Standards on Internal Audit

Why Standards?

- Guidance to Members
- Codification of Current Practices
- Assurance of Consistent Practices adopted across the Profession
- Assurance of Quality

Why are SIAs introduced?

- To provide a benchmark for quality of services during an internal audit.
- With the introduction of SIA's the ICAI aims to codify the best practices in the area of internal audit services.

Strategic Importance

As internal audit may be conducted by professionals other than CAs, our Institute has indeed made a strategic move by initiating the codification of Standards on Internal Auditing, and thereby gain the advantage of being the first professional body to give a disciplined structure to the Internal Audit function. This would indeed give the first mover's advantage to ICAI and its members.

Preface – Procedural Framework

- Formation of the Committee on Internal Audit
- Scope and Functions of the Committee
- Scope of the SIAs
- Procedure for issuing SIAs – new, revised and limited revisions
- Procedures for issuing Guidance Notes
- Members' obligation for compliance with Standards & Guidance Notes
- Effective Date of Standards

Preface – Fundamental Principles

- Definition of Internal Audit
- Objectives of Internal Audit

FRAMEWORK FOR SIA

Mandatory

- The Code of Conduct
- The Competence Framework
- The Body of Standards

Recommendatory/guidance

- The Technical Guidance

Our Privilege

- To read and understand exposure drafts
- To respond to exposure drafts, so that our concerns are addressed
- To participate in the study groups constituted for preparation/review of SIAs

Our Responsibility

- To study the standards as and when they are issued.
- To initiate the implementation when they are at a recommendatory stage.
- To ensure adoption when the standards become mandatory.

What is Internal audit?

"Internal audit is

- an *independent* management function,
- involving a continuous and *critical appraisal* of the functioning of the entity
- to *suggest* certain improvements and value additions
- to strengthen the *governance mechanism* of the entity
- including *strategic risk management and internal control system*
- To provide assurance regarding *transparency* in reporting."

Objectives

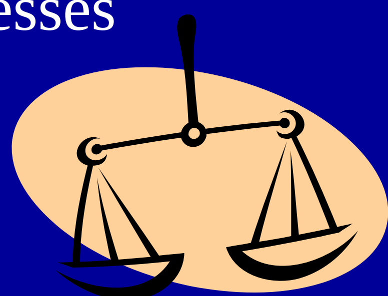
- To strengthen Governance
- To enhance internal control system
- To assist strategic risk management
- To assure transparency in reporting – both for internal MIS purposes and statutory purposes.

Objectives

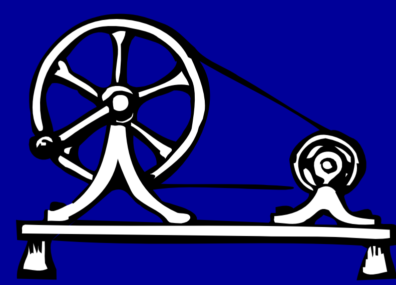
- Compliances – external and internal

- Risks and controls

- Optimization of resources, costs and processes



- Governance processes and ethical practices



STANDARDS ON INTERNAL AUDIT

SIA 1 TO SIA 10

SIA 1	Planning	SIA 2	Basic Principles
SIA 2	Basic Principles	SIA 7	Quality Assurance
SIA 3	Documentation	SIA 1	Planning
SIA 4	Reporting	SIA 8	Terms of Engagmt
SIA 5	Sampling	SIA 10	Evidence
SIA 6	Analytical Proc.	SIA 3	Documentation
SIA 7	Quality Assurance	SIA 9	Communication
SIA 8	Terms of Engagmt	SIA 4	Reporting
SIA 9	Communication	SIA 5	Sampling
SIA 10	Evidence	SIA 6	Analytical Proc

SIA 2 - BASIC PRINCIPLES GOVERNING INTERNAL AUDIT

Principles Governing Internal Audit

- Integrity, Objectivity and Independence
- Confidentiality
- Due Professional Care, Skills and Competence
- Work Performed by Others
- Documentation
- Planning
- Evidence
- Internal Control and Risk Management – suggest improvements
- Reporting

