    - **Risk of Safety, Health and Environment** of the Employees and Assets
    - **Risk relating to Intellectual Property and its misuse** – Risks relating to misuse, theft and pilferage of drawing and design of the products
    - **Risk relating to Asset Safety and Management –**
    - **Risk of Competition** – Risk of competition impacts the operational efficiency of the company as well and needs to reviewed and analyzed from all angles

- **Strategic risks** include
    - **Political Risk** – India being a democratic country will have different ruling parties with different ideologies. The risks pertaining to change in Govt. and policies need to be identified and insulated
    - **Risk due to Competition** – Again risks pertaining to competitors need to evaluated strategically and future long term and short term business plans should be designed accordingly

- **HR Risks** would consists of
    - **Risks** relating to **Employee turnover, retention** and management
    - Risks of Frauds due to mis-utilization of various HR policies, norms and delegation of Powers

- **IT related Risks** would consists of
    - **Risks relating to Data Security** – Now in this era of technology, the company is heavily dependent on electronic data, the security and safety of which is of utmost important to any organization
    - **Risks relating to loss of Data** – This would relate to the risks arising from loss of data due inadequate backup policy or its implementation.

## Measurement and Validation of Risks

Organisation must develop sound internal loss reporting practices, supported by an infrastructure of loss database systems that are consistent with the scope of operational losses defined by the industry norms.

The organisation must have an operational risk measurement methodology, knowledgeable staff, and an appropriate systems infrastructure capable of identifying and gathering comprehensive operational risk loss

Sources of external data must be reviewed regularly to ensure the accuracy and applicability of the loss data. The organisation must review and understand the assumptions used in the collection and assignment of loss events and resultant loss statistics.

Every identified risk needs to be assigned values based on the following parameters;

- Risk Intensity: This would define the intensity of the impact of the risk, if occurred as High/Medium/Low
- Risk Occurrence: This defines the probability of occurrence of the risk in future such as Frequent, Occasional, Not probable
- Risk Weightage: Based on the ratings of the above criteria, each risk is assigned with weights to assess the overall impact on the company in case of occurrence of the risk and the action plans are designed accordingly.

After the risks are identified and their intensity, frequency and weightages are defined, decision needs to be taken for management of the risks. That is whether the Company wants to mitigate, retain, reduce or carry the risks in the future based on its priority for each risk. Based on this decision the Action plan for management of risks is then prepared.

## Handling the Risk

Careful determination of risks, along with analysis and control of the hazards they create results in a plan of action that anticipates difficulties that might arise under varying conditions, and pre-determines ways of dealing with these difficulties. Managers are responsible for the routine use of risk management at every level of activity, starting with the planning of that activity and continuing through its completion.

### Risk Transfer and Mitigation

In an effort to encourage better risk management practices, the Committee is keenly interested in efforts by institutions to better mitigate and manage operational risk. Such controls or programs have the potential to reduce the exposure, frequency, or severity of an event. Due to the crucial role these techniques can play in managing risk exposures, the Committee intends to work with the industry on risk mitigation concepts over the next several months. However, careful consideration needs to be given to whether the control is truly reducing risk, or merely transferring exposure from the operational risk area to another business sector.

### Insurance

One growing risk mitigation technique is the use of insurance to cover certain operational risk exposures. During discussion with the industry, the Committee found that firms were using, or were considering using, insurance policies to mitigate operational risk. These include a number of traditional insurance products, such as bankers. blanket bonds and professional liability insurance. Specifically, insurance could be used to externalize the risk of potentially .low frequency, high severity losses, such as errors and omissions (including processing losses), physical loss of securities, and fraud. The Committee agrees that, in principle, such mitigation should be reflected in the capital requirement for operational risk. However, it is clear that the market for insurance of operational risk is still developing.

### Periodical Review of the Risk

With the rapid change in business scenario, the Risk that was applicable at a particular time may not be applicable any more in the current scenario. Hence there is a need for regular review of the Risk Areas in accordance with the changing domestic and global business environment.

### Task Force for Risk Management

The Risk Action plans should mention of a Task Force that would regularly review the suggested measures.

**CA. Anil Agarwal, FCA**
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Articles

# Analytical Procedures: One of the Important Tools in Internal Auditing

## Introduction & Definition

Analytical procedures can be defined as the analysis of:

- Significant ratios,
- Trends,
- Investigation of fluctuations,
- Relationship between Financial & Non Financial Data that is inconsistent with other relevant information or which deviates significantly from predicted amounts.

Analytical procedure can be said to be one of the very important part of Internal Auditing. It is a technique based on the concept that there are relatively stable relationships among the economic events recorded in financial statements. The auditors' expectation is that the amounts in the financial records that summarize & represent these economic events will be marked by relative stable relationships. When deviations from these expected relationships are identified, the auditor should react by investigating to determine whether material errors, irregularities or opening inefficiencies have occurred.

## Analytical procedures are applied at two stages & those are:

- For Risk Assessment at planning stage &
- Overall review stage.
-

## Nature & Purpose of Analytical Procedures:

Basically the main function of analytical procedure is to compare the information or results of two or more periods, study the deviations & come to result. The comparison of information could be:

- Financial Information of two or more periods
- Budgets, forecasts & Estimates from various experts within the organisation.
- Estimates calculated by the Internal Auditor e.g. depreciation charge, Deferred Tax Calculations, Advance Tax calculations etc.
- Comparison of organisations information with industry standards
- Establishing the relationship with financial & relevant non financial information.

