



Internal Audit - Module 1

(ADVANCED CERTIFICATE COURSE IN INTERNAL AUDIT)

ACIA

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Agenda- Introduction to ACIA & Internal Audit

- ◆ **Module 1**
- ◆ Evolution and History of Internal Auditing
- ◆ Definition, Objectives, and Scope of Internal Auditing
- ◆ Types of internal Audit
- ◆ Assurance & Consulting Services in Internal Audit

Internal Audit

Independent

Objective

Assurance

Consulting Activity

Add Value

Improve Operations

Management activity to Evaluate and improve the effectiveness of governance, risk management and control processes.

Evolution and History of Internal Auditing

- ◆ Historians have traced the roots of internal auditing to centuries B.C., as merchants verified receipts for grain brought to market.

10,000 years ago—Temple priests took inventory of village livestock.

3,000 B.C.—Scribes recorded ruler's wealth.

The era of 4000 BC = first step in the process of keeping formal record-keeping systems which were firstly introduced by organized businesses and governments in the Near East to ensure the correct accounting, followed by the similar developments in the Zhao dynasty in China (1122-256 B.C.)

Since the beginning of human civilization, auditing has been around.

History of Internal Audit

It has its genesis in the era of Maurya dynasty where Kautilya, a 4th century B.C.E. economist, recognized the importance of accounting methods in economic enterprises.

1800 s =Articles on arbitration, Internal check, fraud, investigation, controls etc began appearing in the late 1800s.

1856—In England, the audit of corporations became required.

1887—American Association of Public Accountants (later becoming the AICPA) was formed.

1896—New York State legislated the first CPA law.

Father of Internal Audit

- ◆ Lawrence Sawyer (1911-2002), = as “the father of modern internal auditing” who perceived the theory of Internal Auditing.
- ◆ 1st major book on Internal Auditing was authored by Victor Z. Brink, a former auditor and Columbia University educator.
- ◆ Presently the philosophy, theory and practice is defined by the International Professional Practices Framework (IPPF) of the Institute of Internal Auditors.

IIA - USA: History & evolution

- ◆ Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association with global headquarters in Lake Mary, Florida, USA.
- ◆ The IIA is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator.
- ◆ Members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.
- ◆ The IIA's certificate of incorporation was filed on November 17, 1941, and just prior to the first annual meeting on December 9, 1941 at the Williams Club located at 24 East 39th Street in New York City, 24 charter members were accepted for membership.
- ◆ 1941 = Victor Z. Brink, authored the first major book on internal auditing.
- ◆ John B. Thurston, internal auditor for the North American Company in New York, had been contemplating establishing an organization for internal auditors.
- ◆ Thurston was elected as the first president of The IIA.
- ◆ Currently = more than 200,000 members worldwide

◆ **Mission**

- ◆ to provide dynamic leadership for the global profession of internal auditing. Activities in support of this mission will include, but will not be limited to:
- ◆ Advocating and promoting the value internal audit professionals add to their organizations.
- ◆ Providing comprehensive professional educational and development opportunities, standards and other professional practice guidance, and certification programs.

- ◆ Researching, disseminating, and promoting knowledge concerning internal auditing and its appropriate role in control, risk management, and governance to practitioners and stakeholders.
- ◆ Educating practitioners and other relevant audiences on best practices in internal auditing.
- ◆ Bringing together internal auditors from all countries to share information and experiences.

“Kautilya- Niti “: Internal Control & Fraud prevention

- ◆ creating the necessary conditions for reducing fraud

The ruler should avoid appointing persons who are fraudulent, dishonest, cruel, without enthusiasm, incompetent and cowardly [Kautilya's Rajanitisastra, Subramanian]

“Just as it is impossible to know when a fish moving in water is drinking it, so it is impossible to find out when government servants in charge of undertakings misappropriate money. It is possible to know even the path of birds flying in the sky but not the ways of government servants who hide their (dishonest) income”

◆ **Kautilya's Contribution**

- ◆ Appropriate format for bookkeeping and codification
- ◆ compliance with financial rules
- ◆ recording data systematically
- ◆ advocating frequent periodic reporting
- ◆ adoption of independent audits to reduce system failure
reducing the scope for conflicts of interest.
- ◆ Anti-fraud controls

- ◆ It has been very long since 'Internal Audit' was introduced in India by some enlightened companies.
- ◆ Internal audit specifically was first made mandatory for a particular set of companies vide the Manufacturing and Other Companies (Auditor Report) Order, (MAOCARO, 1975). With the advent of Companies Act 2013 and regulations being undergoing dynamic changes on daily basis, the demand for professionalism, knowledge and integrity has increased manifold.