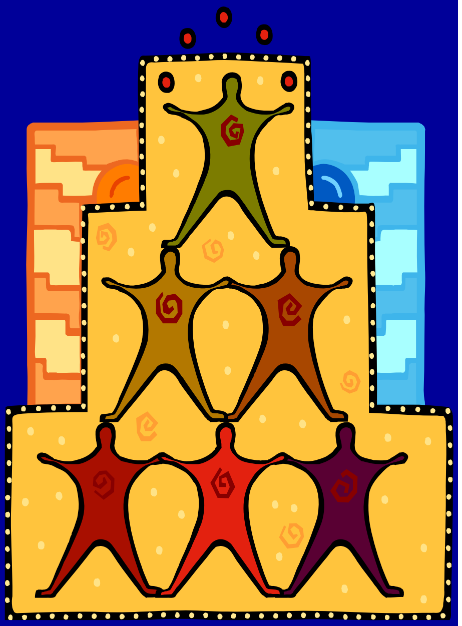
Characteristics of An Internal Auditor

An Internal Auditor possess the following qualities:

- Integrity, Objectivity & Independence
- Confidentiality
- Professional Care, Skills and Competence

Work Performed By Others

- The internal auditor should carefully direct, supervise and review the work delegated to assistants.
- The internal auditor may also need to rely on the opinion provided by other auditors and experts.
- The ultimate responsibility of forming an opinion should be independent, notwithstanding the reliance placed on other auditors and experts.



….in short, the buck stops at the Internal auditor.

Documentation

•To provide evidence that the audit was performed in accordance with the SIAs.

•To support the audit conclusions and reports.

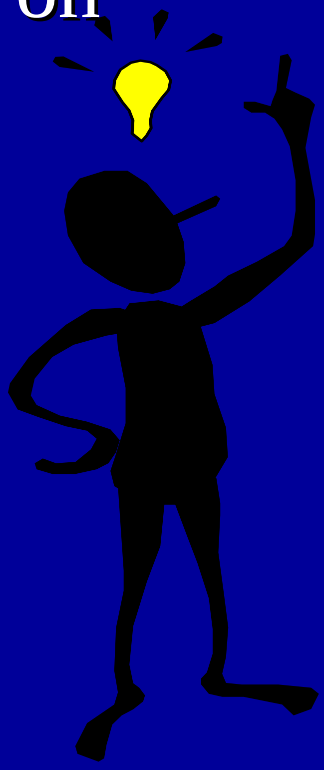
….setting stage for peer review and litigation support

Planning

- To ensure sufficient attention to critical areas.
- Should flow from understanding the entity's business, the industry in which the entity operates and its external environment.

Audit Evidence

- The internal auditor should, based on his professional judgement, obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom on which to base his opinions or findings.



IC & RM !!

Two words that form the heart of Internal Audit – Internal Control and Risk Management:

IA should:

- Understand the IC & RM framework
- Assess its adequacy
- Review its adequacy periodically
- Perform risk-based audits.

Reporting

- The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained as the basis for his findings contained in his report and suggest remedial action.

SIA 7 – QUALITY ASSURANCE IN INTERNAL AUDIT

Scope

- In-house internal audit department
- External firm of professional accountants
  - Sole proprietor
  - Firm
  - Any such entity of professional accountants as may be permitted by law
- *Footnote: SQC 1 applies to firms carrying out internal audit to the extent applicable*

Quality Assurance & Responsibility

- The internal auditors should comply with professional standards, regulatory and legal requirements, so that the reports issued by them are appropriate in the circumstances.
- A person within the organization should be entrusted with the responsibility for the quality in the internal audit, whether done in - house or by an external agency.

Objective

System of quality assurance to include policies on:

- Leadership responsibilities
- Ethical requirements
- Acceptance and continuation of clients
- Human resources
- Engagement performance
- Monitoring

Objective

System of quality assurance to consider these parameters:

- Terms of engagement and adequacy
- Professional standards – compliance
- Internal audit goals and achievement
- Recommendations and extent of implementation
- Skills and technology used.