Various methods used for performing analytical procedures:

- **Ratio Analysis**: Ratio analysis involves computation of relationship between two numbers. If we take an example of Profit & Loss Statement main relationship is based on Sales. Gross profit or Net Profit percentage is calculated by considering sales. We can calculate inter statement ratios. For example, Inventory turnover ratio is the relationship of Average Inventory ( Balance Sheet Item) to cost of sales (Profit & Loss Item). After the computation of ratios they are compared with entity's prior period ratios or industry ratios.
- **Conversion to a common size financial statement**: It is the method where all the numbers are converted to a percentage of a certain number. For Example, cash, inventory, receivables & other assets in the balance sheet are converted to percentage based on the relationship of each asset to total assets. In case of profit & loss statement cost & expenses are converted to to percentage based on their relationship to sales. Those percentages may be compared to prior years' percentages or industry percentages.
- **Trends Analysis**: It indicates the relative changes in data from period to period based on the data of base year. Trend statements may be computed for any financial statement item. The statements may be computed for any financial statement item. The statements highlight departures from the norm in a company's operations.
- **Regression Analysis**: It is a tool by which presumed cause & effect relationships are used to make predictions. The relationships are expressed in terms of a dependent variable and one or more independent variables. Regression analysis is used to estimate or predict what an account balance should be for comparison with what that account balance is.

## Generally followed Analytical Procedures while auditing:

While applying analytical procedures, the auditor should do the following:

- Develop expectations
- Define what will be considered a material difference between expected & recorded amounts
- Identify significant differences
- Investigate the cause the significant differences
- React to the conclusion.

Research has been conducted for over twenty years to determine when analytical procedures are used, the effectiveness of those procedures, and the impact they have on auditors' decisions.

Questions have been raised concerning the effectiveness of analytical procedures as a means of accumulating audit evidence. One study concludes that "many auditors lack confidence in analytical procedures because of the perceived low precision of the procedures and the perceived unreliability of the data that are necessary for the procedures, for example, monthly [or annual unaudited] data."

Another study concludes that "analytical procedures are useful for the auditor with respect to detecting overstatements of revenue, fictitious sales and receivables, fictitious and overvalued inventory, understated bad debts and allowances for doubtful accounts, unrecorded purchase liabilities, under accrual of expenses, and inappropriate expense capitalization. Analytical procedures, used effectively in those situations, would have revealed unusual relationships and significant changes in relationships. By following up the unusual relationships and the changes in relationships with other audit procedures, the auditor could have detected large errors in the financial statements"

Auditor's experience is a factor in the effectiveness of analytical procedures. When a procedure indicates that the actual data deviates from the expected data, the auditor must determine the cause. One of the advantages of experience is the ability to generate a greater number of plausible explanations for the deviation. The more experienced auditor is also more efficient in that he or she first investigates the more likely explanations for the deviation. At times, deviations from expected values are not caused by accounting errors but by environmental factors. One study concludes that "audit experience was positively associated with the number and ranking of environmental factors selected. Thus, accumulated direct experience does affect plausibility assessment and appears to enable auditors to understand that significant fluctuations in ratios do not necessarily indicate the occurrence of accounting errors".

Other factors influence the use and effectiveness of analytical procedures. When those procedures produce deviations from expected results, auditors seek explanations from management. Auditors consider managers' competence when evaluating the reliability of their explanations of deviations. That is, the greater the managers' competence the more willing the auditor is to accept their explanations of deviation.

The use and effectiveness of the more common analytical procedures depends on other factors. For example: if the auditor determines that a client's internal control structure is strong, the auditor will have greater flexibility in planning the mix between analytical procedures and tests of details. That is, the quality of the client's internal control structure influences the extent to which the auditor applies analytical procedures.

### Use of Analytical Procedures in planning the Audit:

One of the important uses of analytical procedure at planning stage is that it can be used to understand the basics of that business & potential risk to the business.

## Analytical Procedures as Substantive Procedures:

Substantive procedures (or **substantive tests**) are those activities performed by the auditor to detect material misstatement at the assertion level. Tests in details or analytical procedures both can be used as substantive procedures to reduce detection risks relating to specific financial assertions. The judgment & circumstances are the best tools an auditor can use for which procedure to follow. He has to take into account the effectiveness & efficiency of those procedures.

Following factors has to be taken into account for applying analytical procedures as substantive procedures.

- Objectives of Analytical procedures
- Availability of Financial & Non Financial Information.
- Reliability of Information
- Relevance of Information
- Sources of Information
- Comparability of Information
- Experience of Internal Auditor
- Control over information generation.

## Use of Analytical procedures in the overall review of audit

Analytical procedures are necessary in the overall review of audit to form conclusion that the systems, procedures & controls are working efficiently & effectively. These conclusions are then compared with the individual conclusions formed for individual components or elements of financial statements. It also gives insight to the Auditor that whether further procedures are required about the systems & controls.

## Reliance on Analytical procedures:

For reliance of analytical procedure it is important that there should be logical relationship of data exists.
For authenticity & reliability of analytical procedures following factors are important & they are:

- Materiality of Items involved i.e. how many items are tested & taken for analysis.
- Help of other procedures according to the judgment & experience of Internal Auditor.
- Accuracy of the data & meticulous mathematical calculations with which these analytical procedures are performed
- Consistency of data i.e. elements in the calculations should be consistent over a period of time.
- Assessment of inherent & control risks.
- One of the important aspect of reliability of Analytical procedure is that auditor should check the control system in the organisation. Controls over reports & information generation should be the utmost important factor for analytical procedures to be accurate & reliant.

Non financial information can be tested for controls in conjunction with Financial Information.

### Unusual Items & Trends:

One of the widely acknowledged benefits of Analytical procedure is that it can easily identify items with unusual nature & trends. When we see significant fluctuations in ratios, there must be some kind on inconsistency in the items we tested for analysis. Auditor can also use other audit procedures according to the suited environment & his judgement. These significant changes in ratios can be potential errors, irregularity or illegal acts.

An analytical procedure is one of the important tools in the hands of Internal Auditor. It can give the correct & easy flaws in the systems & controls. Lots of meticulous calculations & handling of huge data are two important factors for the success of analytical procedure.