Basic Categories & Types of Internal Audit

- ◆ IA covers internal controls over financial reporting (ICFR) within the Organisation
- ◆ **1. Compliance Audits** evaluate compliance with applicable laws, regulations, policies and procedures. Some of these regulations may have a significant impact on the company's financial well-being. Failure to comply with some laws- Eg FCPA or General Data Protection Regulation (GDPR), may result in millions of dollars in fines or preclude a company from doing business in certain jurisdictions.
- ◆ **2. Environmental Audits** assess the impact of a company's operations on the environment. They may also assess the company's compliance with environmental laws and regulations. ISO 14001, OHSAS 18001, ESG , Net Zero
- ◆ **3. Financial/Controls Audits**
- ◆ Address questions of accounting, recording, and reporting of financial transactions, as well as reviewing the adequacy of internal controls.

- ◆ **3. Information Technology Audits** may evaluate information systems and the underlying infrastructure to ensure the accuracy of their processing, the security and confidential customer information or intellectual property.
- ◆ include the assessment of ITGC - controls related logical access, change management, system operations, and backup and recovery.
- ◆ **4. Operational Audits** assess the organization's control mechanisms for their overall efficiency and reliability.
- ◆ **5. Performance Audits** evaluate whether the organization is meeting the metrics set by management in order to achieve goals and objectives set forth by BoD.
- ◆ **6. Special Investigations**
- ◆ Performed when appropriate. These audit activities focus on alleged violations of federal and state laws and regulations. Internal theft, misuse of university assets, hotline allegations, and conflicts of interest
- ◆ **7. Integrated Audits**
- ◆ Combine a financial/controls audit of an area with an information technology assessment of the systems and infrastructure that support the unit.
- ◆ An integrated audit can assess the effectiveness of the coordination between the information systems and the business activities to support defined goals and objectives.

Present Scope & types of Internal Audit – enhanced canvas

- Efficacy of operations,
- the reliability of financial reporting,
- deterring and investigating fraud,
- safeguarding assets, and
- compliance with laws and regulations

Types

- Corporate Governance Audit
- Financial Audit
- Revenue Audit
- Business strategy process
- Due Diligence
- Special Audit Human resources functions
- Social Audit
- Concurrent Audit

- ◆ Marketing strategy
- ◆ Environmental Audit
- ◆ Income & Expenditure Audit
- ◆ Production process
- ◆ Corporate Social Responsibility (CSR) Audit
- ◆ Grants Audit
- ◆ Stock Audit/Credit Audit
- ◆ Cyber Audit
- ◆ Projects Audi
- ◆ Compliance with Commercial Laws
- ◆ Industry Specific Internal Audit
- ◆ Investigative Audit
- ◆ ERM Audit
- ◆ Assurance On Sustainability Reporting
- ◆ CAG Audit for PSUs

IA – Statutory Recognition

- ◆ Recognition as a Statutory Process With the companies Act 1913 audit of company accounts was made compulsory in India.
- ◆ The qualification of the auditors was also prescribed first time in the Companies Act 1913.
- ◆ International Accounting Standards Committee and the Accounting Standard board of the Institute of Chartered Accountants of India have developed standards on accounting and auditing practices to provide the guidance on the day to day work being undertaken by auditors (SA, SIA)
- ◆ Internal audit specifically was first made mandatory for a particular set of companies vide the Manufacturing and Other Companies (Auditor Report) Order, (MAOCARO, 1975). With the MAOCARO, 1988 and CARO 2003 the need for internal audit was emphasized and focused.
- ◆ Section 581ZF of the Companies (Amendment)Act, 2002 also stipulated that ‘Every Producer Company shall have internal audit of its accounts carried out, at such interval and in such manner as may be specified in articles, by a chartered accountant’.
- ◆ **Sec 138 – Companies Act 2013**

Internal Audit – Opportunities & Assignments

- ◆ Internal Audit Functions/Requirements under various Laws
- ◆ Risk Based Internal Audit (RBIA) in Banks under RBI Guidance
- ◆ Compliance of Internal Audit requirements under Companies (Auditors Report) Order, 2003/2015/2016 / 2020
- ◆ Internal audit of Operations of Depository Participants
- ◆ Internal Audit requirements mandated by SEBI on a half yearly basis for stock brokers/trading members/ clearing members
- ◆ System Audit of Investment functions of Insurance Companies
- ◆ Concurrent audit in Banks
- ◆ Internal audit to be undertaken in respect of Credit Rating Companies Operations
- ◆ Internal audit of Mutual Funds
- ◆ Internal Audit of Custodians
- ◆ Internal audit of Registrar & Share Transfer Agents
- ◆ Internal audit mandatory for multiple banking or consortium
- ◆ Internal Audit requirement every quarterly required for insurers under IRDA (Investment) (Fourth Amendment) Regulations

Institute Guidelines - IAAS

◆ Objectives of Internal Audit

- ◆ Internal Audit (IA) = independent assurance and consulting activity performed to provide value addition to the entity's operations to achieve its objectives.
- ◆ It helps to evaluate and improve the effectiveness of internal control, risk management and governance processes.
- ◆ IA provides an assurance relating to effectiveness of operations, reliability of financial
- ◆ management and reporting, efficiency of systems & processes, and compliance with laws and regulations.
- ◆ IA also provides safeguard against potential fraud, waste, or abuse and value adding consultancy to the management to improve the entity's operations and efficiency of resource utilization.
- ◆ While attaining these objectives, the three 'E's of audit –
 - ❖ Efficiency,
 - ❖ Effectiveness, &
 - ❖ Economy,
- ◆ must be followed by the internal audit team.