Quality Assurance Framework

- Quality assurance framework should be embedded in the internal audit which should include –
  - Developing an internal audit manual
  - Trained and adequately supervised internal audit staff
  - Identifying the customers of the internal audit activity.
  - Establishing a formal process of feedback
  - Establishing appropriate performance criteria
  - Benchmarking with industry/ peer group performance

Contents of the Quality Assurance Framework

- Development and implementation of the internal audit policies and procedures.
- Maintenance and monitoring of the internal audit activity budget.
- Maintenance and updations of the overall internal audit plan.
- Identification of the risk areas and the internal audit plan to address these risks.
- Co-ordination with the external auditors.
- Staffing related aspects of internal audit - recruitment, training, etc.
- Implementation of the performance metrics for the internal audit activity and periodic monitoring of the same.
- Review of the follow up actions taken on the findings of the internal audit activity.

Quality Reviews & Communication

- Internal

  The internal quality reviews should be undertaken on an ongoing basis. The results of the internal quality reviews should also be communicated to the appropriate levels of management and those charged with governance on a timely basis.

- External – Peer Review

  The external quality reviewer should be professionally qualified person having an in depth knowledge and experience of Professional Standards applicable to the internal auditors, the processes and procedures. An action plan to be submitted to address the issues and concerns raised by the external quality reviewers in his report.

SIA 8 – TERMS OF INERNAL AUDIT ENGAGEMENT

Terms of Engagement

- Need to agree on the terms prior to audit commencement
- Need to be approved by the BOD or a Committee thereof (Such as, the Audit Committee)
- Should be reviewed periodically and modified to match the changed circumstances.

Terms of Engagement

Scope

- Broad areas to be specified
- Areas where recommendations/value add is expected
- Exclusions – financial statements preparation
- Additional services to be separately agreed

Responsibility

- Responsibility of the auditee vis a vis the IA
- Responsibility of the IA, specifically emanating from a regulatory requirement.

Terms of Engagement

Authority

- Access rights and authority to be defined – ideally, should not be limited
- Authority on the technologies, hardware and audit tools that may be used *(Ambiguously drafted)*

Confidentiality

- Ownership of the working papers rests with the IA
- May provide non-proprietary papers to the auditee on request
- Provision for peer review

Terms of Engagement

- *Reporting – manner, frequency of reporting and distribution list*
- *Compensation – with clarity as to the taxes, out of pocket expenses etc.*
- *Compliance - Statement indicating that audit will be conducted in compliance with IA standards.*
- *Withdrawal – in case of disagreement as to the terms; to consider the obligation to communicate the circumstances necessitating the withdrawal.*

SIA 1 - PLANNING AN INTERNAL AUDIT

Background

- Standard was issued in May 2006
- Was initially recommendatory in nature
- Standard had been notified to be effective for internal audits commenced after April 1, 2007
- Subsequently, the effective date appears to have been withdrawn – this has been confirmed by the Internal Audit Standards Board via e-mail.

Internal Audit helps …

- Understanding and assessment of risks
- Identification of areas for system improvement
- Ensuring optimum resource utilization
- Ensuring timely identification of liabilities – accrued, contingent and potential
- Ensuring compliance – internal and external
- Safeguarding of assets
- Reviewing and ensuring adequacy of IT security
- Reviewing and ensuring adequacy of management information systems

Internal Audit Charter

- A mother document which establishes the organizational positioning and empowerment of internal audit function.
- Outlines broad scope, duties and responsibilities of internal auditors, whether in-house or outsourced.
- Internal audit plan flows from the internal audit charter.

  Though reference to Internal Audit Charter has been made in SIA 1 and later in SIA 3, a standard format of an IA charter has not been given. Also, the IA Charter has not been clearly explained in terms of its purpose, contents and issuing authority.

Objective of Planning

- An Internal Audit Plan is a document defining

Scope

Coverage

Resources

- The Internal auditor should in consultation with, those charged with governance, including Audit Committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in efficient and timely manner.