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# Internal Audit Outsourcing – An Analysis

Internal auditing is an independent, objective assurance and consulting activity which helps an organization to accomplish its objectives by bringing a systematic and a disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. It is a catalyst for improving an organization's effectiveness and efficiency by providing insight and recommendations based on analysis and assessment of data and business processes.

Internal auditing is becoming more and more important for every organization irrespective of their area and size. The scope of internal auditing within an organization is broad and may involve topics such as the efficacy of operations, reliability of financial reporting, deterring and investigating fraud, safeguarding assets, and compliance with applicable laws and regulations. Establishing and maintaining an effective internal audit department is a daunting challenge and most of them struggle with it.

Effective internal audit functions require a diversity of skills that many companies find difficult to source and retain. Maintaining world class internal audit resources requires significant investment in recruiting, training and professionally developing internal audit personnel. Add to that the cost of the latest methodology, technology and management's time and resources.

During the early 1980s, internal audit outsourcing was not very popular as the internal audit functions were primarily in-house with full-time and dedicated employees. This structure worked adequately and can still be effective today, but only if full-time internal auditors possess all the skills needed to address key business risks faced by the organization. If the auditors do not have the requisite skills, then the internal audit function places the company at risk by not being able to address adequately the key risks areas for which the audit was undertaken.

However, as the concept of "core competency" gained more momentum and attention, companies evaluated many of their business objectives and the potential for outsourcing the internal audit function. The functions which the companies decided to go for outsourcing are employee's payroll, real estate, printing, information systems operation and maintenance, and aspects of design or manufacturing. As a result of outsourcing, many companies found clear and tangible benefits, reduced capital expenditures and improved service levels.

It has been stated by The Institute of Internal Auditors (IIA) in its paper titled – ***"Resourcing Alternatives for the Internal Audit Function"***, that a fully resourced and professionally competent staff is an integral part of the organization, whether in-sourced or outsourced. The IIA recognizes that many "partnering" arrangements with outside providers have been effective in helping organizations obtain internal auditing services to help achieve management's objectives. Ultimately, deciding whether to outsource internal audit or not is a matter of consideration by the company based on the general pros and cons. Given below are two scenarios wherein the company decides upon outsourcing the internal audit function

### A. If there is no internal audit function:

- Are we better off taking the time and effort to start our own in-house internal audit function?
- Should we initially outsource it to gain quick start-up and access to a greater level of expertise and broader level of resources, and then monitor this decision and delivery model to ensure it is effective?

### B. If there is an internal audit function:

- Do we have the resources we need to effectively address all of the key risks we face and in which internal audit should be involved?
- Do we need to have all of these resources in-house all of the time?
- Might we be better off considering an arrangement to have one or more outside organizations assist us with addressing our risks?

Internal audit outsourcing allows the management to hire fully dedicated internal audit professionals, as they are needed, without the day-to-day managerial requirements an internal department would require. Likewise, many companies may find that full or partial internal audit outsourcing makes sense, it is cost-effective and provides significant short- and long-term benefits like-

a. Quick start-up of the function and execution of work.
b. Variable-cost arrangement rather than a fixed-cost function.
c. Access to a greater number and wider range of resources
d. Potentially greater objectivity and independence

According to a press release in July 2010, The Institute of Chartered Accountants of India (ICAI) had made a suggestion to the Ministry of Corporate Affairs, Government of India to make outsourcing of internal audit functions mandatory for companies to prevent a Satyam-like fraud from happening again.

However, both public and private organizations should also consider the potential negative impact of outsourcing internal audit, which may include, but is not limited to, the potential loss of control since resources are not directly employed by the company. Therefore while concluding it can be said that though internal audit outsourcing has some drawbacks, the fact that they are beneficial cannot be ignored. That is why there are so many organizations today that outsource their internal audit functions to various service providers, including off-shore destinations like India, China and Philippines.

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# RISK MANAGEMENT – A STRATEGY (A probable case study)

Kangla Food is a company incorporated with its headquarter in Imphal. Its operations are confined to natural resources and it has three main lines of business: exploration, production, and processing the main resources under consideration being ginger, onion, natural vegetation etc. exploration and production primarily species products; and pickle production. In a probable year, 35 per cent of its revenues came from Guwahati and the remaining from Imphal District (17 per cent), Bishnupur District (13 per cent) and others (35 per cent). Thus, the company's revenue streams are geographically diversified.

In spite of being diversified – product wise and geographically, Kangla Food's businesses are influenced by external factors. It is exposed to selling and purchasing price risks, credit risks and interest rates and exchange rates risks. In foods business, the company is exposed to volatile prices of items like onion, garlic, etc. it also purchases large quantity of diesel and gas. Its purchases relating to pickle business include fruits, meats, bamboo sooth and electricity. In chips pack business, it is exposed to risk of selling prices all kinds of food based products.

The basic consideration in the traditional risk management policy has been the reduction of the variability of the firm's future cash flows. Under this policy, derivatives are used as the major tools of reducing the cash flow variability. It is assumed that cash flow variability mitigation is good from the shareholders point of view and this will cause the shareholder value to increase. One effect is to reduce the chances of financial distress and thus, improve the firm's debt capacity and increased interest tax shields. However, these are not unique advantages as, according to the portfolio theory, shareholders can diversify their portfolios and mitigate their risks arising from cash flow variability of a particular business. A firm's financial policies – investment and financing – have an impact on the variability of its cash flows and financial distress. Thus, the risk management policy should be seen as an integrated risk management system incorporating the investment and financing choices.