Nature and role of Internal audit

- ◆ Internal auditors' attributes:
- ◆ a) **Independence (organizational)**- The freedom from conditions that threaten the ability of IA activity to carry out its ***responsibilities in an unbiased manner. CAE should report to audit committee functionally.***
- ◆ b) **Objectivity(individual)**- ***Unbiased mental attitude, belief in their work, no quality compromise and no subordination of their judgement on audit matters.***
- ◆ Nature of services:
- ◆ a) **Assurance service**- Objective examination of evidences for the purpose of providing an ***independent assessment on GRC process of the organization.*** The scope is decided independently by the auditor.
- ◆ b) **Consultancy service**- ***Advisory*** in nature. Scope is decided jointly by the requestor of the service and auditor.

Internal auditors are expected to apply and uphold the following principles:

- Integrity
- Objectivity
- Confidentiality
- Competency

Definition of Internal Audit - IIA

By Institute of Internal Auditors Inc

- ◆ An **independent objective assurance** and **consulting activity** designed to and improve an organisation's operations
- ◆ It helps an organisation to **accomplish its objective** by bringing a systematic, disciplined approach to **evaluate and improve** the effectiveness **of Risk Management ,Control and Governance process**
- ◆ **IIA Standard 1100**
- ◆ IIA standard 1100 clearly states that the organisation's internal audit **function must be independent** and internal auditors should be objective in performance their work.
- ◆ **Independence is achieved** through the organisational status and objectivity and is decisive factor in ensuring that the internal auditors can perform their tasks in line with the requirements
- ◆ **Reporting**
- ◆ The Chief Audit Executive (CAE) **should report to a level within the organisation** that allows Internal Audit to achieve independence.
- ◆ Ideally, the CAE should report **functionally to the Audit Committee** and administratively to the CEO of the organisation

Internal Auditor: Independence

- ◆ **Staff Department**
- ◆ To maintain independence, the internal audit function should be **managed as a separate staff department** without the authority to manage or direct employees to other units
- ◆ This ensures that Internal Audit does not **Audit any process or scenarios that it has been involved in creating**
- ◆ As an independent department, internal audit can evaluate operations and provide recommendations for improvement, but cannot implement them.
- ◆ Implementing Internal Audit's recommendations as well as designing and implementing control solutions, is the responsibility of the management.
- ◆ **Maintaining independence**
- ◆ It is essential **that Internal Audit remains independent.**
- ◆ IA must be enabled to **work independently and free from pressure to ensure** it can meet its objectives ,including assisting the work of external auditor.
- ◆ IIA Standard 1100 clearly states that that **the IA activities of an organisation must be independent.**

Internal Audit: Non Audit Related other Service

- ◆ **1. Ongoing Support**
- ◆ By providing ongoing support, IA can acquire expertise necessary for subsequent Audits'
- ◆ Can support other departments in the implementation of the new systems
- ◆ Even assist with temporary resource shortage.
- ◆ Internal Audit **can gain practical insight** into specific areas of areas of the organization by providing **on going support**
- ◆ Ongoing **support** should not exceed one year.
- ◆ IA staff should not spend more than 50% of their time for the ongoing support so that their traditional Audit work does not suffer
- ◆ Because on going **support represents a departure** from the traditional responsibility of IA, these activities must be approved by the BOD

Internal Audit: Internal Consulting

- ◆ Internal Audit can provide consulting support in following areas :
 - Basic analyses to improve information and communication flows
 - Creation of early warning systems with regard to Risks , budgets or revenue
 - Assessment and commentary on problems and suggested solutions.
 - Mediation associated with above.
 - Improvement of decision processes
 - General support for procedure and conduct recommendations
 - IT/ ERP / Cloud implementation
- ◆ Internal Audit's consulting services can add value within the company.
- ◆ Its activities can involve providing **an expert opinion or design input**.
- ◆ However, these activities **can pose a significant risk** to IA's independence.
- ◆ **Due care must be taken** to ensure that the objectivity and independence are maintained.
- ◆ When Internal Audit has provided internal consulting services, any subsequent audit must be conducted by a different auditor.
- ◆ The auditor who was involved with the consulting work should not conduct the audit of those areas at least for two years.