What Does Planning Involve?

- Developing a comprehensive audit plan and a detailed audit programme showing nature, timing and extent of audit procedures.
- Continuous review to identify modifications.
- Major modifications to be done in consultation with those charged with governance
- Any change to the internal audit plan should be documented.
- Identification and assessment of risks and organization’s expectations – the audit plan to be aligned to the assessed risks.

Scope of Planning

- Internal audit plan covers the following:

Obtaining knowledge of

•Legal & Regulatory framework

• Accounting & Internal Control Systems & Policies.

Determining

•Effectiveness of internal controls and policies

•Nature timing and extent of procedures to be adopted.

Identifying

•Key Concern areas based on criticality and risk involved.

•Optimum allocation of human resources.

•Reporting responsibilities

Setting up

•Time Budget for all activities.

•Benchmarks for evaluation of actual results of IA.

Factors effecting IA Scope

- Terms of engagement
- Accounting System, policies, IT systems
- Delegation matrix and organization chart
- Nature of MIS
- Expected audit coverage – special attention areas
- Materiality thresholds established
- Nature of audit evidence
- Skills of staff assigned
- Applicability of ICAI pronouncements


Knowledge of Client's Business
Preparation of Audit Programme
Establishing Audit Universe
Planning Process
Deciding Resource Allocation
Establishing Objectives of Engagement
Establishing Scope of Engagement

Knowledge of Client's Business

- Sources for obtaining client's business

Past Experience	Discussions With Staff and Management	Policy & Procedure's Manual	Visit to entity's plant and accounts department	Minutes of Meetings

- Knowledge of entity's business helps to identify areas requiring special focus and priorities for smooth running of business.

Audit Universe

- Identification of all activities, function and locations that are to be covered by IA for the period under consideration.
- The Audit Universe is identified based on the risks assessed, organizational priorities and plans and regulatory requirements.

Objectives of Engagement

- The establishment of objectives of engagement should be based on auditor’s knowledge of the client’s business, especially a preliminary review of risks and controls associated with activities forming subject matter of internal audit engagement.
- The internal auditor should also document the results of his preliminary review so conducted

Scope of the Engagement

The scope of the engagement should be

- Documented comprehensively
- Sufficient in coverage
- Stating clearly the information required

Resource Allocation

- Finalization of work scope is succeeded by resource allocation.
- Efficient resource allocation is instrumental to achieve desired objectives within constraints of time and cost.
- The engagement work schedule should be flexible enough to accommodate any unanticipated changes as well as professional judgments.

Audit Programme

The audit programme should be so designed

- as to achieve the objectives of the engagement
- Provide assurance that the internal audit is carried out in accordance with the Standards on Internal Audit.

The internal audit programme should be finalized in consultation with *appropriate authority* before commencement of work