Like many companies, Kangla Food, in the past, had been using derivatives to hedge its risks. Also, there was no integrated policy for the entire company rather each business was individually managing risk exposures to specific commodities and exposures arising from interest rates and exchange rates. The Kangla Food's risk management policy had the following problems:

i. Kangla Food used financial derivatives, generally with a maximum period of 60 months, as main tools of hedging risks. Financial derivatives, with a limited time horizon as the main risk mitigating instruments cannot reduce all kinds of risks.
ii. It did not consider its worldwide operations, locations, investments and financing choices as tools of natural hedge.
iii. Each business was left to itself to hedge its risks. There was no coordination. At times, there was duplication of efforts and risk policies of businesses would contradict each other.

Under the new management policy, Kangla Food introduced a new risk management policy. The following are the features of the new policy:

i. The firm recognizes financial structure as a tool to reduce risk. In fact, the company had a very high debt ratio, which it has reduced now as a substitute for the un-hedged position. The maturity of debt has also been reduced.
ii. The company considers both direct and indirect costs of risk reduction under its new risk management policy.
iii. The company considers the natural hedge created from its diversified operations as the effective risk mitigation tool. It will reduce the residual risks, which are not expected to be very high.
iv. The company focuses on Cash flow at risk (CFaR) for the firm. CFaR is a concept that estimates cash flows and their probabilities. Assuming a normal distribution, CFaR is estimated.

Suppose a rice farmer will produce 50,000 bushels of rice next year. He is expecting a price of Rs. 200 per bushel. Hence his expected cash flows are 50,000 X 200 = Rs. 100,00,000. Since rice prices fluctuate, there is uncertainty about the fall to Rs.135 per bushel or could rise to Rs. 210 per bushel. The farmer needs to estimate the range of prices (and hence cash flows) with associated probabilities. The farmer may choose, say 95 per cent level of confidence at which the expected cash flows are given. Suppose the expected cash flows are 75,00,000/- and Rs. 10,00,000/-. The farmer can say that he has Rs. 2,50,000/- cash flow at risk with a 5 per cent probability.

v. It considers integrated Risk management from the entire firm's point of view rather than allowing each business to have its own risk programmed.
vi. The company's approach of encouraging structured non-recourse financing for projects helps the company to pass on risks to financiers.
vii. To improve the overall performance and the effectiveness of risk management, the company has affected organizational restructuring. The new structures and systems enable the company to operate in a coordinated manner.

Financial Accounting Standards 133, *Accounting for Derivative Instruments and Hedging Activities-*

This Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction.

The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation.

- For a derivative designated as hedging the exposure to changes in the fair value of a recognized asset or liability or a firm commitment (referred to as a fair value hedge), the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. The effect of that accounting is to reflect in earnings the extent to which the hedge is not effective in achieving offsetting changes in fair value.
- For a derivative designated as hedging the exposure to variable cash flows of a forecasted transaction (referred to as a cash flow hedge), the effective portion of the derivatives gain or loss is initially reported as a component of other comprehensive income (outside earnings) and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately.
- For a derivative designated as hedging the foreign currency exposure of a net investment in a foreign operation, the gain or loss is reported in other comprehensive income (outside earnings) as part of the cumulative translation adjustment. The accounting for a fair value hedge described above applies to a derivative designated as a hedge of the foreign currency exposure of an unrecognized firm commitment or an available-for-sale security. Similarly, the accounting for a cash flow hedge described above applies to a derivative designated as a hedge of the foreign currency exposure of a foreign-currency-denominated forecasted transaction.
- For a derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change.

Under this Statement, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entities approach to managing risk.

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# CASE – (A tool of Credit worthiness assessment)

Debtors occupy an important position in the structure of current assets of a firm. They are the outcome of rapid growth of trade credit granted by the firms to their customers. Trade credit is the most prominent force of modern business. It is considered as a marketing tool acting as a bridge for the movement of goods through production and distribution stages to customers. It is generally believed that credit policy stimulates sales as it helps in retaining existing customers and winning clients from rivals.

Trade debtors represent amounts owed to the firm as a result of credit sale of goods or services in the ordinary course of business. The key function of credit management is to optimize the sales at the minimum possible cost of credit. According to Joseph, "The purpose of any commercial enterprise is the earning of profit. Credit in itself is utilized to increase sales, but sales must return a profit".

The offer of trade credit should not only optimize sales but also lead to maximization of overall return on investment. Management of receivables, therefore, should be based on sound credit policies and practices.

Credit policy effects debtor management because it guides management about how to control debtors and how to make balance between liberal and strict credit. Behind every credit decision there is an inherent potential for loss. Credit decision will minimize the risk, enhance the profitability and lead to better structuring of credit. Credit risk assessment of the customer is assessed based on the following parameters:

- Risk classification of the entry i.e. low/ medium/ high
- Should we extend credit to this entity? If yes, the recommended credit limit
- The structure of the credit i.e. Secured (%) Unsecured (%)
- Recommend credit as per % of the net worth
- Sanctioned credit limit(specify the structure and the amount)
- Individual firm / company wise credit limits (in case the entity has different firms or companies)
- Sales centre wise allocation of the sub limits.

The assessment criteria are:

1. Solvency
2. Financial Viability
3. Technological Soudness
4. Commercial Feasibility

Depending upon the above basis one can develop a module- "Credit Assessment & Solvency Evaluation" (CASE) for assessing the risk associated with each and every account and to judiciously take a decision based on the information available, which are as follows:

Case-1 (Solvency- Z Score Analysis)
Case-2 (Financials- Ratio Analysis)
Case-3 (Technology and Commercial)
Case-4 (Quality and Credibility)

## CASE- 1- Z SCORE ANALYSIS

Edward I. Altman (1968) is the dean of insolvency predictors. He was the first person to successfully use step-wise multiple discriminate analysis to develop a prediction model with a high degree of accuracy.

Z Score Calculator is a probability tool for data analysis, programmed to predict the quick financial assessment. According to the value of Z-score probability that a firm will go into bankruptcy within two years by using actual financial data available to the firm. Altman's Z is commonly employed to assess financial distress. The Altman's Z score can be calculated from four or five linear combinations of business ratios, weighted by coefficients. Altman's Z is a weighted composite of financial indicators relating to profitability, revenue, slack resources, and market return. When interpreting Altman's Z-Score, higher values indicate that firms carry out more actions at a fast pace, while low scores indicate that firms carry out few total actions and respond slowly.

The predetermined cut-off scores will be compared to the obtained Z score value. The assumed values of Altman's score that with a Z-Score less than 1.8 were likely to experience bankruptcy; companies with a Z-score 1.8 to 2.99 were in a zone of ignorance, or a grey zone in which distress may or may not be impending. Last, companies with a Z-score greater than 2.99 were likely to be financially sound. However, there is no single formula that has the power to predict the future; Z-Score users should look at the trend of the business over time as they interpret the score rather than just looking at the score itself, which is only a snapshot in time.

## Corporate Bankruptcy Prediction ("Z")

| S.No. | DESCRIPTION | RESULT | WEIGHT AGE | ("Z") |
|---|---|---|---|---|
| 1 | Working Capital/ Total assets | A1 | 1.2 | Z1 |
| 2 | Retained Earnings/ Total assets | B2 | 1.4 | Z2 |
| 3 | EBIT/ Total Assets | C3 | 3.3 | Z3 |
| 4 | Market Value of equity / Total Liabilities | D4 | 0.6 | Z4 |
| 5 | Sales/ Total Assets | E5 | .999 | Z5 |

Total (Z1+Z2+Z3+Z4+Z5)

Credit Decicion (Tick the Appropriate Column)

**Low Risk** **Medium Risk** **High Risk**

**Notes**

- "Z" Score Above 3.00 To Be Considered As **Low Risk**
- "Z" Scores Between 2.99 To 1.80 To Be Considered As **Mediem Risk**
- "Z" Score Less Than 1.80 Is A Sign Of Bankruptc
-

## Case-2- Ratio Analysis

| Ratios | Descriptions |
|---|---|
| | |
| **Structural Ratio** | |
| Debt Equity Ratio | Debt/ Equity |
| Interest Coverage Ratio | Pbit/ Interest On Debt |
| | |
| **Liquidity Ratio** | |
| Current Ratio | Current Assets/ Current Liabilities |
| Acid Test Ratio | Quick Assets/ Current Liabilities |
| | |
| **Turnover Ratio** | |
| Assets Turnover Ratio | Sales/ Total Assets |
| Inventory Turnover Ratio | Sales/ Inventory |
| Receivables Turnover Ratio | Sales/ Receivables |
| | |
| **Profitability Ratio** | |
| Gross Profit Ratio | Ebit/Sales |
| Net Profit Ratio | Eat/Sales |

reviewing the Ratios in Totality.

## Case-3-Technological and Commercial

| Particulars | Strong | Medium | Weak |
|---|---|---|---|
| **Part I-Technological** | | | |
| Technology | | | |
| Product Quality | | | |
| Product Mix | | | |
| Technological Know How | | | |
| Power Availability | | | |
| Process Suitability | | | |
| Plant/ Equipment | | | |
| **Part II- Commercial** | | | |
| Marketing Network | | | |
| Organization I.e. Prop/ Partnership/ Co. | | | |
| Resource Mobilization | | | |
| Other Suppliers/ Exclusive Dealer | | | |
| Relations/ Dealing With Other Customers | | | |

Credit Decision (Tick the Appropriate Column)

**Low Risk** **Medium Risk** **High Risk**

### Case-4 Quality and Credibility of Management

| Particulars | STRONG | MEDIUM | WEAK |
|---|---|---|---|
| Quality of Management<br>• Track record<br>• Market Reputation<br>• Experience in field<br>• Ownership dispute<br>• Technical competence | | | |
| Credibility of Management<br>• Ethical in business dealings<br>• Commitment level<br>• Relationship with zegularity authorities<br>• Relation with bank<br>• Relation with competitors | | | |
| Past performance with us<br>• Length of sound dealing<br>• Promptness in payment<br>• Honoring commitments<br>• Payment patterns &<br>• Adherence to credit terms<br>• Willingness to furnish information<br>• Capacity to hold stock<br>• Ability to absorbs supply spikes<br>• Avoidance of over trading | | | |
| Health of group companies<br>• Financial soundness of group companies<br>• Possible diversion of funds to new business ventures<br>• Bank rating | | | |

Credit Decision (Tick The Appropriate Column)

Low Risk Medium Risk High Risk

### Composite Credit Decision Module

Notes:

- Maximum weight-age should be given to criteria no 1 & 2 for customers in organized sector.
- In case of a new company, financial data's may not be available and hence it is suggested that the promoters past record and performance of the group companies should be considered as guide.

| Module | **Criteria** | **Low Risk** | **Medium Risk** | **High Risk** |
|---|---|---|---|---|
| Case-1 | Solvency | | | |
| Case-2 | Financial | | | |
| Case-3 | Technical & Commercial | | | |
| Case-4 | Quality & Creditability | | | |

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# Case Study
# A Confidence Boost for Management

Management at a medium-size manufacturing firm was very concerned about expenses. which were growing 2 to 3 % per year faster than revenues. A large one-time audit of the entire amounts payable function was ordered, focusing on operational efficiency as well as fraud. The A/P data for the past 12 months amounted to three million transactions. Using the statistics tool, the team determined that just over 140,000 of these transactions were worth $500 or more, and in total these represents more that half of all expenditures (roughly $ 1.5 billion). A cut-off point pf $50 was therefore established, and sample sizes required for a confidence level of 95% was computed separately for the two subsets.