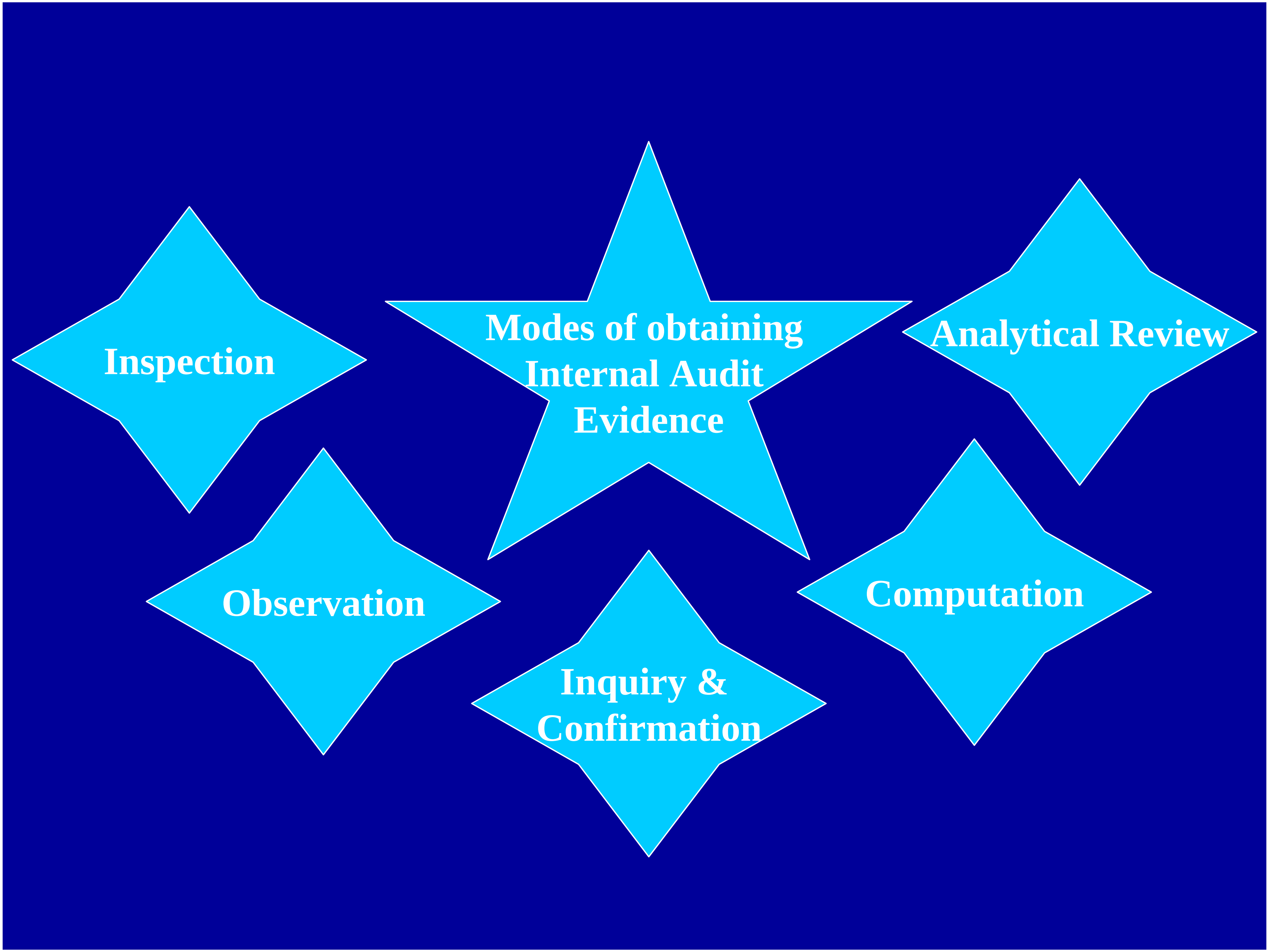
SIA 10 – INTERNAL AUDIT EVIDENCE

Evidence

- Sufficient appropriate evidence to enable drawing up reasonable conclusions for forming opinion/findings.
- Sufficiency and appropriateness of evidence to be judged based on materiality of item, type of information and degree of risk associated.

Categories of Documentary Evidence

- Originating from and held by third parties
- Originating from third parties, held by the entity
- Originated from the entity and held by third parties
- Originated from and held by the entity


Modes of obtaining Internal Audit Evidence
Inspection
Analytical Review
Observation
Computation
Inquiry & Confirmation

SIA 3 – DOCUMENTATION

Definitions

- Internal Audit Documentation
- Experienced Internal Auditor or Reviewer

This standard is structured differently in as much as it provides definitions in a specific section.

Documentation Purpose

- Aid in planning and performance
- Aid in supervision
- Provide evidence
- Aid in 3^{rd} party reviews
- Confirm adherence to SIAs and other ICAI pronouncements

Form & Contents

Form

- Paper or electronic
- Correspondence may be in e-mail form

Contents

- Planning documents including outsourcing terms
- Specific to each engagement – policies to be framed to assist standardization
- Complete and detailed

Most Important

The documentation must enable an experienced internal auditor or reviewer, having no previous connection with the internal audit, to understand the audit plan, terms of reference, scope and extent, timing of execution, results of procedures and significant issues and conclusions.