For the 2,860,000 transactions under $500, using attribute sampling add an expected error rate of 1 per 1000, a sample size of 3,000 was considered sufficient. For the 140,000 large items, a separate sample size of 2,600 was set using monetary unit sampling. The weeks of work involved in manually examining 5,600 individual transactions was considered well worth spending, if it would help identify problems in processing or ongoing frauds.

Eventually, some 24 bad transactions were found out of 5,600 tested. Of these, 19 were from under $500 range, and so in themselves they were barely worth the substantial labor cost of finding them. However, they pointed to several systematic problems that management could address:

- The majority of suspect items were paid late, paid twice, or contained processing errors. Changes were made to the training of A/P clerks to reduce the errors and delays, for an eventual savings of $35,000 in interest and $180,000 in other charges each year.
- Six of the small items involved repeated purchases of similar items that should have been consolidated and paid by a single monthly statement. These were just the tip of the iceberg: Searching outside the sample set, the team found more than 3,600 such transactions worth about $1.2 million. The resulting purchasing savings in the following year were at least $250,000.
- Two items were small tools or special materials for the shop floor that were not needed but were bought in duplicate due to poor communications between the purchasing department and engineering. Again this turned out to be representative of a much bigger problem in planning and scheduling.

Overall, management estimated that close to $600,000 per year would eventually be saved due to the "low-value" portion of the audit alone.

The remaining five high-value items represented a more serious problem. They were progress payments for $10,000 to $28,000 made on three different large service contracts where the vendor had not delivered the promised services on time or at all. Upon further investigation, the auditors found that two purchasing officers were receiving kick-backs in exchange for not terminating the nonperforming vendors. The total loss to the company was at least $75,000 per year.

Sadly, the audit could account for only a small portion of the firm's excessive cost growth. However, because of its thoroughness and carefully laid statistical foundation, the audit convinced management that the main causes of that problem did not lay in purchasing fraud or inefficiency in processing.

| | |
|---|---|
| *Scheme:* | Inefficiency and fraud in a large database |
| *Symptoms:* | Numerous small transactions processed incorrectly and found by attribute sampling, plus a handful of large fraudulent ones found by monetary sampling. |
| *Date Requirements:* | Accounts payable – amount paid (For purposes of sampling – follow-up investigation requires additional fields |

Certificate Course on Enterprise Risk Management

# Certificate Courses organised by the Internal Audit Standards Board

| Chennai | Kolkata |
|---|---|
| September 15 & 16, 22 & 23, 29 & 30, 2012 | October 13 & 14, 20 & 21, 27 & 28, 2012 |

The Internal Audit Standards Board of the ICAI is pleased to offer Certificate Course on "Enterprise Risk Management" to enable members to develop competence in this emerging field and offer value added services. This course would help the members to understand the various issues relating to the enterprise risk management and in developing the necessary skills to provide value added services in this area.

The Board has successfully completed the four batches of the Course organised at Delhi, Mumbai and Hyderabad respectively.

## Course Objectives

**The overall objectives of the course are:**

- To enhance the role of Chartered Accountants in the area of ERM.
- To build ERM as one of their core competencies.

**The main thrust of the course is to educate the participants on:**

- Theory and concepts of ERM.
- Manner in which ERM is designed and implemented in practice.
- Current thinking on risk management and its impact on contemporary business enterprises

Having regard to the professional and personal pre-occupations of the participants, the course si designed as a balanced mix of class room teaching, E-learning as well as self study.

## The Course is targeted at

- Members who, either already or prospectively, are working in areas related to internal audit, enterprise risk management or corporate governance.
- Members who are working with various corporate houses, public sector enterprises, government departments, not-for-profit organisations inefficiently carrying out their day-to-day activities.

## Course Registration & Batches

While the course registration is open throughout the year, batches would start in respective cities where minimum of candidates becomes available. Maximum number of seats per session per centre is 40 and minimum is 20.

Course registration is on the receipt of a duly filled-in and signed form available on ***http://www.icai.org/post.html?post_id=4287*** at along with the course fee and requisite enclosures. Course registration is on first-come-first-served basis

## Eligibility

The course is open for the members of the Institute of Chartered Accountants of India as well as the students who have cleared CA final examinations.

## Registration Details

The Course will be conducted initially at New Delhi, Mumbai, Kolkata and Chennai and later on at other parts of the country.

## Certificate on Completion of the Course

Participants who successfully complete the course in line with the evaluation criteria outlined here and qualifies the evaluation test will be awarded Certificate.

## Course Fees

The fees for the course is Rs. 25000/- only, payable by Pay Order/ Demand Draft drawn in favor of "The Secretary, ICAI" payable at Delhi. Course fees once paid is non-refundable under any circumstances. The following will be charged extra from the participants:

- Evaluation Tests fees – there is no separate examination fees for the first appearance in the exam. For every successive appearance, an examination fees of Rs. 2000/- will be charged per appearance.

Updated details on http://www.icai.org/post.html?post_id=4287

The Board would be hosting details of forthcoming batches and updated details form time to time on the http://www.icai.org/post.html?post_id=4287. Members are requested to visit the said link regularly for updated details.

## Course Structure

The total duration of the course is 200 hours divided as follows:

Self Study : 100 hours<br>
Class room teaching : 50 hours<br>
E-Learning : 20 hours<br>
Case Study preparation and presentation : 30 hours

Class room teaching will be completed over a 5week/ 6 class room time with classes being held on weekends.

The participants will be required to devote time to self study, preparing case studies and other class assignments, if any given to them, as per the above requirements. The participants will be grouped in a group of four each for preparing and presenting case studies. The case studies and presentations will be evaluated by an individual/team of experts.

## CPE Hours

CPE credit of 100 Hours (50 hours of structured learning and 50 hours of unstructured learning) will be given to the participants.

## Evaluation

- Eligibility - A candidate will have to attend a minimum of 40 hours of classes and complete the entire E-learning module, failing which, he/ she will not be entitled to appear in the evaluation.
- Weightage – the following weightage is assigned during evaluation:
  - » Class room learning and tests: 80 per cent
  - » E-learning: 20 per cent
  - » Case Study presentation: 20 per cent
  - » Class room attendance: 10 per cent
- Number of attempts: There is no limit on the permissible number of attempts for the evaluation tests. A candidate will be allowed to re-appear for the evaluation test only after six months of the previous attempt.

| Chennai | Kolkata |
|---|---|
| September 8 & 9, 15 & 16, 22 & 23, 29 & 30, 2012 and October 6 & 7, 2012 | October 6 & 7, 13 & 14, 20 & 21, 27 & 28, 2012 and November 3 & 4, 2012 |

The Board has successfully completed the first batch of the Residential Certificate Course on Internal Audit which commenced in October, 2011 at Centre of Excellence, Hyderabad.

## Course Objectives

**The objectives of the Course therefore are:**

- Disseminating knowledge on the theory and practice of Internal Audit and allied functions.
- Reflect current internal audit thinking and practices and how they impact contemporary business enterprises.
- Enhancing the role of chartered accountants in the area of Internal Audi and allied functions.
- Building up Internal Audit as a core competence area of chartered accountants.

The Course is designed as a balanced mix of class room teaching, E-learning as well as self study.

## Course Registration & Batches

While the course registration is open throughout the year, batches would start in respective cities where minimum of candidates becomes available. Maximum number of seats per session per centre is 40 and minimum is 20.

Course registration is on the receipt of a duly filled-in and signed form available on ***http://www.icai.org/post.html?post_id=7606*** at along with the course fee and requisite enclosures. Course registration is on first-come-first-served basis

## Eligibility

The course is open for the members of the Institute of Chartered Accountants of India as well as the students who have cleared CA final examinations.

## Registration Details

The Course will be conducted initially at New Delhi, Hyderabad, Mumbai, Kolkata and Chennai and later on at other parts of the country.

## Certificate on Completion of the Course

Participants who successfully complete the course in line with the evaluation a criterion outlined here and qualifies the evaluation test will be awarded Certificate.

## Course Fees

The fees for the course is ` 25000/- only, payable by Pay Order/ Demand Draft drawn in favor of "The Secretary, ICAI" payable at Delhi. Course fees once paid is non-refundable under any circumstances. The following will be charged extra from the participants:

- Evaluation Tests fees – there is no separate examination fees for the first appearance in the exam. For every successive appearance, an examination fees of Rs. 2000/- will be charged per appearance.

## Residential Course at Hyderabad

Ten days residential course will be organised at Hyderabad. For this, apart from fees, boarding and lodging costs will also be charged form the participants.

Updated details on ***http://www.icai.org/post.html?post_id=7606***

The Board would be hosting details of forthcoming batches and updated details form time to time on the http://www.icai.org/post.html?post_id=7606. Members are requested to visit the said link regularly for updated details.

## Course Structure

The total duration of the course is 200 hours, divided as follows:

| | | |
|---|---|---|
| Self study | : | 100 hours |
| Class room teaching | : | 60 hours |
| E-learning | : | 20 hours |
| Case study preparation and presentation | : | 20 hours |

Class room teaching will be completed over a 9 week/10 class room time frame with classes being held on weekends.

The participants will be required to devote time to self study, preparing case studies and other class assignments, if any given to them, as per the above requirements. The participants will be grouped in a group of four each for preparing and presenting case studies. The case studies and presentations will be evaluated by an individual/team of experts.

## Evaluation

*Eligibility - A candidate will have to attend a minimum 80 % classes and complete the entire E-learning module, failing which, he/ she will not be entitled to appear in the evaluation.*

*Weightage – the following weightage is assigned during evaluation:*

- Class room learning and tests : 50 per cent
- E-learning : 20 per cent
- Case Study presentation : 20 per cent
- Class room attendance : 10 per cent
- Number of attempts : There is no limit on the permissible number of attempts for the evaluation tests. A candidate will be allowed to re-appear for the evaluation test only after six months of the previous attempt.

Certificate Course on Concurrent Audit of Banks

| Chennai | Kolkata |
|---|---|
| September 21-23, 28-30 2012 | October 5-7 ,12-14 2012 |

The Board has successfully completed the four batch of the Certificate Course on Concurrent Audit which commenced in at Noida, Mumbai, Hyderabad, Nagpur,

## Course Objectives

The purpose is to provide an opportunity to the members to understand the intricacies of concurrent audit of banks which would thereby help them:

- to supplement the efforts of the bank in carrying out internal check of the transactions and other verifications and compliance with the procedures laid down;
- to improve the effectiveness of concurrent audit system in banks;
- to improve quality and coverage of concurrent audit reports.

## Course Registration & Batches

While the course registration is open throughout the year, batches would start in respective cities where minimum of candidates becomes available. Maximum number of seats per session per centre is 40 and minimum is 20.

Course registration is on the receipt of a duly filled-in and signed form available on http://www.icai.org/post.html?post_id=8236 at along with the course fee and requisite enclosures. Course registration is on first-come-first-served basis

## Eligibility

The course is open for the members of the Institute of Chartered Accountants of India as well as the students who have cleared CA final examinations.

## Registration Details

The Course will be conducted initially at New Delhi, Hyderabad, Mumbai, Kolkata and Chennai and later on at other parts of the country.

## Certificate on Completion of the Course

Participants who successfully complete the course in line with the evaluation criteria outlined here and qualify the evaluation test will be awarded Certificate.

## Course Structure

The total duration of the course is 6 days divided into 24 Technical sessions which may be held either on weekends or on three consecutive days as per the requirement of the concerned batch.