Other Requirements

- Must cover all aspects of IA
- Must identify preparer, reviewer and dates of preparation/review
- Must be initialed by preparer/reviewer
- Source of information
- Cross referencing to other documents
- File to be completed within 60 days of signing the report… and no documents to be discarded thereafter till the retention period is over.

Additional Audit Procedures

- Circumstances that required the extension of audit scope/coverage
- Details of the additional procedures
- When and by whom the resultant changes to audit documentation are made

Finally…

- Audit documentation custody and ownership remains with the internal auditor
- Retention of papers as per the retention policy, subject to appropriate regulatory retention requirements.

SIA 9 – COMMUNICATION WITH MANAGEMENT

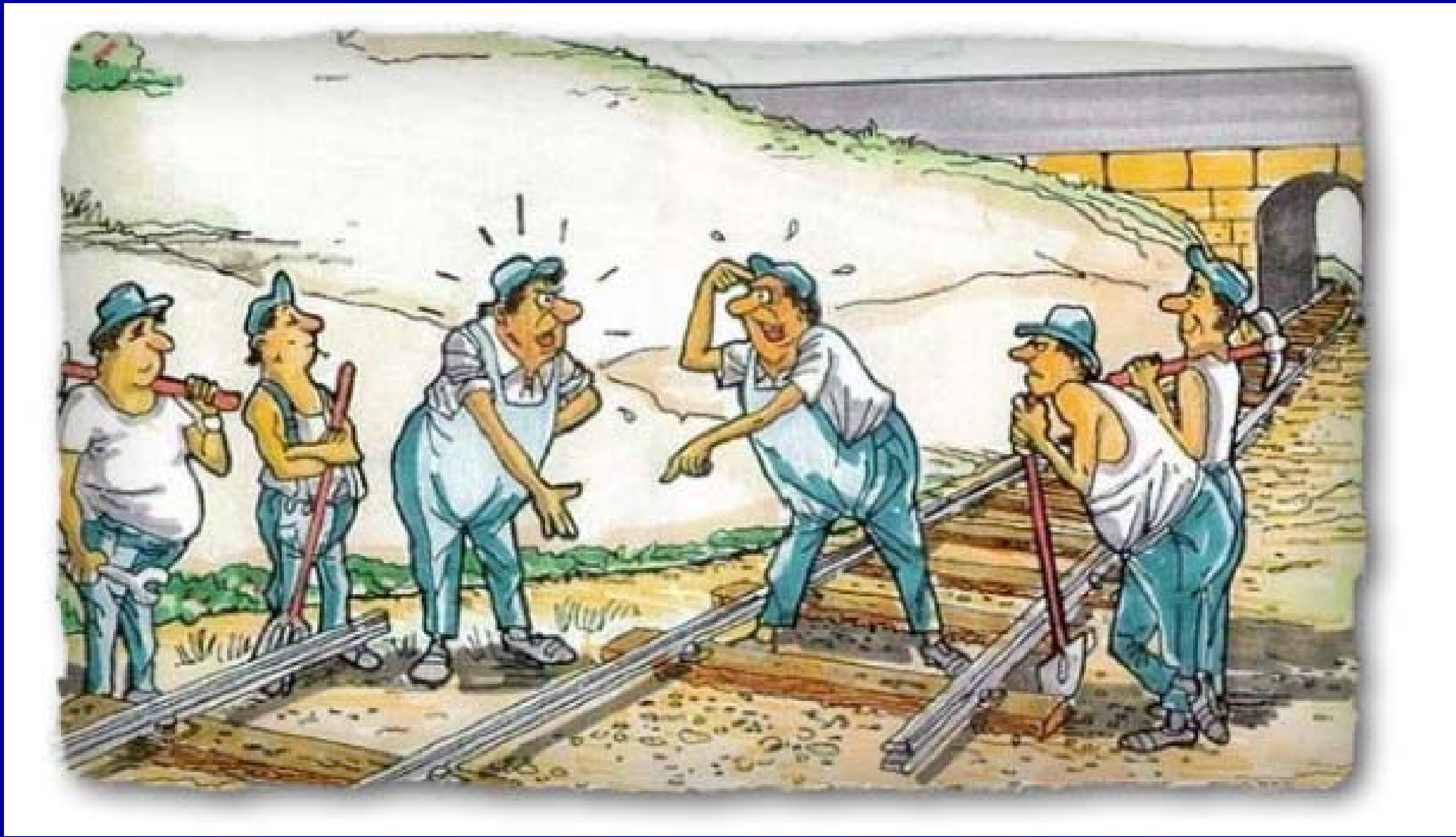
Communication Protocols

- IA to communicate the scope, responsibilities and timing of audit
- Obtain relevant information from the management
- Provide timely observations arising from internal audit
- Promote effective two way communication

Communication Essentials

- Lay down the communication protocols
- Document minutes of important discussions and meetings
- Ensure timeliness of communicating critical observations
- Avoid haste – do not communicate audit findings that are not well founded or adequately evidenced.
- Distinguish between findings, doubts and conjectures.

AVOID: Communication Breakdown



SIA 4 - REPORTING

Report Fundamentals

- Internal audit conclusions to be based on evidence obtained
- Report to contain a clear written expression of observations, suggestions based on the comprehensive audit undertaken
- Clear, factual, specific, concise, unambiguous, timely, comply with *generally accepted audit procedure in India.*

Report Contents

- Title
- Addressee
- Distribution List
- Coverage
- Introductory paragraph
- Scope paragraph
- Executive Summary
- Observations
- Comments from local management
- Action taken report
- Date/place/signature

Report Stages

Important

- Limitations to Scope to be stated and described
- Restrict circulation of the report to unintended persons.

Is this intended?

- Para 14: “The report should include a statement that the internal audit was planned and performed to obtain reasonable assurance whether the systems, processes and controls operate efficiently and effectively and *financial information is free of material misstatement*.”

SIA 5 - SAMPLIING

Sampling Basics

- Sampling – studying a small number of items to conclude on the whole