## Course Fees

The fees for the course is Rs. 15,000/- for metro cities & Rs. 12,500/- Non metro cities payable by Online and Pay Order/ Demand Draft drawn in favour of "The Secretary, ICAI" payable at Delhi. Course fee once paid is non-refundable under any circumstances. The following will be charged extra from the participants:

- Evaluation Tests fees – there is no separate examination fees for the first appearance in the exam. For every successive appearance, an examination fees of Rs. 1,000/- will be charged per appearance.

Updated details on http://www.icai.org/post.html?post_id=8236

The Board would be hosting details of forthcoming batches and updated details form time to time on the http://www.icai.org/post.html?post_id=8236. Members are requested to visit the said link regularly for updated details.

## Evaluation

- Eligibility - A candidate will have to attend at least 80% of classes failing which, he/ she will not be entitled to appear in the evaluation.
- Number of attempts: There is no limit on the permissible number of attempts for the evaluation tests. A candidate will be allowed to re-appear for the evaluation test only after six months of the previous attempt.

# Invitation to Participate in Activities for the Board

## The Board is Providing Opportunity to Participate Beyond the Membership Level.

**Please refer link:** ***http://220.227.161.86/25581announ15266.pdf***

1. Drafting of Standards on Internal Audit
2. Preparation of Drafts of Industry Specific Technical Guides on Internal Audit
3. Generic Guides
4. Revision of Existing Guides
5. Quarterly E-newsletter "Internal Audit and Beyond", Contrubit Articles.
6. Industry Specific Seminars
7. "How to audit…." Series of Seminars for various functional areas
8. Dedicated Workshops on "Improving Internal Audit Through Information Technology"
9. Certificate Courses-Develop Modules or be a Faculty
10. To maintain the databases of industry wise Mentor
11. Invitation to Participate in the Certificate Course on Enterprise Risk Management
12. Invitation to Participate in the Certificate Course on Internal Audit
13. Invitation to Participate in the Certificate Course on Concurrent Audit of Banks

# Publications Internal Audit Standards Board

### Standards on Internal Audit (SIAs)

i. Standard on Internal Audit (SIA) 1, Planning an Internal Audit
ii. Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit
iii. Standard on Internal Audit (SIA) 3, Documentation
iv. Standard on Internal Audit (SIA) 4, Reporting
v. Standard on Internal Audit (SIA) 5, Sampling
vi. Standard on Internal Audit (SIA) 6, Analytical Procedures
vii. Standard on Internal Audit (SIA) 7, Quality Assurance in Internal Audit
viii. Standard on Internal Audit (SIA) 8, Terms of Internal Audit Engagement
ix. Standard on Internal Audit (SIA) 9, Communication with Management
x. Standard on Internal Audit (SIA) 10, Internal Audit Evidence
xi. Standard on Internal Audit (SIA) 11, Consideration of Fraud in an Internal Audit
xii. Standard on Internal Audit (SIA) 12, Internal Control Evaluation
xiii. Standard on Internal Audit (SIA) 13, Enterprise Risk Management
xiv. Standard on Internal Audit (SIA) 14, Internal Audit in an Information Technology Environment
xv. Standard on Internal Audit (SIA) 15, Knowledge of the Entity and its Environment
xvi. Standard on Internal Audit (SIA) 16, Using the Work of an Expert
xvii. Standard on Internal Audit (SIA) 17, Consideration of Laws and Regulations in an Internal Audit
xviii. Compendium of Standards on Internal Audit (As October 1, 2010)

### Technical Guides

i. Technical Guide on Risk- based Internal Audit in Banks
ii. Technical Guide on Internal Audit in Oil & Gas Refining & Marketing (Downstream) Enterprises
iii. Technical Guide on Internal Audit in Aluminium Industry
iv. General Guidelines on Internal Audit
v. Technical Guide on Internal Audit in Upstream Oil & Gas Companies
vi. Guide on Risk- based Internal Audit

vii. Guide to Internal Controls over Financial Reporting
viii. Technical Guide on Internal Audit in Telecommunications Industry
ix. Guide to Implementing Enterprise Risk Management
x. Technical Guide on Internal Audit of Stock Brokers
xi. Technical Guide on Internal Audit of Intangible Assets
xii. Technical Guide on Internal Audit of Treasury Function in Banks
xiii. Technical Guide on Internal Audit of Educational Institutions
xiv. Technical Guide on Internal Audit of Construction Industry
xv. Technical Guide on Internal Audit of Sugar Industry
xvi. Technical Guide on Internal Audit of BPO Industry
xvii. Technical Guide on Social Audit
xviii. Technical Guide on Internal Audit of Retail Industry
xix. Technical Guide on Internal Audit of Life Insurance Business
xx. Compendium of Technical Guides on Internal Audit
xxi. Technical Guide on Internal Audit of Mutual Fund
xxii. Technical Guide on Stock and Receivables Audit
xxiii. Technical Guide on Internal Audit of Infrastructure Industry
xxiv. Technical Guide on Internal Audit of Not-for-profit Organisations (NPOs)
xxv. Technical Guide on Internal Audit of Mining and Extractive Industry

## Other Technical Literature

i. Manual on Concurrent Audit of Banks
ii. Manual on Internal Audit
iii. Training Material on Internal Audit
iv. Background Material on Due Diligence
v. Study on Co-ordination of Internal Auditor with Functional Heads
vi. Study on Investigative Audit
vii. "What is an Internal Audit"- An Informative and Concise Booklet
viii. Modules of the Certificate Course on Enterprise Risk Management
ix. Handbook on Professional Opportunities in Internal Audit
x. Guide on Environmental Audit

## Ordering Information

The publications are available at the sales counters of the Institute at New Delhi, Chennai, Mumbai, Kolkata and Kanpur. To order by post, please send a demand draft in favour of "**Secretary, The Institute of Chartered Accountants of India**", payable at New Delhi to :

**Postal Sales Department**
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Email: cia@icai.org

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**The Institute of Chartered Accountants of India**
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