- Samples should be unbiased, objective, representative
- Sample results should be protracted to the population in a logical manner
- Sample may be extended if the conclusion based on samples do not provide requisite assuarnce.

Sampling Techniques

- Statistical/Non-statistical
  - Random
  - Systematic
  - Haphazard
  - Block

- The standard is very similar to AS 530
- Principles of sampling as applied in Statutory audit are extended for internal audit as well
- Use of Sampling in Risk assessment procedures – this is unique to SIA.
- Detailed documentation prescribed for sampling.

SIA 6 – ANALYTICAL PROCEDURES

Definition

"Analytical procedures" means the analysis of significant ratios and trends, including the resulting investigation of fluctuations and relationships in both financial and non-financial data that are inconsistent with other relevant information or which deviate significantly from predicted amounts.

Comparison/ Analyses

- Comparison of financial information like
  - Comparable information for prior periods.
  - Anticipated results of the entity, such as budgets or forecasts or expectations of the internal auditor.
  - Similar industry information such as a comparison of the entity's ratio of sales to trade debtor, with industry averages, or with other entities of comparable size in the same industry.

Comparison/ Analyses

- Comparison of financial and non-financial information like
  - Payroll costs to number of employees or total production costs to quantity produced.
  - in retail business, the relationship between sales and square footage of selling space or volume

Use of Analytics

- Risk Assessment
- Planning
- As substantive procedures
- For overall review at the end of the audit
- For identifying areas that need further investigation/audit focus – unusual trends/items

Factors – to determine the extent of using analytical procedures

- The significance of the area being examined.
- The adequacy of the system of internal control.
- The availability and reliability of financial and non-financial information.
- The availability and comparability of information regarding the industry in which the organization operates.
- The extent to which other auditing procedures provide support for audit results.

To conclude…

- Let us consider these SIAs as a starting point, shape of things to come
- Let us review and provide feedback on SIAs, so that, hopefully, when these become mandatory adequate redrafting would have been done.
- Going forward, let us focus on exposure drafts – let us exercise our privilege!!